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

(147 DOCUMENTS)

1 of 2

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75802 / September 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16564

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

I.

On June 1, 2015, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Gerard Haryman ("Haryman" or "Respondent").

II.

In response to these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent 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 15(b) and 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[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 arise out of a fraudulent scheme in which insiders of publicly-traded penny stock companies paid secret kickbacks to a purported corrupt hedge fund manager, who was in fact an undercover agent with the Federal Bureau of Investigation ("Fund Manager"), in exchange for the Fund Manager's purchase of restricted stock of the penny stock companies on behalf of his purported hedge fund ("the Fund"), which did not actually exist.

Respondent

1. Respondent, age 71, a resident of Lake Worth, Florida, was a consultant to and investor in A Clean Slate, Inc. ("Clean Slate"), a publicly-traded company that provides financial services and specialized in debt relief and financial recovery services. Respondent participated in an offering of Clean Slate stock, which is a penny stock. Haryman was charged with two counts each of mail fraud and wire fraud and one count of conspiracy to commit securities fraud on March 21, 2014 and pleaded guilty to all counts on May 2, 2014 in *U.S. v. Haryman*, 14-CR-10077-RGS (D. Mass.). On November 13, 2014, he was sentenced to 1 day in prison and 3 years' supervised release. He was also ordered to pay a $500.00 special assessment and $24,000 in restitution. On November 21, 2014, Haryman was ordered to forfeit $24,000.

Other Relevant Entities and Individuals

2. A Clean Slate, Inc. is a Delaware corporation with its principal place of business in Palm Beach, Florida that provides financial services and specializes in debt relief and financial recovery services. Its securities had been registered with the Commission under Exchange Act Section 12(g), but Clean Slate filed a Form 15-12G on April 13, 2012 terminating its securities registration. Clean Slate's securities are publicly quoted on the OTC Link under the symbol "DRWN," but the OTC Link website contains a warning that the company may not be making material information publicly available.

Background

3. At some point prior to September 28, 2011, an individual serving as a cooperating witness for the Federal Bureau of Investigation ("CW") arranged for Haryman and another individual ("R.G.") to meet with the Fund Manager to discuss funding for Clean Slate.

4. On or about September 28, 2011, Haryman and R.G. met with the Fund Manager and CW to discuss a potential investment of the Fund's monies in Clean Slate in exchange for a fifty percent kickback to the Fund Manager (the "September 28 Meeting").

5. Haryman and R.G. indicated that they were both willing to enter into the kickback arrangement.

6. At the September 28 Meeting, the Fund Manager, Haryman, R.G., and CW also discussed the mechanics of the funding. Haryman and R.G. were informed that

the Fund Manager would begin by investing smaller amounts in Clean Slate, while planning to increase the funding in installments, or tranches, in the future.

7. At the September 28 Meeting, the Fund Manager further discussed with Haryman and R.G. the mechanics of the kickbacks to the Fund Manager. The Fund Manager explained to Haryman and R.G. that Haryman and R.G. would be sending the kickbacks to one or more companies that the Fund Manager himself controlled. The Fund Manager discussed with Haryman and R.G. that Clean Slate would execute consulting agreements with one or more of the Fund Manager's companies, and Haryman and R.G. would pay the relevant company owned by the Fund Manager an amount equal to fifty percent of Fund monies invested in Clean Slate as purported fees for consulting services that would not, in fact, be rendered. The Fund Manager further explained to Haryman and R.G. that the Fund would not know about these kickbacks paid to him through such sham consulting agreements. After the Fund Manager had explained the scheme, Haryman and R.G. agreed to enter into the kickback arrangement.

8. On various dates between on or about September 29, 2011 and on or about November 2, 2011, Haryman and R.G. sent the Fund Manager documents related to the kickback transactions, including purported consulting agreements between Clean Slate and the Fund Manager's nominee consulting companies and phony invoices in the name of the Fund Manager 's nominee consulting companies.

9. On or about October 5, 2011, $16,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts, purportedly belonging to the Fund, to a corporate bank account of Clean Slate outside of Massachusetts. The wire transfer represented the first tranche of funding for Clean Slate.

10. On or about October 6, 2011, Haryman and R.G. caused $8,000 to be sent by wire transfer from a corporate bank account of Clean Slate outside of Massachusetts to a bank account maintained in Boston, Massachusetts, purportedly belonging to one of the Fund Manager's "nominee" companies. This wire transfer represented Haryman and R.G.'s kickback to the Fund Manager from the first tranche of funding for Clean Slate.

11. On or about October 13, 2011, Haryman and R.G. caused a stock certificate representing the shares purchased by the Fund in Clean Slate to be sent to the Fund Manager.

12. On or about October 20, 2011, $32,000 was sent by wire transfer from a bank account maintained in Boston, Massachusetts, purportedly belonging to the Fund, to a corporate bank account of Clean Slate outside of Massachusetts. This wire transfer represented the second tranche of funding for Clean Slate

13. On or about October 21, 2011, Haryman and R.G. caused $16,000 to be sent by wire transfer from a corporate bank account of Clean Slate outside of Massachusetts to a bank account maintained in Boston, Massachusetts, purportedly belonging to one of the Fund Manager's "nominee" companies. This wire transfer represented Haryman and R.G.'s kickback to the Fund Manager from the second tranche of funding to Clean Slate.

14. On or about October 24, 2011, Haryman and R.G. caused phony invoices for consulting services that were never performed to be sent to the Fund Manager by electronic mail. These phony invoices related to the monies Haryman and R.G. caused to be kicked back to the Fund Manager on or about October 6, 2011, and October 21, 2011, respectively.

15. On or about October 28, 2011, Haryman and R.G. caused a stock certificate representing the additional shares purchased by the Fund in Clean Slate to be sent to the Fund Manager.

16. On or about November 2, 2011, Haryman and R.G. caused phony invoices for consulting services that were never performed to be sent to the Fund Manager by electronic mail. These phony invoices related to the monies Haryman and R.G. agreed to kick back to the Fund Manager from a proposed third tranche of funding for Clean Slate. This proposed third tranche of funding did not, ultimately, occur.

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

IV.

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

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

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

B. Respondent Haryman be, and hereby is:

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

By the Commission.

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. 75806 / September 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16774

In the Matter of **GW One, Inc.,** **Pacific Power Group, Inc.,** **PFF Bancorp, Inc.,** **Robertson Acquisitions II, Inc. (CIK No. 1554100), and** **Robertson Acquisitions II, Inc. (CIK No. 1554622),** **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 GW One, Inc., Pacific Power Group, Inc., PFF Bancorp, Inc., Robertson Acquisitions II, Inc. (CIK No. 1554100), and Robertson Acquisitions II, Inc. (CIK No. 1554622).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. GW One, Inc. (CIK No. 1381976) is a void Delaware corporation located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GW One, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $37,397 from the company's May 4, 2006 inception to September 30, 2007.

2. Pacific Power Group, Inc. (CIK No. 1013628) is a Nevada corporation located in Monterey, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pacific Power Group, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on July 12, 1996.

3. PFF Bancorp, Inc. (CIK No. 1004969) is a forfeited Delaware corporation located in Claremont, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PFF Bancorp, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $85,845,000 for the prior six months. On December 5, 2008, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was pending as of July 3, 2014.

4. Robertson Acquisitions II, Inc. (CIK No. 1554100) is a revoked Nevada corporation located in Woodland, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Robertson Acquisitions II, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on July 13, 2012.

5. Robertson Acquisitions II, Inc. (CIK No. 1554622) is a California corporation located in Woodland, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Robertson Acquisitions II, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on July 24, 2012.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75807 / September 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16775

In the Matter of **Calico Commerce, Inc. (a/k/a CCI Liquidation Corp.),** **China Fuhua New Material Holdings, Inc.,** **China Multimedia, Inc.,** **China Water & Drinks, Inc., and** **CMR Mortgage Fund II, LLC,** **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 Calico Commerce, Inc. (a/k/a CCI Liquidation Corp.), China Fuhua New Material Holdings, Inc., China Multimedia, Inc., China Water & Drinks, Inc., and CMR Mortgage Fund II, LLC.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Calico Commerce, Inc. (a/k/a CCI Liquidation Corp.) (CIK No. 1081154) is a dissolved Delaware corporation located in Burlingame, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Calico Commerce 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, 2002, which reported a net loss of $883,000 for the prior nine months.

2. China Fuhua New Material Holdings, Inc. (CIK No. 1423590) is a void Delaware corporation located in Beverly Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Fuhua is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of $10,000 from the company's January 8, 2008 inception to June 30, 2009.

3. China Multimedia, Inc. (CIK No. 1385211) is a revoked Nevada corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Multimedia 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, 2011, which reported a net loss of $14,766 for the prior twelve months.

4. China Water & Drinks, Inc. (CIK No. 1344133) is a dissolved Nevada corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Water & Drinks 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.

5. CMR Mortgage Fund II, LLC (CIK No. 1397396) is a California limited liability company located in San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CMR Mortgage Fund II is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of over $39 million for the prior nine months. On March 31, 2009, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was pending as of January 26, 2015.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75810 / September 2, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16354

In the Matter of **David B. Havanich, Jr., Carmine A. DellaSala, Matthew D. Welch, Richard Hampton Scurlock, III, RTAG Inc. d/b/a Retirement Tax Advisory Group, Jose F. Carrio, Dennis K. Karasik, Carrio, Karasik & Associates, LLP, and Michael J. Salovay,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND ORDERING CONTINUATION OF PROCEEDINGS AGAINST MICHAEL J. SALOVAY**

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 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Ordering Continuation of Proceedings against Michael J. Salovay ("Salovay").

II.

Salovay 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, Salovay consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Ordering Continuation of Proceedings Against Michael J. Salovay ("Order"), as set forth below.[1]

[1]On January 23, 2015, the Commission instituted public administrative and cease-and-desist proceedings pursuant to:

III.

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

A. RESPONDENTS

1. Havanich is 49 years old and resides in Jupiter, Florida. He was the co-founder, president, and director of Diversified Energy Group, Inc. ("Diversified") and is the president and director of St. Vincent de Paul Childrens Foundation Inc. ("St. Vincent"), a non-operating, non-profit corporation.

2. DellaSala is 54 years old and resides in Jupiter, Florida. DellaSala was the co-founder, vice president of business development, and director of Diversified and is the vice president and director of St. Vincent. DellaSala previously held a series 3 commodities license at various times between 1988 and 2002 while associated with 10 different commodities firms. In addition, DellaSala previously was a registered representative of SEC-registered broker dealers Meyers Pollock Robbins, Inc. and Joseph Charles & Assoc., Inc. between February 1997 and May 1997. The state of Kansas issued a cease-and-desist order against DellaSala as president of Apex Petroleum, Inc. ("Apex") in December 1995 in connection with the offer and sale of Apex securities. In the Matter of Apex Petroleum, Inc., et. al, Docket No. 96E046 (December 20, 1995).

3. Welch is 35 years old and resides in Gainesville, Florida. He was the vice president of investor relations of Diversified and is a board member of St. Vincent. Welch previously held a series 3 commodities license from approximately 2000-2002.

4. Scurlock is 38 years old and resides in Lexington, Kentucky. Scurlock is the owner and president, and therefore an associated person of, RTAG, a Kentucky registered investment adviser. Between 1999 and 2005, in ascending order, Scurlock was a registered representative of SEC-registered broker-dealers IDS Life Insurance Company ("IDS Life"), Ameriprise Financial Services, Inc., Ameritas Investment Corp., and Synergy Investment Group, LLC.

(a) Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Dennis K. Karasik ("Karasik") and co-respondent Richard Hampton Scurlock, III ("Scurlock");

(b) Sections 15(b) and 21C of the Exchange Act against Salovay and co-respondents Jose F. Carrio ("Carrio") and Carrio, Karasik & Associates, LLP ("CKA");

(c) Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Exchange Act against co-respondents David B. Havanich, Jr. ("Havanich"), Carmine A. DellaSala ("DellaSala"), and Matthew D. Welch ("Welch"); and

(d) Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act against RTAG Inc. d/b/a Retirement Tax Advisory Group ("RTAG").

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

5. RTAG is a Kentucky corporation and a Kentucky registered investment adviser. Scurlock is the owner and president of RTAG.

6. Carrio is 50 years old and resides in York, Pennsylvania. He is the co-founder and 50% owner of CKA, a limited liability partnership doing business in Baltimore County, Maryland. Carrio was not registered as a broker-dealer nor associated with a registered broker-dealer during the relevant period. Between 1989 and 2006, in ascending order, Carrio was a registered representative of SEC-registered broker-dealers First Investors Corporation, The Prudential Insurance Company of America, Pruco Securities Corporation, Equity Services, Inc., and New England Securities. On April 1, 2014 the Securities Division of the Office of the Maryland Attorney General ("Maryland AG") issued a consent order against Carrio in connection with his offer and sale of Diversified's bonds ordering that he cease and desist from violating certain of Maryland's anti-fraud and registration statutes and that he pay a $1,499,315.87 penalty which was waived based on his sworn financial statements. The consent order also permanently barred Carrio from engaging in the securities or investment advisory business in Maryland. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

7. Karasik is 60 years old and resides in Reisterstown, Maryland. He is the co-founder and 50% owner of CKA. Between 1984 and 2013, in ascending order, Karasik was a registered representative of SEC-registered broker-dealers NEL Equity Services Corporation, MML Investors Services, Inc., VIP Financial Companies, Inc., Equity Services Inc., New England Securities, Multi-Financial Securities Corporation, and H. Beck, Inc. Between 2009 and 2013, Karasik was an investment adviser representative of, and associated with, first Multi-Financial Securities Corporation and later H. Beck, Inc, both dually registered as broker-dealers and investment advisers. Karasik was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and CKA. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).[3] On July 8, 2014, by consent, FINRA imposed a bar from association with any FINRA member firm against Karasik in connection with Karasik's offer and sale of Diversified's bonds. Dennis Keith Karasik, Letter of Acceptance, Waiver and Consent, No. 2012034750401 (Jul. 8, 2014).

8. CKA is a limited liability partnership doing business in Baltimore County, Maryland. CKA states it is an independent financial services firm for wealth management issues. Carrio and Karasik each own 50% of CKA. CKA was not registered as a broker-dealer or an investment advisor during the relevant period. CKA was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and Karasik. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

9. Salovay is 44 years old and resides in Pittsburgh, Pennsylvania. Salovay's current employment status is unknown. Between 1997 and 2007, in ascending order, Salovay was a registered representative of SEC-registered broker-dealers IDS Life, American Express Financial Advisors Inc., Metropolitan Life Insurance Company, Metlife Securities Inc., First Security Investments, Inc., Midsouth Capital, Inc., Nations Financial Group, Inc. and Natcity Investments, Inc. In October 2008, he settled an action with FINRA related to his failure to disclose material information on a Form U4 by agreeing to a nine-month suspension and a $5,000 fine.

[3] In addition, the Maryland consent order revoked Karasik's Maryland investment adviser representative registration.

B. OTHER RELEVANT ENTITIES

1. Diversified was a Delaware corporation founded by Havanich and DellaSala in 2006 and located in Tequesta, Florida. Diversified was dissolved on April 28, 2014. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and commodities trading in the futures market. Diversified filed nine Form Ds with the Commission between 2007 and 2012 claiming exemptions under Rules 504 and 506 of the Securities Act for approximately $19 million in stock and bonds in nine purportedly separate offerings but did not file Forms D for an additional $8 million in stock and bonds in five other purported separate offerings. Diversified has never been registered with the Commission nor registered any offering of securities under the Securities Act or a class of securities under the Exchange Act.

C. SUMMARY

1. Between 2006 and 2012, Diversified and its principal officers, Havanich, DellaSala, and Welch, raised at least $17.4 million from approximately 440 investors nationwide through a series of fraudulent, unregistered offerings of stock and bonds. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and also engaged in commodities trading in the futures market. Ultimately, as its disclosed use of proceeds expanded, Diversified used a portion of the investor funds to buy fractional interests in oil and gas wells, cattle, a hydrogen device that purported to increase gas mileage on vehicles, trade commodities contracts, and invest in real estate. Diversified, Havanich, DellaSala, and Welch made material misrepresentations and omissions about Diversified's financial performance and use of industry experts and technologies in Diversified's offering material and correspondence to investors. Havanich, DellaSala, and Welch also touted their affiliation with a charity organization in Diversified's offering materials but that charity never had any substantive charitable activities.

2. Starting in 2009, Diversified also hired unregistered sales agents to sell Diversified's bonds paying them commissions of 5% or 10% of the investor proceeds. Diversified and DellaSala employed the unregistered sales agents to raise money for Diversified even after receiving an email and other correspondence from Diversified's outside counsel detailing the limits on Diversified's use of unregistered sales agents. Diversified's top grossing independent sales agents were (1) Scurlock and his state registered investment advisory firm RTAG, (2) Carrio, Karasik, and their limited liability partnership CKA, and (3) Salovay. Collectively, they earned approximately $985,000 in transaction-based compensation in connection with their sales activities.

D. OFFER AND SALE OF UNREGISTERED SECURITIES

1. Beginning in 2006 and continuing through approximately 2008, Diversified submitted to potential investors one or more versions of a private placement memoranda ("PPM"), offering to sell Diversified common stock at per share prices ranging from 20 cents to $1.55 (the "Stock Offerings").

2. As a result of the Stock Offerings, Diversified raised approximately $910,304 from 160 investors both inside and outside the State of Florida.

3. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Stock Offerings.

4. No exemption from registration existed with respect to the Stock Offerings.

5. Between 2006 and 2008, there was no period of six months or more in which there was no offer or sale of Diversified's stock.

6. Beginning in approximately 2009 and continuing through 2012, Diversified submitted to potential investors various versions of a brochure, PPM, and business plan as part of offers to sell Diversified bonds with maturities between 12 and 24 months and paying annual interest rates between 8% and 10.25% (the "Bond Offerings"). Some of the bonds included an option to purchase Diversified common stock.

7. As a result of the Bond Offerings, Diversified raised approximately $16.5 million from 280 investors both inside and outside the State of Florida.

8. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Bond Offerings.

9. No exemption from registration existed with respect to the Bond Offerings.

10. Between 2009 and 2012, there was no period of six months or more in which there was no offer or sale of Diversified's bonds.

11. DellaSala, Havanich, and Welch participated in the Stock Offerings and the Bond Offerings by undertaking the offerings, by drafting and reviewing the brochures and business plans, reviewing and approving the PPMs, engaging sales agents to sell the bonds, facilitating Diversified's website, participating in presentations to potential investors, and soliciting potential investors for at least one stock offering using "lead lists." In addition, Havanich and DellaSala touted Diversified's securities on radio broadcasts, where Havanich appeared under his own name and DellaSala appeared under the alias "Jim Clark."

E. <u>DIVERSIFIED AND DELLASALA'S USE OF UNREGISTERED SALES AGENTS</u>

1. Starting in April 2009, Diversified had a formal contract, titled Finder's Fee Agreement ("Finders agreement") that it used to employ unregistered sales agents to act as commissioned sales agents.

2. The unregistered sales agents solicited investors and received a commission of either 5% or 10% from Diversified based on the amount invested.

3. Diversified participated in the unregistered sales agents' solicitation of investment in Diversified bonds by entering into written agreements with the unregistered sales agents, paying them a commission, and supplying them with brochures, PPMs, and business plans relating to Diversified bonds. DellaSala participated in the unregistered sales agents' solicitation of investment in Diversified bonds by paying them commissions in his role as a principal of Diversified.

4. In connection with their efforts to obtain purchasers for Diversified bonds, the unregistered sales agents used the mails or means or instrumentality of interstate commerce.

5. The unregistered sales agents were either not associated with any registered brokers or dealers or were engaged in sales activities that occurred outside and without the knowledge of the broker-dealers with which they were associated.

F. THE UNREGISTERED SALES AGENTS' INVOLVEMENT IN THE SALE OF DIVERSIFIED'S BONDS

1. Scurlock and RTAG

a. Scurlock entered into a Finders agreement with Diversified in December 2009. That agreement stated Scurlock would be paid a 5% commission for each investor that purchased Diversified's bonds although in practice he was actually paid a 10% commission.

b. While RTAG did not enter into a Finders agreement with Diversified, starting in February 2012, Diversified paid commissions to RTAG instead of directly to Scurlock.

c. Between January 2010 and March 2012, Scurlock recommended Diversified's bonds to RTAG's clients and other investors, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in Diversified bonds, fielded investor inquiries, and handled investor funds.

d. Scurlock and RTAG collectively received approximately $448,000 in transaction-based compensation for selling Diversified bonds to approximately 50 investors while not registered as broker-dealers or associated with a registered broker-dealer.

2. Carrio, Karasik, and CKA

a. In November 2009, Carrio entered into a Finders agreement with Diversified that paid him a 10% commission for each investor that purchased Diversified's bonds.

b. While Karasik and CKA did not enter into Finders agreements with Diversified, starting in December 2010, Carrio and CKA began equally sharing Diversified commissions. Karasik received either all or a supermajority of the Diversified commissions paid to CKA as some of the commissions were used to pay CKA expenses.

c. Between December 2009 and March 2012 Carrio, Karasik, and CKA recommended the bonds to CKA clients, provided prospective investors with offering documents, discussed the returns of the bond offerings with prospective investors, weighed in on the merits of the bond investment, provided and directed prospective investors to complete the paperwork necessary for an investment in the bonds, and, as to Karasik and CKA, handled investor funds.

d. Carrio, Karasik, and CKA collectively received approximately $434,974 in transaction-based compensation for selling Diversified's bonds to approximately 40 investors.

e. Between December 2009 and March 2012, Carrio and CKA were not registered as broker-dealers or associated with a registered broker-dealer.

f. Between December 2010 and March 2012, Karasik's activities occurred outside and without the knowledge of the broker-dealers with which he was associated during the relevant time.

3. Salovay

a. Salovay entered into a Finders agreement with Diversified in July 2009. That agreement provided that Salovay would be paid a 10% commission for each investor that purchased Diversified bonds.

b. Between August 2009 and March 2012, Salovay recommended Diversified's bonds to his insurance clients, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in the bonds, fielded investor inquiries, and handled investor funds.

c. Salovay received approximately $101,790 in transaction-based compensation for selling Diversified's bonds to approximately 20 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

G. MISREPRESENTATIONS AND OMISSIONS TO INVESTORS

During the course of the Bond Offerings, Diversified, Havanich, DellaSala, and Welch made numerous false and misleading statements and omissions, many of which are described below. At the time these statements and omissions were made, Diversified, Havanich, DellaSala, and Welch either knew, or should have known, or were severely reckless in not knowing their false and misleading nature.

1. <u>Misrepresentations and Omissions Concerning Diversified's Financial Performance</u>

a. The PPMs Respondents distributed beginning in 2009 and continuing through 2010 list "Operating Deficits" as one of several risk factors, stating: "The expenses of operating the Company may exceed its income, thereby requiring that the difference be paid out of the Company's capital, reducing the Company's investments and potential for profitability." Diversified omitted disclosures regarding Diversified's current or past profitability, stating only that "[a]dditional financial information is available on a confidential basis upon request." In fact, Diversified's incurring of losses was not a mere contingency. To the contrary, Diversified had suffered steadily rising losses from its inception, as described below:

YEAR	NET INCOME (LOSS)
2006	(31,200)
2007	(257,975)
2008	(564,347))
2009	(672,749)
2010	(1,114,901)

b. While Diversified's October 2011 PPM disclosed that Diversified had recently sustained losses, it omitted the five-year history of losses.

c. In addition, Diversified's brochures paint a rosy picture of the company, claiming consistently over a three-year period of deepening insolvency that its bonds would produce "reliable monthly cash flow," were backed by "continually growing" assets, and were "[s]uperior to traditional fixed income instruments," while omitting that Diversified's survival depended upon its ability to borrow greater and greater sums.

d. In a brochure distributed in 2009 to prospective bond purchasers:

i. Diversified claimed one of Diversified's "Revenue Sources" was a "Hedge Account (for asset protection)," which earned an average monthly return on investment of 14.73%.

ii. Diversified represented that as of June 2009, Diversified had $2,126,269 in "Oil and Gas Assets," and that its "Asset Allocation" was 39% "Oil and Gas Acquisition" and 61% "Hedging Portfolio," implying that its Hedging Portfolio was worth $3,325,703.

iii. Diversified presented a bar chart comparing the three year returns of the "Trading Strategy History" with the returns on the "S&P." According to the chart, the trading strategy returned 82.70% in 2006, 138.70% in 2007, and 29.4% in 2008, for a three year average of 83.60%.

e. In brochures distributed in 2010, Diversified included a chart showing Diversified's "4 YR Average Strategy History" producing an average annual return of 90.9%.

f. In brochures distributed in 2010 and 2011, Diversified included a chart showing Diversified's "5 YR Average Strategy History" producing an average annual return of 79.4%

g. As Diversified, Havanich, DellaSala, and Welch knew, the representations in the brochures distributed in 2009 and 2010 were false and misleading as to material matters. In fact, in 2006 and 2007, Diversified had no hedging assets and had engaged in no commodities trading. In 2008, Diversified never had more than $6500 in hedging assets and Diversified's portfolio had an annual return of -95%. During June 2009, Diversified had far less than $3,325,703 in its hedging portfolio—during this period the value of the Diversified portfolio ranged from $38,000 to $75,000.

h. On March 30, 2010, Welch signed and sent to at least 9 individuals in Pennsylvania who had bought Diversified bonds a letter stating: "Due to the tremendous demand for [Diversified] Bonds, and the favorable financial position in which the company finds itself, management has decided to 'call' the existing bonds and is providing you a complete repayment" of principal and interest. This statement was false and misleading:

i. as of March 30, 2010, Diversified was not in a "favorable" financial condition but had been suffering significant and increasing losses since its inception;

ii. Diversified was not calling all of its bonds, as the letter implied, but rather was only calling bonds sold to some Pennsylvania investors; and

iii. Diversified's motivation for calling the bonds was not related to the demand for Diversified's bonds or Diversified's financial condition; rather, Diversified called the bonds because Pennsylvania regulatory authorities had raised questions regarding the legality of Diversified's sale of bonds to Pennsylvania residents.

i. Within approximately one month, several of the Pennsylvania investors reinvested their returned capital and some later invested additional funds.

2. <u>Misrepresentations Concerning Diversified's Use of Industry Experts and Technologies</u>

a. In business plans distributed to prospective investors between 2006 and 2011, Diversified stated, "Diversified will from time to time retain the advice and recommendation of experts based on the prospects we are looking at. … [T]he company will look to hire the best qualified individuals to evaluate each new prospect before we make an investment."

b. In business plans distributed to prospective investors between at least 2009 and 2011, Diversified stated, "[t]he key is working with *our geologists* and industry partners to find the best prospects that meet the companies risk to reward ratio." (emphasis added).

c. Diversified's website stated that its business strategy includes, among other things, acquiring "proven producing properties which meet the standards of management and *our* independent reservoir engineering firm." (emphasis added).

d. In several 2009 and 2010 versions of Diversified's investor power point presentations, shown at investor summits in various cities and led by Havanich, DellaSala, and Welch, Diversified included the names of an independent geologist and a reservoir engineering firm as part of its "independent team."

e. In a business plan provided to a mid-2009 investor, Diversified stated, "[w]e utilize advanced 3-D seismic imaging, drilling and completion technologies to systematically evaluate domestic onshore oil and natural gas reserves." Later Diversified business plans utilized similar language until late 2010 when the language was ultimately changed to read, "...Diversified Energy Group focuses its acquisition and development activities in provinces where we believe technology and the knowledge of our technical staff can effectively maximize return and reduce risk...."

f. Diversified stated in each of its marketing brochures that it had "[a]n Experienced Location and Acquisition Team boasting a proven track record with such companies as Chesapeake Energy, Marathon Oil, Union Pacific, Hess and Torch Energy, to name a few."

g. The foregoing statements were false and misleading. In fact:

i. Diversified did not hire geologists or a reservoir engineering firm as represented to evaluate the oil and gas wells in which it invested. Diversified made at least 93 separate investments in at least 44 oil and gas prospects between 2006 and 2011, the majority of which were in producing oil and gas wells. While Diversified did retain a geologist in early 2007, that geologist only provided Diversified with 15 reports related to *non-producing* oil and gas prospects and it did not retain an independent reservoir engineering firm in connection with any of its investments;

ii. Diversified never had 3-D seismic imaging, drilling and completion technologies;

iii. Diversified did not have a technical staff; and,

iv. DellaSala, Havanich, and Welch were the sole members of Diversified's "location and acquisition team" and they had never worked with any of the major energy companies listed in the brochures.

H. <u>HAVANICH, DELLASLA, AND WELCH TOUTED THEIR AFFILIATION WITH ST. VINCENT</u>

1. In September 2006, shortly before the start of Diversified's capital raising activities, Havanich and DellaSala created St. Vincent. St. Vincent has no relationship to the St. Vincent de Paul Catholic voluntary organization.

2. In Diversified's business plans, Diversified described St. Vincent as "a non-profit corporation to benefit children in need around the world," and described DellaSala and Havanich as officers and directors of St. Vincent, and Welch as member of St. Vincent's board.

3. St. Vincent never raised any money for children or had any substantive charitable activities.

I. <u>VIOLATIONS</u>

As a result of the conduct described above, Salovay willfully violated Section 15(a) of the Exchange Act, which makes it unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless such broker or dealer is registered or associated with a registered broker-dealer.

IV.

Pursuant to his Offer, Salovay agrees that disgorgement is appropriate, and further agrees to additional proceedings in this proceeding to determine (a) the amount of such disgorgement, plus prejudgment interest if ordered, and (b) whether a civil penalty is appropriate, and the amount of any such penalty, pursuant to Sections 21B and 21C of the Exchange Act. In connection with such additional proceedings, Salovay agrees: (a) he will be precluded from arguing that he did not violate the federal securities laws described in his Offer; (b) he may not challenge the validity of his Offer; (c) solely for the purposes of such additional proceedings, the allegations of the Offer shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Salovay's Offer, and to continue proceedings to determine the amount of disgorgement and civil penalties.

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

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

B. Salovay 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.

C. Any reapplication for association by Salovay 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 Salovay, 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. Salovay shall pay disgorgement, and additional proceedings shall be held to determine (i) the amount of such disgorgement, plus prejudgment interest if ordered, and (ii) whether a civil penalty is appropriate, and the amount of any such penalty. and civil penalties, in amounts to be determined by additional proceedings.

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Piwowar Dissents as to the Undertaking (III. A.)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75814 / September 2, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4186 / September 2, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31803 / September 2, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16776

In the Matter of **TABERNA CAPITAL MANAGEMENT, LLC** **MICHAEL FRALIN and** **RAPHAEL LICHT** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C, 15(b), AND 21C 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 CEASE-AND-DESIST ORDERS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Taberna Capital Management, LLC ("Taberna"), and Sections 4C and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, Section 9(b) of the Investment Company Act of 1940 ("Company Act"), and Rule 102(e) of the Commission's Rules of Practice against Michael Fralin ("Fralin") and Raphael Licht ("Licht") (collectively with Taberna, "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 over 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 Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C, 15(b) and 21C 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 Cease-and-Desist Orders ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of Taberna's multi-year effort to charge and retain certain fees (known as "Exchange Fees") in connection with restructuring transactions undertaken between Taberna's collateralized debt obligation ("CDO") clients (the "Taberna CDOs") and the issuers of the underlying obligations in the Taberna CDOs' portfolios. Between 2009 and 2012, Taberna, a wholly-owned indirect subsidiary of RAIT, retained over $15 million of Exchange Fees. As Taberna knew, the Exchange Fees should have gone to the CDOs, and retention of the Exchange Fees was impermissible under the governing documents for the Taberna CDOs. Moreover, the Exchange Fees created actual and potential conflicts of interest that Taberna failed to disclose to its clients, in violation of Taberna's fiduciary duty as an investment adviser, and to the investors in the Taberna CDOs, including on Taberna's Forms ADV. As described further below, Michael Fralin and Raphael Licht played key roles in the relevant misconduct. Fralin had responsibility for exchange negotiations and documentation that incorporated false and misleading language about Exchange Fees. Licht, a senior Taberna executive at the time, was among those who approved Taberna's collection of Exchange Fees. Licht also had a role in supervising Fralin's efforts to generate Exchange Fees, and also failed to ensure those fees were disclosed in Taberna's Forms ADV.

Respondents

1. **Taberna** is a Delaware limited liability company with a principal place of business in Philadelphia, PA. Taberna registered with the Commission as an investment adviser in 2008 and terminated this registration in January 2015. Taberna is an indirect subsidiary of RAIT, a Maryland, SEC-registered Real Estate Investment Trust listed on the New York Stock

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

Exchange, whose primary business is investing in and managing real-estate related assets, as well as providing debt financing to real estate-related borrowers. Taberna's sole business was the management of the Taberna CDOs. Between 2010 and the end of 2014, Taberna sold or transferred the management rights to the Taberna CDOs. Taberna currently has no advisory clients.

2. **Michael Fralin**, age 40, is a resident of New York, New York. From 2007 through 2010, Fralin was employed by Taberna and RAIT, first as a Vice President, then a Managing Director, with responsibility for coordinating and negotiating restructuring transactions in the portfolios of the Taberna CDOs. Fralin continued to provide consulting services to Taberna until 2011. Prior to coming to Taberna and RAIT, Fralin worked as an attorney and as an investment banker. Fralin is a member of the New York bar and is currently practicing law.

3. **Raphael Licht**, age 47, is a resident of Philadelphia, Pennsylvania. From February 2009 to December 2014, Licht was the Chief Operating Officer of RAIT. From December 2006 to February 2009, Licht was the Chief Legal Officer and Chief Administrative Officer of RAIT. Licht joined Taberna in March 2005. Licht separated from RAIT and Taberna in December 2014. Licht is a member of the Pennsylvania bar and is currently self-employed as a real estate consultant.

Background

4. Taberna was established in 2003 for the purpose of managing a series of Collateralized Debt Obligations ("CDOs"). In 2006, RAIT acquired Taberna. At the time that RAIT acquired Taberna, Taberna was acting as the manager of seven CDOs – called in sequential order Taberna Preferred Funding I through VII. RAIT acquired Taberna with a view to continuing to issue and manage additional CDOs. Two additional domestic CDOs – Taberna VIII and IX – and two European CDOs –Taberna Europe CDO I and II – were issued after RAIT acquired Taberna (collectively Taberna I through IX and Taberna Europe CDO I and II are referred to as the "Taberna CDOs").

5. A CDO is a special-purpose vehicle that issues debt to investors and uses the proceeds to invest in fixed income securities or loans. The CDO's debt is issued in different tranches that feature varying levels of risks and returns. The senior tranche is the highest rated and is first in the priority of repayment through what is called the CDO's "waterfall." Remaining proceeds then flow to the lower-rated junior tranches, and any proceeds remaining after the junior tranches are paid flows to the lowest, or "equity," tranche. Taberna invested in the equity tranche of most of the Taberna CDOs.

6. The Taberna CDOs invested primarily in real estate, mostly in the form of trust preferred securities ("TruPS") issued by real estate investment trusts ("REITs") that, in turn, invested in commercial and residential real estate. TruPS are a form of deeply subordinated debt issued by REITs. By virtue of their investment in the TruPS, the Taberna CDOs, and their investors, essentially functioned as lenders to the REITs that issued the TruPS ("TruPS Issuers").

7. The Taberna CDOs were each governed by an indenture, which, among other things, defined whether and how cash generated by the TruPS in the CDO's portfolio would be applied towards interest and principal payments owed to the CDO investors. Each indenture also provided for the engagement of a Collateral Manager for that CDO. Taberna was engaged by each CDO as Collateral Manager, pursuant to the terms of a Collateral Management Agreement ("CMA"). The indentures for each of the Taberna CDOs (generally, the "Indenture") were substantially similar, as were the CMAs.

8. Taberna's duties as Collateral Manager were defined in the CMA and the Indenture. Among those duties were various responsibilities relating to the disposition of collateral in the CDO's portfolio. Other provisions authorized Taberna to take specific actions with respect to exchanges. In particular, Section 6.16 of the Indenture authorized Taberna to instruct the Trustee to cause the CDO to enter into 'exchanges.' An exchange, in this context, means a transaction in which the CDO returns a TruPS Issuer's securities to that issuer in return for new securities and/or other consideration.

9. As an investment adviser, Taberna owed fiduciary duties to its CDO clients. Among other things, it was obligated to act in the best interests of its CDO clients and to disclose any material conflicts of interest that it had.

10. Taberna's compensation for acting as collateral manager of the Taberna CDOs was also defined in the CMA. Pursuant to the CMA, Taberna was entitled to a "Collateral Management Fee," to be paid by the CDO, as "compensation for the performance of its services and obligations as Collateral Manager under the terms of [the CMA]." As was typical for many CDOs, the Collateral Management Fee was broken out into a senior fee, paid at the top of the CDOs' waterfall, and a subordinated fee paid out at the bottom of the waterfall, only after other investors received their principal and interest. The CMA also provided that Taberna could accept fees for services provided to the TruPS Issuers. However, the Collateral Management Fee was intended as Taberna's exclusive compensation for undertaking its defined duties as Collateral Manager, including exchanges. Prior to 2009, Collateral Management Fees represented Taberna's primary source of income.

Taberna's Multi-Year Effort to Charge and Retain Exchange Fees

11. In the wake of the global financial crisis, many of the TruPS Issuers experienced severe financial difficulties due to their heavy exposure to the real estate market. These financial difficulties threatened the ability of the TruPS Issuers to continue to make payments on the TruPS in the portfolios of the Taberna CDOs. As a result, the performance of several of the Taberna CDOs suffered.

12. Starting in early 2008, TruPS Issuers began to approach Taberna seeking to restructure their obligations under the TruPS. The TruPS Issuers typically sought a period of relief from interest rate obligations on their outstanding debts, with the goal of enhancing the TruPS Issuer's ability to survive until the real estate market stabilized. Because the TruPS were subordinated debt, a bankruptcy by a TruPS Issuer would likely lead to little, if any, recovery to the CDOs that held the TruPS.

13. As the Collateral Manager, Taberna was authorized to negotiate such restructurings on behalf of the Taberna CDOs. Restructurings could potentially take several forms: amendment, whereby the terms of the TruPS would be changed on a negotiated basis; redemption or prepayment, whereby the TruPS Issuer would redeem some or all of the TruPS, typically at a deep discount to their par value; or an exchange pursuant to Section 6.16 of the Indenture, as described above.

14. In a typical restructuring, including a typical exchange transaction, Taberna's responsibilities included negotiating transaction terms and documents; assessing the financial condition of the TruPS Issuer; valuing the TruPS held by the Taberna CDOs; and evaluating the consideration being offered by the TruPS Issuer as part of the restructuring, such as cash, amended debt terms, or, in the case of exchanges, new securities. In undertaking these activities, Taberna was acting in its capacity as Collateral Manager to the Taberna CDOs. The TruPS Issuers were Taberna's counterparties, and Taberna was not retained by the TruPS Issuers – and did not render any services to them – in connection with the restructurings.

15. In connection with several restructurings in 2008 which were not exchanges, Taberna negotiated a fee to be paid by the TruPS Issuer directly to the Taberna CDOs that held the restructured TruPS as part of consideration for the CDO agreeing to the restructuring. Such fees were paid into the waterfall of the CDOs pursuant to the provisions of the Indenture defining Interest Proceeds as including ". . . all amendments and waiver fees, all late payment fees and all other fees and commissions received during the related Due Period," and defining Principal Proceeds as including ". . .any other payments received with respect to the Collateral and not included in Interest Proceeds."

16. Initially, Taberna believed that neither the Indenture nor the CMA authorized it to charge TruPS Issuers fees in connection with exchange transactions. Starting in February 2009, Taberna reconsidered its position regarding charging such fees and Taberna then insisted that TruPS Issuers pay a fee ("Exchange Fee") directly to Taberna as consideration for Taberna's willingness to consider exchange transactions executed on behalf of the Taberna CDOs. Between 2009 and 2012, Taberna executed over fifty exchange transactions in which it collected gross Exchange Fees totaling more than $17 million. After paying third-party expenses for lawyer fees, outside advisers, or other third party costs, Taberna retained over $15 million in Exchange Fees. RAIT senior executives approved of Taberna's plan to retain Exchange Fees, and the Exchange Fees were recognized as fee income by RAIT.

17. Taberna typically sought an Exchange Fee of approximately 1% of the value of the exchanged securities, paid directly to Taberna by the TruPS Issuer. The 1% figure was not calculated in relation to actual costs incurred by Taberna in connection with the exchanges. In fact, the Exchange Fees greatly exceeded Taberna's actual out-of-pocket costs associated with the exchanges.

18. The Exchange Fees Taberna collected were significant to Taberna's business, which had been impacted by the financial crisis, and replaced some of the revenue lost when the Taberna CDOs, due to their declining performance, ceased paying subordinated management fees to Taberna. In 2009, for example, Taberna's Exchange Fees revenues actually exceeded the management fees paid by the Taberna CDOs. In May 2009, senior Taberna and RAIT

executives participated in a presentation to the RAIT Board of Trustees discussing the declining income faced by Taberna. That presentation identified as a "New Source of Fee Income" for 2009 the transformation of "our TruPS workouts into fee for service revenue."

Taberna Attempted to Obscure the Nature of the Fees by Referring to Them as Payment of "Third Party Costs"

19. In connection with exchanges, Taberna executed transaction documents on behalf of the Taberna CDOs, including term sheets and exchange agreements. Taberna acted to ensure that some of these documents were either silent on fees or mischaracterized fees as compensation only for third party expenses.

20. For example, in the template Taberna typically sought to use for exchanges, the section describing the fee in the term sheets Taberna provided to the TruPS Issuers was titled "Third Party Costs," and read "In connection with the exchange offer described herein, Taberna will engage (a) outside legal counsel to draft and negotiate the documents evidencing the new securities and (b) one or more financial advisory and/or due diligence firms to provide financial analysis, underwriting and other due diligence services solely with respect to the issuance of the new securities" and then described the Exchange Fee as being paid "to cover the foregoing third party costs incurred by Taberna in connection with the new securities." Thus, this language misrepresented that the fee was limited to third party costs, when it was not. For virtually every exchange, there were no third-party "financial advisory and/or due diligence firms" retained at all.

21. As part of the exchange process, Fralin would provide the exchange documents to an informal committee composed of Licht and others for review and approval. On at least one occasion, in early May 2009, a senior manager on this committee apparently noticed this third party cost language was false and misleading and suggested it be altered. Nothing was done in response, however, and substantially similar language was used in dozens of subsequent transactions over the next two years.

The Exchange Fees Created Actual and Potential Conflicts of Interest

22. Taberna's decision to charge Exchange Fees created actual and potential conflicts between Taberna's interests and the interests of the CDOs and the CDO investors. For instance, because Taberna retained fees paid in connection with exchanges, and not other types of restructurings, Taberna had an incentive to steer TruPS Issuers interested in a restructuring towards doing an exchange, irrespective of what form of restructuring might be most advantageous to the Taberna CDOs. Similarly, Taberna threatened some TruPS Issuers that it would walk away from certain exchange negotiations if the issuers did not agree to pay an Exchange Fee to Taberna, again irrespective of whether the exchange would benefit Taberna's clients, the Taberna CDOs. Taberna, however, recommended both exchanges and restructurings during the relevant period, and did not receive a fee in connection with every exchange.

23. Typically, the exchanges provided for a longer payment period at a reduced interest rate, but with an increased principal amount greater than the original underlying

securities. This often had the effect of at least temporarily allowing continued payments to the CDOs.

24. In some restructurings, the distressed TruPS Issuers were focused on preserving their limited available cash assets, and had a maximum amount of cash available for such exchanges. From the perspective of the TruPS Issuer, it was irrelevant whether that cash went to the Taberna CDOs, as consideration for an exchange, or to Taberna, in the form of an Exchange Fee, so long as the TruPS Issuer was receiving the relief it was seeking. Moreover, given the distressed condition of the TruPS Issuers, some exchanges involved the Taberna CDOs accepting less than the full value of the TruPS it was giving up. Therefore, in seeking Exchange Fees in those instances, Taberna effectively reduced the amount of cash available to the Taberna CDOs to bring their recovery in the exchange closer to the full value of what the CDOs were giving up.

25. In one example of the way in which the conflict manifested itself, Taberna knowingly waived a fee owed by one TruPS Issuer to several of the Taberna CDOs in favor of a new fee, payable directly to Taberna. In this case, the TruPS Issuer ("Issuer A"), pursuant to the terms of a prior restructuring in 2009, had an outstanding obligation to pay Taberna's CDO clients $250,000. When Issuer A approached Taberna to seek a new restructuring transaction in early 2010, Issuer A resisted paying an additional fee to Taberna due to the drain it would cause on Issuer A's limited available resources. Taberna was ultimately only able to obtain its 1% fee by agreeing to waive the $250,000 payment that Issuer A owed Taberna's CDO clients. Taberna recognized that it was giving up a substantial right belonging to its client; one Taberna executive referred to waiving the payment owed to the CDOs as "a huge give." Nevertheless, Taberna proceeded with the transaction without disclosing the conflict presented by waiving the fee owed to the CDO in order to collect payment for itself.

26. Taberna was on notice that its conduct with respect to Exchange Fees was inconsistent with the practices of other CDO managers. Taberna often negotiated restructuring transactions alongside another CDO manager ("Manager A"), who was Taberna's main competitor in this space. Manager A informed Taberna in early 2009 that Manager A was not retaining Exchange Fees. This information was conveyed to Taberna's senior management. In response, a senior Taberna executive said in an email, "We have different needs than [Manager A]. We need fee income, not just expense reimbursement."

27. Ultimately, Taberna retained over $15 million in net Exchange Fees to which it was not entitled.[2] The fees were paid directly to Taberna, and flowed through to its corporate parent, RAIT. Taberna itself was not a registered broker-dealer under Section 15(b) of the Exchange Act. Moreover, Taberna's affiliated broker-dealer, RAIT Securities LLC, played no role in the exchanges or exchange fee program. At one point, Taberna apparently considered using a registered broker-dealer, but opted not to, based on a belief that the structure would be "too complicated."

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2 In 2012, in connection with the settlement of a dispute relating to Taberna VIII, Taberna paid to that CDO $2 million to reimburse it for exchange fees it had retained.

Taberna's Failure to Disclose Its Exchange Fee Practices and the Resulting Conflicts of Interest to Clients and Investors

28. Taberna did not tell its clients or the investors in the Taberna CDOs that it was retaining Exchange Fees.

29. Directors of the CDO vehicles did not receive full and accurate descriptions of the fees that Taberna was retaining.

30. Taberna also knew that fees were not disclosed in information included in regular reports from the CDO trustee to investors.

31. Taberna wrote a regular report to investors in each Taberna CDO called the "State of the CDO" report. These State of the CDO reports included detailed, narrative descriptions of the exchange transactions that had taken place. Taberna understood that the purpose of the narrative descriptions was to provide Taberna's justifications for doing the exchanges.

32. Taberna knew that investors were interested in Taberna's reasons for exchanges. The representative of the senior investors in a number of the CDOs asked whether Taberna received fees in connection with exchange work. It appears that Taberna provided, in 2009 and 2010, an ambiguous and non-specific response to that representative's questions. Moreover, at least one other investor also asked Taberna about Exchange Fees and Taberna declined to respond. Taberna was also aware that another manager's proposal to collect fees similar to the Exchange Fees was publicly criticized by investors, at least one of whom referred to the effort as "an illegal fee grab."

33. Notwithstanding this known investor interest in Taberna's motivations for exchanges, Taberna considered disclosing the Exchange Fees in State of the CDO reports but decided not to do so.

34. Taberna also made direct misrepresentations to investors in consent requests. Certain exchanges required the consent of the investors in the participating Taberna CDO(s). To obtain investor consent, investors were sent a summary of the exchange terms, as drafted by Taberna. As with other transaction documents, Taberna included in these consent solicitations a description of Exchange Fees, typically stating that the TruPS Issuer agreed to pay a certain amount "to cover outside legal costs...and to cover underwriting, placement and other due diligence costs." This language failed to disclose that, after legal costs were paid, Taberna would receive the remainder of the fee.

Taberna's Inaccurate Forms ADV

35. As a registered investment adviser, Taberna was required to file Form ADV with the Commission. In this form, Taberna was required to identify, among other things, its sources of compensation in connection with advice it provided to its clients, potential conflicts of interests it had, and how it dealt with such conflicts. Between 2009 and 2012, Taberna filed numerous Forms ADV that failed to disclose the Exchange Fees, failed to describe the conflict of interest raised by the Exchange Fees, and falsely and misleadingly described Taberna's compensation for managing the Taberna CDOs. Clients and investors were thus unaware of the

existence, nature, and extent of the conflict raised by Taberna's retention of Exchange Fees from TruPS Issuers.

36. For example, Part II, Item 13.A of Form ADV required the adviser to answer the question "Does the applicant . . . have any arrangements, oral or in writing, where it is paid cash by . . . a non-client in connection with giving advice to clients?"[3] Exchange fees, which were paid by non-clients (the TruPS Issuers) in connection with giving advice about whether to accept the exchange offer to clients (the Taberna CDOs), were responsive to this item. Taberna did not disclose the Exchange Fees as required by Item 13.A.

Fralin

37. Fralin was a Managing Director of Taberna during some of the relevant period. He was responsible for handling restructuring negotiations with the TruPS Issuers, and would present proposed exchanges to the informal committee, including Licht and Fralin's immediate supervisors at Taberna. The exchanges and other restructuring transactions occupied most of his time at Taberna.

38. Fralin viewed part of his job responsibilities as maximizing Taberna's Exchange Fee income. Because he had a background as an attorney and an investment banker, he was given some autonomy to do so. In his own words, "[m]ost of the fees [generated in 2009] were purely based on my hard work and determination." Notwithstanding this, the exchanges had to be approved by Fralin's immediate supervisors at Taberna.

39. Fralin sought, and in early 2010 obtained, from his managers at Taberna a compensation structure for himself under which Fralin would receive some portion of Exchange Fees that he helped Taberna collect while still employed by Taberna. This structure gave Fralin a personal incentive to complete exchanges he was then working on, and earn Exchange Fees for Taberna, prior to his departure in the middle of 2010.

40. Fralin was responsible for drafting language in exchange transaction documents that mischaracterized Exchange Fee payments as compensation to Taberna for actual third party costs. Fralin knew that this false and misleading language was sent to or seen by representatives of the CDOs and of the CDOs' investors. He also knew or should have known that the language was misleading. On multiple occasions, recipients of the documents outside of Taberna indicated to Fralin their understanding that the fee described in the document was meant as compensation for Taberna's actual costs incurred.

41. Fralin also knew that investors wanted to know whether Taberna was collecting fees, because they asked him and others at Taberna. He helped draft and review the descriptions of the exchanges in the State of the CDO reports, which did not disclose the Exchange Fees.

3 Form ADV was amended effective September 19, 2011. Thereafter, the same disclosure was required by Item 14.A of Part 2 of Form ADV.

Licht

42. Licht served as the Chief Administrative Officer and Chief Legal Officer of Taberna and RAIT until February 2009, and additionally as Chief Operating Officer and General Counsel of Taberna from 2009 until December 31, 2014. As an officer of Taberna, he reviewed and approved certain exchange transactions, including the Exchange Fees.

43. In addition to helping to supervise Fralin's day-to-day negotiation of exchange transactions, Licht personally negotiated some exchanges and Exchange Fees. He also helped to negotiate Fralin's compensation structure, described above, through which Fralin was paid a portion of the Exchange Fees he helped arrange.

44. Licht was also aware of language Fralin used in certain exchange transaction documents that mischaracterized Exchange Fees as compensation for third party costs.

45. Licht failed to ensure that Taberna's disclosures to clients and investors about exchanges – including disclosures in the State of the CDO reports – disclosed the Exchange Fees. Licht knew that the representative of the senior investors in several of the CDOs wanted to know about Exchange Fees and Taberna's reasons for undertaking the exchanges, because it asked him, among other Taberna personnel, whether Taberna was collecting Exchange Fees.

46. Licht also played a role in the drafting and review of Taberna's materially inaccurate Forms ADV, which included misleading descriptions of Taberna's compensation and, as Licht knew, did not include references to Taberna's collection of Exchange Fees. He was listed as a principal of Taberna on certain of the ADV filings.

Violations

47. As a result of the conduct described above, Respondent Taberna willfully violated Section 15(a) of the Exchange Act, which prohibits a person from effecting any transactions in, or inducing or attempting to induce the purchase or sale of, securities unless registered with the Commission as a broker or dealer.

48. As a result of the conduct described above, Taberna willfully violated Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for an investment adviser to employ any device, scheme or artifice to defraud clients or to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. Fralin and Licht willfully[4] aided and abetted and caused Taberna's violations of Section 206(2).

49. As a result of the conduct described above, Taberna willfully violated, and Respondent Fralin willfully aided and abetted and caused Taberna's violation of, Section 206(4)

[4] As used herein with respect to Fralin and Licht, 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 Act.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

of the Advisers Act and Advisers Act Rule 206(4)-8, which prohibit any fraudulent, deceptive, or manipulative act, practice, or course of business by an investment adviser to any investor or prospective investor in a pooled investment vehicle.

50. As a result of the conduct described above, Taberna willfully violated, and Licht willfully aided and abetted and caused Taberna's violation of, Section 207 of the Advisers Act, which makes it unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed under the Advisers Act or willfully to omit to state in any such application or report any material fact which is required to be stated therein.

Undertakings

Taberna undertakes to the following:

A. Taberna shall not act or seek to act as an investment adviser, as defined in section 202(a)(11) of the Advisers Act for a period of three (3) years following the date of the Order.

B. Within ten (10) days of the entry of the Order, to have posted prominently on RAIT's principal website a summary of this Order and hyperlink to the entire Order. The hyperlink shall be maintained for a period of twelve (12) months from the entry of this Order.

C. Within thirty (30) days of the entry of the Order, to provide a copy of the Order to the current managers of the Taberna CDOs (to the extent known to Taberna), along with a cover letter requesting that the current managers provide notice to each Taberna CDO of the existence of the Order, and further requesting that the current managers post a hyperlink to the Order on any website maintained to communicate with investors in the Taberna CDOs.

D. To cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Taberna shall: (i) produce, without service of a notice or subpoena, any and all non-privileged documents and other information requested by the Staff subject to any restrictions under the law of any foreign jurisdiction; (ii) use its best efforts to cause its officers, employees, and directors to be interviewed by the Staff at such time as the Staff reasonably may direct; (iii) provide any certification or authentication of business records of the company as may be reasonably requested by the Staff; and (iv) use its best efforts to cause its officers, employees, and directors to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Staff.

E. To certify, in writing every six (6) months from the date of this Order, and continuing for three years after the date of this Order, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s) and provide written evidence of compliance in the form of a narrative. The Commission staff may make reasonable requests for further evidence of compliance, and Taberna agrees to provide such evidence. The certification and supporting material shall be submitted to Reid A. Muoio, Assistant Director in the Division of Enforcement ("Division") (100 F St., NE, Washington, DC 20549) with a copy to the Office of Chief Counsel of the Enforcement Division (100 F St., NE, Washington, DC 20549).

Michael Fralin undertakes to the following:

A. To cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Fralin undertakes:

i. To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff;

ii. To be interviewed by the Commission's staff at such times as the staff reasonably may request and to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

iii. That in connection with any testimony of Fralin to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, Fralin

a. agrees that any such notice or subpoena for his appearance and testimony may be served by regular mail on his counsel, Alan R. Friedman, Esq., Kramer Levin Naftalis & Frankel LLP, 1177 Avenue of the Americas, New York, NY 10036; and

b. agrees that any such notice or subpoena for his appearance and testimony in an action pending in a United States District Court may be served, and may require testimony, beyond the territorial limits imposed by the Federal Rules of Civil Procedure.

In determining whether to accept the Offers, the Commission has considered these undertakings.

IV.

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

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

A. Taberna cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act, Sections 206(1) 206(2), 206(4), and 207 of the Advisers Act, and Advisers Act Rule 206(4)-8.

B. Fralin 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 Advisers Act Rule 206(4)-8.

C. Licht cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 207 of the Advisers Act.

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

E. Licht 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;
>
> with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission. Any reapplication for association by Licht 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 Licht, 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.

F. Fralin is denied, pursuant to Rule 102(e) and 102(e)(1)(iii) of the Commission's Rules of Practice, the privilege of appearing or practicing before the Commission as an attorney for five (5) years from the date of the Order.

G. Licht is denied, pursuant to Rule 102(e) and 102(e)(1)(iii) of the Commission's Rules of Practice, the privilege of appearing or practicing before the Commission as an attorney for two (2) years from the date of the Order.

H. Fralin, after five (5) years from the date of the Order, and Licht, after two (2) years from the date of the Order, 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.

I. With respect to such an application by either Fralin or Licht (whichever is making such an application, "Applicant"), in support of such an application, Applicant must provide a certificate of good standing from each state bar where Applicant is a member.

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

1. that Applicant has complied with the Order;

2. that Applicant:

   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 Applicant, 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 Applicant, 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.

K. If Applicant provides the documentation required in Paragraphs I and J, 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.

L. If Applicant is not able to truthfully attest to the statements required in Subparagraphs J(2)(b) or J(4), Applicant 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.

M. Taberna shall pay disgorgement of $13,000,000, prejudgment interest of $2,000,000, and a civil penalty of $6,500,000 to the Securities and Exchange Commission. Fralin shall pay a civil penalty of $100,000 to the Securities and Exchange Commission in four installments, with $25,000 due within ten (10) days of the entry of the Order, $25,000 due 90 days after the entry of the Order, $25,000 due 180 days after the entry of the Order, and $25,000 due 270 days after the entry of the Order. Licht, within ten (10) days of the entry of the Order, shall pay a civil penalty of $75,000 to the Securities and Exchange Commission. If any payment is not made by the date payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 and/or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

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

(2) 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 Taberna, Fralin, or Licht (as appropriate) 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 Michael Osnato, Unit Chief, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

N. 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 each agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury. 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.

O. A fund (the "Disgorgement Fund") shall be established for the distribution of the disgorgement and interest referenced in paragraph M above (the "Disgorgement Amounts"). The Disgorgement Fund shall be distributed pursuant to a distribution plan (the "Plan") to be administered in accordance with the Commission's Rules of Practice Governing Fair Funds and Disgorgement Funds. A Fund Administrator (the "Administrator") shall be appointed by the Commission. The Administrator will prepare, in coordination with Commission staff, the Plan to distribute the Disgorgement Fund to the injured parties in the amounts necessary to compensate them for the harm they suffered as a result of Taberna's violations. The Plan shall be subject to

Commission approval. Commission staff shall seek the appointment of a tax administrator in regard to the Disgorgement Fund as the fund constitutes a qualified settlement fund ("QSF") under section 468B(g) of the Internal Revenue Code (IRC), 26 U.S.C. § 468B(g), and related regulations, 26 C.F.R. §§ 1.468B-1 through 1.468B-5. Taxes, if any, and related administrative expenses shall be paid from the Disgorgement Fund. After the Commission makes the foregoing payments, any remaining funds consisting of the Disgorgement Amounts shall be remitted to the general fund of the United States Treasury subject to Exchange Act Section 21F(g)(3).

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 Respondents Fralin and Licht, and further, as to Respondents Fralin and Licht, 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. 75818 / September 2, 2015

Admin. Proc. File No. 3-16502

In the Matter of LUMINARY ACQUISITION CORP.	ORDER DISMISSING UNTIMELY PETITION FOR REVIEW

The Division of Enforcement requests that we dismiss as untimely the appeal filed by Luminary Acquisition Corp. ("Luminary") challenging the revocation of the registration of its registered securities. Luminary opposes the Division's request. For the reasons explained below, we grant the Division's request and dismiss Luminary's appeal as untimely.

I. Background

Before June 24, 2015, Luminary was a company with securities registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934.[1] Between April 1, 2008 and March 18, 2015, Luminary did not make any periodic filings with the Commission with respect to those securities.[2] On March 19 and 20, 2015, Luminary filed 28 quarterly and annual reports on Forms 10-Q and 10-K addressing the seven-year period from 2008 to 2014. On April 14, 2015, Luminary's former auditor advised the Office of the Chief Accountant that the filings attributed audit reports to it that the auditor had not issued. Luminary acknowledged these deficiencies in an April 15, 2015 letter to Commission staff.[3]

On April 21, 2015, the Commission issued an order instituting proceedings, which asserted that Luminary and two other issuers with securities registered with the Commission had failed to file timely periodic reports as required by Exchange Act Section 13(a).[4] The OIP also

1 15 U.S.C. § 78l.

2 On March 28, 2008, Luminary filed a Form 10KSB for the year ended December 31, 2007.

3 In its petition for review, Luminary contended that a third party service provider had made "erroneous filings," which Luminary has "now corrected through a new auditor." But the EDGAR system shows that Luminary never made any corrected filings and never withdrew its March 2015 filings.

4 *Hi-Q Wason, Inc*, Exchange Act Release No. 74772, 2015 WL 1800396 (Apr. 21, 2015); 15 U.S.C. § 78m(a).

gave notice that the Commission would consider whether to revoke the registration of the respondents' registered securities in light of these violations. Consistent with Rule 141(a)(2)(ii) of the Commission's Rules of Practice, the OIP was served by express mail on Luminary on April 21, 2015 at "the most recent address shown on [its] most recent filing with the Commission."[5] The OIP was delivered to that address the following day, as reflected by tracking information obtained from the United States Postal Service website.[6]

Luminary did not respond to the OIP, and on May 12, 2015, the law judge issued an Initial Decision Making Findings and Revoking Registrations by Default with respect to Luminary's registered securities (the "Initial Decision").[7] The Initial Decision stated, among other things, that "a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision." On May 14, 2015, the Commission sent the Initial Decision to Luminary via certified mail to the same addresses to which the OIP was sent.[8] The USPS website shows that unsuccessful delivery attempts were made at each address.

On June 24, 2015, a Notice that Initial Decision Has Become Final ("Finality Notice") was issued.[9] The Finality Notice explained that "[t]he time for filing a petition for review of the initial decision in this proceeding ha[d] expired," and that no respondent had filed a petition. The Finality Notice also stated that the Initial Decision had become the final decision of the Commission with respect to Luminary and the other respondents.

On July 1, 2015, Luminary filed a notice of appeal pursuant to Rule of Practice 410(a) requesting that the Commission "set aside or reverse the decision granted on June 24th 2015." The Commission then issued a briefing order requesting the views of the parties as to whether Luminary's appeal should be dismissed as untimely pursuant to Rule 410(b), which provides that a petition for review of an initial decision must be submitted within the time period identified in the initial decision.[10] In its initial brief, the Division of Enforcement requested that we dismiss Luminary's appeal as untimely. Luminary acknowledged that, "in contravention of" the Rules of

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5 17 C.F.R. § 201.141(a)(2)(ii).

6 The OIP also was sent by express mail to the address listed on Luminary's April 15 letter to the Commission. The USPS website reflects that the OIP was returned to the Commission from that address.

7 *Hi-Q Wason, Inc*, Initial Decision Release No. 791, 2015 WL 2196504 (May 12, 2015). The decision also revoked the registration of the registered securities of the other respondents.

8 *See* Rule of Practice 141(b), 17 C.F.R. § 201.141(b) (authorizing service of subsequent orders and decisions by the same means that the OIP is served).

9 *Hi-Q Wason, Inc*, Exchange Act Release No. 75275, 2015 WL 3878333 (June 24, 2015).

10 *Luminary Acquisition Corp.*, Exchange Act Release No. 75502, 2015 WL 4465322, at *1 (July 22, 2015); Rule 410(b), 17 C.F.R. § 201.410(b) (generally providing that "[t]he petition for review of an initial decision shall be filed with the Commission within such time after service of the initial decision as prescribed by the hearing officer pursuant to Rule 360(b)").

Practice, it had filed its appeal after the 21-day period during which it could appeal the initial decision had expired. But Luminary requested that we set aside the Finality Order, continue "its status as a fully reporting company," and allow it to work with the Commission "to ensure all filings are correct and in accordance with [the] Rules of Practice."

II. We dismiss Luminary's appeal as untimely.

We find that it is appropriate to dismiss Luminary's appeal as untimely under Rule of Practice 410. Under Rule 410, Luminary was required to file any petition for review by June 8, 2015, i.e., 21 days after service of the Initial Decision, plus three days for mailing.[11] Instead, Luminary did not file its petition until July 1, 2015, i.e., 23 days after the appeal deadline and one week after the Finality Order was entered. Indeed, Luminary concedes that its appeal was untimely. Accordingly, we dismiss Luminary's petition.

Luminary argues that we should entertain its petition for three reasons. We find none of them persuasive.

First, Luminary contends that its periodic filings "were brought up to date on March 20[,] 2015, therefore negating the revoking [of] the registration of the securities." But this argument does not bear on or excuse Luminary's failure to timely file an appeal.[12] In any event, Luminary's argument appears to rest on a false premise. Although Luminary contends that it is current in its reporting obligations, it concedes that its recent filings are deficient.[13]

Second, Luminary asserts that the Initial Decision served in mid-May 2015 did not reach it because it changed its "lawyers, auditors, and registered office on April 27, 2015." It also

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[11] Rule of Practice 160(b), 17 C.F.R. § 201.160(b) ("If service is made by mail, three days shall be added to the prescribed period for response unless an order of the Commission or the hearing officer specifies a date certain for filing."); *see also* Rule 160(a), 17 C.F.R. § 201.160(a) (providing that where a response date falls on a "Saturday, Sunday, or Federal legal holiday" the period for response "runs until the end of the next day that is not a Saturday, Sunday, or Federal legal holiday"); *see also BDO China Dahua CPA Co., Ltd.*, Exchange Act Release No. 72753, 2014 WL 3827605, at *1 n.2 (Aug. 4, 2014) (clarifying application of Rule of Practice 160).

[12] *See Walter V. Gerasimowicz*, Exchange Act Release No. 72133, 2014 WL 1826641, at *2 n.19 (May 8, 2014) ("Unmet deadlines may cut off substantive rights to review, but this is their function.") (*citing Carter v. Wash. Metro Area Transit Auth.*, 764 F.2d 854, 857 (D.C. Cir. 1985) ("[F]inality of outcome, regardless of the merits of the claim, is exactly the purpose of the statute of limitations that the legislature has enacted."), and *Kavanagh v. Noble*, 332 U.S. 535, 539 (1947) (explaining that limitations "periods are established to cut off rights, justifiable or not, that might otherwise be asserted" (citations omitted))).

[13] Moreover, we have observed that "even if an issuer has filed all delinquent periodic reports, revocation can be appropriate, particularly when . . . the delinquencies continued for an extended period without adequate explanation." *China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *13 (Nov. 4, 2013).

suggests that the Initial Decision could have been served on it by email. But the Rules of Practice unambiguously authorized service on Luminary at the address listed in its most recent securities filing, as was done here.[14] And although it was not required, service also was attempted (unsuccessfully) at the address listed on Luminary's April 15, 2015 letter. As Luminary conceded in its initial brief, it was "its failure to correctly update" its address with the Commission that led to any delay in its receipt of the Initial Decision.

Finally, Luminary asserts that it has acted in good faith to cure its violations since it became aware of the OIP. But Luminary's state of mind is not at issue. Rule 410 provides a bright-line rule for determining the timeliness of an appeal.[15] Because Luminary did not comply with that Rule, despite proper service of the Initial Decision, its appeal accordingly is dismissed.

Accordingly, IT IS ORDERED that the petition for review of Luminary Acquisition Corp. is dismissed as untimely.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

[14] Rule 141(a)(2)(ii) authorizes service on an "issuer of a class of securities registered with the Commission, by sending a copy of the order addressed to the most recent address shown on the entity's most recent filing with the Commission by U.S. Postal Service certified, registered, or Express Mail and obtaining a confirmation of attempted delivery." USPS records confirm the attempted delivery of the Initial Decision.

[15] *See Gerasimowicz*, 2014 WL 1826641, at *2 & nn.18-19 ("[S]trict compliance with filing deadlines facilitates finality and encourages parties to act timely in seeking relief.") (quotation marks omitted).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75820 / September 2, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4187 / September 2, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31804 / September 2, 2015

Admin. Proc. File No. 3-15215

In the Matter of JAMES S. TAGLIAFERRI	ORDER GRANTING MOTION TO AMEND ORDER INSTITUTING PROCEEDINGS

The Division of Enforcement requests that we amend the order instituting proceedings in this case to add allegations regarding respondent James S. Tagliaferri's criminal conviction for, among other things, violating the securities laws, and to remove the OIP's directives to determine whether disgorgement and civil money penalties would be appropriate in the public interest. Tagliaferri asserts that the amendment would prejudice him and opposes the Division's motion. As explained below, we find that the amendment is appropriate and accordingly grant the Division's motion.

I. Background

On February 21, 2013, the Commission instituted proceedings against James S. Tagliaferri,[1] alleging that he willfully violated Sections 17(a)(1) and (3) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Securities Exchange Act of 1934, and Rules 10b-5(a) and (c) thereunder, as well as Sections 206(1), (2), and (3) of the Investment Advisers Act of 1940.[2] On March 11, 2013, an administrative law judge stayed the proceeding against Tagliaferri

1 *James S. Tagliaferri*, Exchange Act Release No. 68963, 2013 WL 635053 (Feb. 21, 2013).

2 15 U.S.C. §§ 77q(a)(1) and (3), 78j(b), 78o(a), 80b-6(1), (2), and (3); 17 C.F.R. § 240.10b-5(a) and (c).

pending a parallel criminal action against him in the United States District Court for the Southern District of New York,[3] and the law judge lifted that stay on June 1, 2015.[4]

On July 24, 2014, a jury convicted Tagliaferri of one count of investment adviser fraud, one count of securities fraud, four counts of wire fraud, and six counts of violations of the Travel Act. On February 13, 2015, Tagliaferri was sentenced to 72 months' incarceration and three years' supervised release, and he was ordered to forfeit $2.5 million and certain real property. On July 2, 2015, Tagliaferri was further ordered to pay in excess of $20 million in restitution.

On July 16, 2015, the Division moved to amend the order instituting proceedings in this proceeding in three principal respects. First, the proposed amended OIP, which the Division submitted with its motion, would add allegations regarding Tagliaferri's criminal conviction. The Division asserts that the conviction provides an independent basis for establishing the violations alleged in the OIP. Such convictions also provide an independent basis for imposing sanctions.[5] Second, in light of the sentence of imprisonment and supervised release imposed on Tagliaferri, the amendment would remove the OIP's directive to determine whether civil money penalties would be appropriate in the public interest. Third, because the forfeiture and restitution orders entered in the criminal action require Tagliaferri to pay more than $20 million, the amendment would remove the OIP's directive to determine whether disgorgement would be appropriate in the public interest. The proposed amended OIP also would make some conforming changes in light of Tagliaferri's current status.

II. Analysis

Under Rule of Practice 200(d)(1), we may, at any time, upon a motion by a party, amend an OIP to include new matters of fact or law.[6] Such amendments to OIPs, which can reflect "subsequent developments" in a proceeding,[7] "should be freely granted, subject only to the

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3 *James S. Tagliaferri*, Admin. Proc. File No. 3-15215 (Mar. 11, 2013), *available at* https://www.sec.gov/litigation/apdocuments/3-15215-event-6.pdf.

4 *James S. Tagliaferri*, Admin. Proc. Release No. 2750 (June 1, 2015), *available at* https://www.sec.gov/alj/aljorders/2015/ap-2750.pdf.

5 *See, e.g.*, Advisers Act Section 203(f), 15 U.S.C. § 80b-3(f) (referencing convictions specified in Advisers Act Section 203(e)(2) and (3)); Exchange Act Section 15(b)(6)(A)(ii), 15 U.S.C. § 78o(b)(6)(A)(ii) (referencing convictions specified in Exchange Act Section 15(b)(4)(B)).

6 17 C.F.R. § 201.200(d)(1).

7 *See Carl L. Shipley*, Exchange Act Release No. 10870, 45 SEC 589, 1974 WL 161761, at *4 (June 21, 1974).

consideration that other parties should not be surprised nor their rights prejudiced."[8] We grant the Division's motion to add the allegations specified above because Tagliaferri's criminal conviction in the parallel criminal proceeding is such a subsequent development.[9] In addition, the conviction may provide an independent basis for remedial sanctions,[10] and it is more efficient to resolve all issues related to Tagliaferri's conduct in a single proceeding.[11] We also have determined, as an exercise of our discretion, to grant the Division's motion to remove the OIP's directives to determine whether civil penalties and disgorgement are appropriate in the public interest, given Tagliaferri's prison sentence and period of supervised release, as well as the monetary obligations imposed on him in the criminal proceeding.[12]

We reject Tagliaferri's argument that the motion should be denied because his rights would be prejudiced by the amendment.[13] Tagliaferri objects to the amendment because it "would allow the Division to argue at trial [that] the criminal conviction is sufficient to find" him liable even though, in his view, the allegations of the original OIP and superseding criminal indictment "differ substantially." Tagliaferri asserts that his objection could be resolved by omitting from the amended OIP language stating that he was criminally convicted "on substantially the same allegations alleged in this case." Tagliaferri does not otherwise oppose the amendment.

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8 *Robert David Beauchene*, Exchange Act Release No. 68974, 2013 WL 661619, at *2 (Feb. 25, 2013) (quoting *Charles K. Seavey*, Advisers Act Release No. 1925A, 2001 WL 228030, at *2 (Mar. 9, 2001)).

9 *See Daniel J. Gallagher*, Exchange Act Release No. 70305, 2013 WL 4716026, at *2 (Sept. 3, 2013) (granting motion for leave to amend OIP to add respondent's conviction in parallel criminal proceeding); *Beauchene*, 2013 WL 661619, at *2 (same); *cf. Shipley*, 1974 WL 161761, at *4 n.17 (noting that motions to amend "are granted routinely" to add allegations regarding injunctions entered against respondents following issuance of the OIP given that "the public interest requires that the injunction and its implications be considered in the administrative proceeding").

10 *See supra* note 5 and associated text.

11 *Gallagher*, 2013 WL 4716026, at *1; *Beauchene*, 2013 WL 661619, at *2.

12 *Gallagher*, 2013 WL 4716026, at *1 (granting Division's request to withdraw OIP's civil money penalty claim given respondent's prison sentence and period of supervised release); *Beauchene*, 2013 WL 661619, at *2 (amending OIP to withdraw disgorgement request in light of restitution order); *A.S. Goldmen & Co., Inc.*, Exchange Act Release No. 48091, 2003 WL 21468605, at *2 (June 26, 2003) (same).

13 Tagliaferri does not argue that he was surprised by the amendment. He learned of the criminal indictment no later than the date the OIP was issued. *See* http://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-arrest-virgin-islands-based-investment-adviser-multi. The law judge stayed this proceeding soon thereafter.

We find no undue prejudice to Tagliaferri. The Division's allegation that he is liable based on the criminal conviction does not establish prejudice sufficient to deny the amendment.[14] The OIP does not establish facts, it alleges them; Tagliaferri will have an opportunity to contest these allegations and their legal effect.[15] And to the extent that Tagliaferri's conviction provides an independent basis for sanctions, it is irrelevant whether he was convicted of the same conduct alleged in the OIP.[16]

Accordingly, IT IS ORDERED that the Division of Enforcement's motion to amend the Order Instituting Proceedings against James S. Tagliaferri is granted.[17]

By the Commission.

Brent J. Fields
Secretary

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

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14 Federal courts have held that leave to amend under Federal Rule of Civil Procedure 15 should not be denied simply because a defendant might be subject to greater liability as a result of an amendment. *See, e.g.*, *Bush v. Ruth's Chris Steak House, Inc.*, 277 F.R.D. 214, 216 (D.D.C. 2011) (holding that "[u]ndue prejudice is not implicated merely because the proposed amendment would 'increase defendant's potential liability'" (quoting 6 Charles Alan Wright et al., Federal Practice and Procedure § 1487, at 723 (3d ed. 2010)); *see also Maiaro v. Alarm Specialists, Inc.*, No. 13–cv–08658 (NSR), 2014 WL 5285695, at *3 (S.D.N.Y. Oct. 15, 2014) (holding that "increased potential liability is 'not the type of prejudice that warrant[s] denial of leave to amend the complaint'" (quoting *In re Osage Exploration Co.*, 104 F.R.D. 45, 49 (S.D.N.Y. 1984))). In construing our rules, "we have been guided by the liberal spirit of the Federal Rules of Civil Procedure" with respect to amendment. *Shipley*, 1974 WL 161761, at *4 n.16.

15 5 U.S.C. § 556(d) (providing for opportunity to present case in formal adjudication); *see also Jethro J. Barlow, CPA*, Exchange Act Release No. 42109, 1999 WL 1000890, at *1 (Nov. 5, 1999) (finding that "the procedural posture of the case," where hearing would not be held for two months, "ensure[d] that respondents will suffer no prejudice from the requested amendment").

16 *See supra* note 5 and associated text.

17 We do not suggest any view as to the outcome of these proceedings.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75819 / September 2, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16777

In the Matter of: Janet L. Waters 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 Janet L. Waters ("Janet Waters" 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 her and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting 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 the foregoing, the Commission finds[1] that:

Summary

1. These proceedings arise out of Janet Waters' failure reasonably to supervise Arnett L. Waters with a view to preventing and detecting his violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act of 1933 ("Securities Act"). From at least 2009 through 2012, while Arnett Waters was a registered representative associated with A.L. Waters Capital, LLC ("Waters Capital"), he operated a fraudulent scheme through which he raised at least $839,000 from multiple investors by promising to use investor funds to purchase a portfolio of securities, and instead misappropriating the money and spending it on personal and business expenses. Throughout this period, Janet Waters was designated as the person to supervise her husband at Waters Capital.

Respondent

2. **Janet Lee Waters**, age 55, lives in Norwood, Massachusetts. She was Arnett Waters' designated supervisor, the chief compliance officer of A.L. Waters Capital, LLC, and a registered representative with the firm from April 2005 through March 9, 2012, when FINRA permanently barred her from association with any FINRA member for failing to provide documents, information, and testimony requested in FINRA's investigation. Janet Waters held Series 7, Series 24, and Series 63 licenses.

Other Relevant Entities

3. **A.L. Waters Capital, LLC,** was a Massachusetts limited liability company formed in 2005 and based in Braintree, Massachusetts. It has been registered with the Commission as a broker-dealer since 2005. On May 1, 2012, the Commission filed a civil enforcement action against Waters Capital and others based on the fraudulent conduct of Arnett Waters. On December 4, 2013, a final judgment was entered by consent against Waters Capital, permanently enjoining it from future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. A.L. Waters Capital, LLC, et al., Civil Action Number 12-CV-10783, in the United States District Court for the District of Massachusetts. On December 11, 2013, the Commission announced the issuance of an Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions against A.L. Waters Capital, LLC and simultaneously accepted Waters Capital's offer of settlement. The Order barred Waters Capital from association with any

[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.

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

4. **Arnett Lanse Waters**, age 63, was a resident of Milton, Massachusetts. At all relevant times, he was the president and chief executive officer of Waters Capital. Arnett Waters was a registered representative with Waters Capital from April 2005 through March 9, 2012, when he was permanently barred from association with any FINRA member for failing to provide testimony requested in FINRA's investigation. During that period, Arnett L. Waters was the husband of Janet Waters.

Civil and Criminal Actions against Arnett Waters

5. In 1993, Arnett Waters was censured and barred for two years by the New York Stock Exchange for forging a document to secure a bank loan and refusing to comply with the Exchange's requests for information and testimony.

6. On May 1, 2012, the Commission filed a civil injunctive action against Arnett Waters and others alleging that Arnett Waters and the other defendants violated the antifraud provisions of the federal securities laws by obtaining money from various investors through false representations that Arnett Waters would invest such monies on behalf of those investors, when in fact he was selling these investors units in sham investment partnerships and spent most of the investors' funds on personal and business expenses.

7. On November 29, 2012, Arnett Waters pleaded guilty to sixteen counts of securities fraud, mail fraud, money laundering, and obstruction of justice arising out of among other things the conduct that is the subject of the Commission's May 1, 2012 civil action. The criminal information to which Arnett Waters pleaded guilty further alleged that he engaged in money laundering through two transactions totaling $77,000. Finally, Arnett Waters pleaded guilty to obstruction of justice in connection with multiple misrepresentations to Commission staff, including that there were no investors in his investment-related partnerships, in order to conceal the fact that investor money was misappropriated in a fraudulent scheme. As a result of his guilty plea to this criminal conduct, Arnett Waters was sentenced on April 26, 2013 to 17 years in federal prison and three years of supervised release, and was ordered to pay $9,025,691 in restitution and forfeiture.

8. On December 3, 2012, Arnett Waters was barred by the Commission pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), based on his criminal conviction for criminal contempt of the asset freeze order entered in the Commission's May 2012 civil action against him, Waters Capital, and a second entity operated by Arnett Waters.

9. On December 4, 2013, the U.S. District Court for the District of Massachusetts entered a final judgment by consent against Arnett Waters in the civil action filed by the Commission in May 2012. Arnett Waters was enjoined from violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

Arnett Waters' Misconduct

10. From at least 2009 through at least April 2012 ("the Relevant Period"), Arnett Waters engaged in a scheme to misappropriate at least $839,000 from at least 9 customers of Waters Capital by falsely representing that he would invest their funds in securities through Waters Capital. Arnett Waters and Waters Capital purported to create various private investment "funds" and offered them to potential investors, creating marketing materials and agreements related to these purported funds and distributing them to investors. All of these materials indicated that these purported funds would invest in portfolios of securities and other investment products. Arnett Waters and Waters Capital accepted investors' money under the pretense that their money would be invested in the portfolios described in the fund documents. Instead, investors' money was spent on the Waters' personal expenses. No money was invested in the manner Arnett Waters had promised. Arnett Waters and Waters Capital made multiple misrepresentations to investors, and to FINRA and Commission staff, to conceal the fact that investor money had been misappropriated in a fraudulent scheme.

Janet Waters' Failure to Supervise

11. In the Waters Capital Supervisory Procedures Manual, Janet Waters was named as the "Supervisor Designated to Conduct Day-To-Day Oversight of Producing Manager's Activity" for Arnett Waters. In this role, Janet Waters was required to "review and supervise the day-to-day customer transactions" of Arnett Waters, which included following supervisory procedures requiring transaction and correspondence reviews. She failed to perform these – or any other – supervisory duties with respect to Arnett Waters during the Relevant Period.

12. Janet Waters knew that firm customers had invested in certain investment partnerships that were offered by Waters Capital and recommended to customers by Arnett Waters and that Waters Capital handled any investments made by the partnerships. If, as Arnett Waters' supervisor, she had reviewed Arnett Waters' correspondence and the firm's transaction reports, she could have detected that the partnerships did not make any investments at all during the Relevant Period, despite what customers were being told. If Janet Waters had followed firm procedures and followed up on these red flags based on a review of the correspondence and transaction reports, she would have prevented and detected Arnett Waters' fraud.

Conclusions

13. Section 15(b)(6) of the Exchange Act, incorporating by reference Section 15(b)(4)(E) of the Exchange Act, authorizes the Commission to sanction a person who is associated, or at the time of the alleged misconduct was associated, with a broker or dealer for failing reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such a violation if that person is subject to the person's supervision. While serving as a registered representative of broker-dealer Waters Capital, Janet Waters was responsible for supervising Arnett Waters.

14. Based on the conduct described above, Arnett Waters violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(a) of the Securities Act. Janet Waters failed reasonably to follow the firm's supervisory procedures with respect to correspondence and transaction reviews, which would have revealed red flags of Arnett Waters' fraud. By failing reasonably to follow the firm's procedures that would have led to detecting Arnett Waters' fraud, Janet Waters failed reasonably to supervise Arnett Waters within the meaning of Section 15(b)(4)(E) of the Exchange Act.

Civil Penalties

15. Respondent has submitted a sworn Statement of Financial Condition dated June 17, 2014, and other evidence and has asserted her 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's Offer.

Accordingly, it is hereby ORDERED that:

A. Respondent Janet Waters be, and hereby is:

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

B. 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.

C. Based upon Respondent's sworn representations in her Statement of Financial Condition dated June 17, 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.

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. 75821 / September 2, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16778

In the Matter of High Point Transport, Inc., Kohler Capital III, Corporation, Mega Group, Inc., Merci, Inc., Our Glass, Inc., and Synthetic Industries, LP 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. High Point Transport, Inc. ("High Point") (CIK No. 1409154) is a dissolved Florida corporation located in Myakka City, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $218,432 for the prior nine months. As of September 1, 2015, the common stock of High Point was not publicly quoted or traded.

[1] In cases where the short form of the issuer's name is in all capital letters, the short form is also its stock symbol.

9 of 147

2. Kohler Capital III, Corporation ("Kohler") (CIK No. 1231074) is a dissolved Florida corporation located in Sheboygan, Wisconsin with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2011, which reported a net loss of $6,450 for the prior nine months. As of September 1, 2015, the common stock of Kohler was not publicly quoted or traded.

3. Mega Group, Inc. ("MGINQ") (CIK No. 828942) is a dissolved New York corporation located in Washington, DC with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MGINQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $456,221 for the prior nine months. As of September 1, 2015, the common stock of MGINQ was not publicly quoted or traded.

4. Merci, Inc. ("Merci") (CIK No. 1112551) is a void Delaware corporation located in Naples, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 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 $1,839 for the prior three months. As of September 1, 2015, the common stock of Merci was not publicly quoted or traded.

5. Our Glass, Inc. ("Our Glass") (CIK No. 1302365) is a revoked Nevada corporation located in Naples, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 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 $1,835 for the prior three months. As of September 1, 2015, the common stock of Our Glass was not publicly quoted or traded.

6. Synthetic Industries, LP ("Synthetic") (CIK No. 901175) is a cancelled and voided Delaware corporation located in Chickamauga, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 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, 1999. As of September 1, 2015, the units of limited partnership interest of Synthetic was not publicly quoted or traded.

B. DELINQUENT PERIODIC FILINGS

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

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

12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

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

III.

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

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

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

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against 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. 75823 / September 2, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16779

In the Matter of INverso Corp., Madison Venture Capital Group, Inc., Plantation Lifecare Developers, Inc., Prins Recycling Corp., SCN Holdings, Inc., Skin Nutrition International, Inc., and Tecfin Corporation, Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS[1]

1. INverso Corp. ("Inverso") (CIK No. 1295128) is a void Delaware corporation located in Jackson Center, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of $47,437 for the prior three months. As of September 1, 2015, the common stock of Inverso was not publicly quoted or traded.

[1]In cases where the short form of the issuer's name is in all capital letters, the short form is also its stock symbol.

2. Madison Venture Capital Group, Inc. ("Madison") (CIK No. 1398603) 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). 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 $3,261 for the prior nine months. As of September 1, 2015, the common stock of Madison was not publicly quoted or traded.

3. Plantation Lifecare Developers, Inc. ("PLDI") (CIK No. 1458704) is a Delaware corporation located in Liverpool, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PLDI 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 $25,561 for the prior nine months. As of September 1, 2015, the common stock of PLDI was not publicly quoted or traded.

4. Prins Recycling Corp. ("PRNSQ") (CIK No. 853529) is a dissolved New York corporation located in Newark, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PRNSQ 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, 1996, which reported a net loss of $4,040,024 for the prior three months. As of September 1, 2015, the common stock of PRNSQ was not publicly quoted or traded.

5. SCN Holdings, Inc. ("SCN Holdings") (CIK No. 1448239) is a revoked Nevada corporation located in Goshen, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 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 $10,000 for the period from inception on October 6, 2008 through December 31, 2008. As of September 1, 2015, the common stock of SCN Holdings was not publicly quoted or traded.

6. Skin Nutrition International, Inc. ("Skin Nutrition") (CIK No. 1349879) is a delinquent Colorado corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 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. As of September 1, 2015, the common stock of Skin Nutrition was not publicly quoted or traded.

7. Tecfin Corporation ("TEFN") (CIK No. 352860) is a void Delaware corporation located in Great Neck, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TEFN 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, 1999. As of September 1, 2015, the common stock of TEFN was not publicly quoted or traded.

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 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

INVESTMENT ADVISERS ACT OF 1940
Release No. 4188 / September 3, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16780

In the Matter of **MACKENSEN & COMPANY, INC. AND WARREN J. MACKENSEN** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission" or "SEC") 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), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Mackensen & Company, Inc. ("MCI"), and Warren J. Mackensen ("Mackensen") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. Summary

1. This matter concerns misleading advertisements created by MCI, a New Hampshire-based registered investment adviser, and distributed by MCI and its then principal Mackensen in connection with MCI's solicitation of potential municipal clients. From late 2010 into 2012, MCI and Mackensen sent hundreds of form letters to the trustees of trust funds held by New Hampshire's municipalities. The form letter and its attachments presented what purported to be actual historical performance for MCI's model portfolios. The letters also claimed that each municipality could have earned more money by investing in MCI's model portfolio than it actually earned in its existing investments. However, the performance claimed for MCI's model portfolios in these advertisements did not represent actual past performance of any MCI model portfolio. Instead, the performance was generated by back-testing MCI's models based on their current holdings at the time each letter was sent. In reality, the model did not even exist throughout the entire time period claimed in the letters. MCI and Mackensen were responsible for distributing the letters to hundreds of municipal trustees.

2. In addition, from 2010 to May 2012, MCI failed to adopt and implement written compliance policies and procedures reasonably designed to prevent its employees from presenting performance information to clients or prospective clients in violation of the Advisers Act and its rules.

B. Respondents

3. **MCI** (SEC File No. 801-55188), is a New Hampshire corporation headquartered in Hampton, New Hampshire. MCI has been registered with the Commission as an investment adviser since 1998. MCI has 526 accounts and approximately $165 million in assets under management.

4. **Warren J. Mackensen,** age 66, is a resident of Hampton, New Hampshire. Mackensen was certified as a financial planner in 1989. From 1998 through 2012, Mackensen and his family were the sole owners of MCI and he was its President, and beginning in 2004, its Chief Compliance Officer. In 2012, Mackensen sold MCI and ceased to be its President. He ceased to be its Chief Compliance Officer in July 2014 and ceased to be an MCI employee in 2015. Mackensen has no disciplinary history.

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

C. Facts

5. The municipalities of New Hampshire generally each have trusts to manage funds for municipal purposes such as maintaining cemeteries. Mackensen attempted to expand MCI's business by offering to provide investment advice to the trustees of municipal trust funds across New Hampshire. Beginning in late 2010, MCI began sending out letters to trustees of trust funds for most of the towns in New Hampshire. MCI sent approximately 500 such letters starting in late 2010 and continuing into 2012. Mackensen personally signed each of those letters.

6. The first page of the letters that MCI and Mackensen sent out typically claimed that the trust funds would have earned additional investment gains if it had invested with MCI. The second page of the letter typically was entitled "Comparative Performance Report" and compared the performance of the town's current trust fund portfolio with the MCI model portfolios and computed the gain that purportedly would have been achieved if the trust had invested with MCI. It was not disclosed in the letter that the described performance was both hypothetical and back-tested. MCI generated the hypothetical and back-tested performance by inputting the investments held at that time in MCI's model municipal portfolio into Morningstar® Principia® software to create a "snapshot." The snapshot calculated how MCI's then current portfolio would have performed over the reported time period had that portfolio of investments been assembled at the earlier date, and had the balance of investments been held constant throughout the time period reflected in the report. Many of the letters offered performance comparisons for periods that included dates during 2010 and early 2011, even though the MCI model portfolio was not assembled until May 2011. In addition, while some of the letters stated that the model portfolios "do not represent actual results of investing for your town or city," this sentence did not disclose that the portfolios did not actually exist.

7. MCI received about 60 calls in response to the letters that it sent out, which ultimately resulted in an additional 20 municipal clients for the firm. When Mackensen met with potential municipal clients he typically carried with him disclosures generated by the Morningstar software that he used to calculate his performance computations. However, Mackensen failed to provide those disclosures to the trustees who were his actual or potential clients, and did not discuss with them how he calculated the purported additional gain the municipality could have received by investing with MCI.

8. Mackensen was the control person at MCI during the time of the conduct. He reviewed and signed every letter that MCI sent out to municipalities soliciting business. Mackensen failed, however, to review the Commission's rule related to advertising before the letters were sent out. He admitted that he was not familiar with the Commission's rule relating to investment adviser advertising.

9. MCI had no written policies and procedures related to performance advertising. MCI's compliance manual contained no substantive information on performance advertising, except to note that it was not used, which was not correct. Mackensen was responsible for MCI's failure to create and implement procedures designed so that its performance advertisements complied with the rules governing investment adviser advertising. Portions of MCI's compliance

manual specify that Mackensen was "solely responsible for regulatory supervision," and state that Mackensen "created Written Supervisory Procedures (WSPs) for all areas of [MCI]," trained other members of the firm on those WSPs annually, and that it was his obligation to "formally review all of the firm's compliance programs and update them to reflect new rules and regulations." Mackensen knew or was reckless in not knowing that the firm had not created or implemented procedures to comply with the performance advertising rules. *See Compliance Programs of Investment Companies and Investment Advisers* ("Compliance Rule Release") Advisers Act Rel. No. 2204 (Dec. 17, 2003).

D. Violations

10. As a result of the conduct described above, MCI and Mackensen willfully violated[2] Section 206(2) of the Advisers Act, and MCI willfully violated 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) promulgated thereunder. Section 206(2) of the Advisers Act prohibits an investment adviser from engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Section 206(4) of the Advisers Act prohibits any investment adviser from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and authorizes the Commission to prescribe rules designed to prevent such conduct. Rule 206(4)-1(a)(5) makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act for a registered investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading. By circulating or distributing misleading performance advertisements to prospective clients, MCI and Mackensen willfully violated Section 206(2) and MCI willfully violated 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.

11. As a result of the conduct described above, MCI also willfully violated Rule 206(4)-7 promulgated under the Advisers Act, which requires that registered advisers adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules that the Commission has adopted under the Act. By failing to adopt and implement such written policies or procedures reasonably designed to prevent violation of the Advisers Act and its rules in connection with the performance advertisements it sent to prospective clients, MCI willfully violated Rule 206(4)-7.

12. By sending misleading advertisements to prospective clients, Mackensen willfully aided and abetted and caused MCI to violate Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5). Also, Mackensen willfully aided and abetted and caused MCI to violate Section 206(4) of the Advisers Act and Rule 206(4)-7 by failing to adopt and implement written policies and

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

procedures reasonably designed to prevent violation of the Advisers Act and the rules promulgated thereunder regarding performance presentations to prospective clients.

E. Undertakings

13. Order Notification

a. Within thirty days of the issuance of this Order, MCI undertakes to mail to each of its existing clients a copy of the Form ADV which incorporates the paragraphs contained in Section III of this Order, and which specifies that the entire Order will be posted on the homepage of MCI's website.

b. Within thirty days of the issuance of this Order, MCI also undertakes to post a copy of this Order on the homepage of MCI's website and to maintain this copy of the Order on the homepage of MCI's website for a period of six months.

14. MCI shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative and be supported by exhibits sufficient to demonstrate compliance. The Commission's staff may make reasonable requests for further evidence of compliance, and MCI agrees to provide such evidence. The evidence and certification material shall be submitted to Robert Baker, Assistant Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

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), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents MCI and Mackensen 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)-1 and 206(4)-7 promulgated thereunder.

B. Respondent MCI is censured.

C. Respondent Mackensen is censured.

D. Respondents MCI and Mackensen shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the Securities and Exchange Commission 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 the following installments: $25,000 on September

11, 2015, $25,000 on September 30, 2015, $25,000 on December 30, 2015, and $25,000 on March 30, 2016.

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. MCI and Mackensen are jointly and severally liable for all payments required to be made by this paragraph. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying MCI and Warren J. Mackensen 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 Robert Baker, Assistant Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

E. Respondent MCI shall comply with the undertakings enumerated in Section III, paragraph 13 above.

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

INVESTMENT ADVISERS ACT OF 1940
Release No. 4189 / September 3, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16556

In the Matter of **STEPHEN A. COLANGELO, JR.,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") instituted proceedings pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Stephen A. Colangelo, Jr. ("Respondent" or "Colangelo") on May 22, 2015.

II.

In connection with this proceeding, 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.5. below, and consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

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

1. Colangelo founded and controlled the Brickell Fund, LLC ("Brickell Fund"), a pooled investment vehicle, and three start-up entities – Hedge Community, LLC ("Hedge Community"); Start a Hedge Fund, LLC ("Start a Hedge Fund"); and Under the Radar SEO, LLC ("Under the Radar"). From March 2009 to February 2011, Colangelo offered interests in each of these entities to investors. During the same time period, Colangelo also provided investment advisory services to private advisory clients. Colangelo is 47 years old and is incarcerated in a

federal correctional institute in Loretto, Pennsylvania. Prior to his incarceration, Colangelo resided in Congers, New York.

2. On December 19, 2013, Colangelo pleaded guilty to two counts of securities fraud and two counts of wire fraud in violation of Title 15 United States Code, Section 78j(b) and Title 18 United States Code, Section 1343, before the United States District Court for the Southern District of New York, in United States v. Stephen Colangelo, Jr., 12-CR-838. On April 10, 2014, a judgment in the criminal case was entered against Colangelo. Colangelo was sentenced to a prison term of 87 months followed by three years of supervised release and ordered to make restitution in the amount of $3,526,815.

3. The counts of the indictment to which Colangelo pleaded guilty alleged, among other things, that Colangelo held himself out as an investment adviser and solicited funds from investors by promising to invest money on the investor's behalf exchange for a percentage of any profits earned, that Colangelo defrauded investors, and that Colangelo obtained money and property from investors by making materially false and misleading statements.

4. In connection with his guilty plea, Colangelo admitted that he: (i) participated in schemes to defraud investors, one connected to the Brickell Fund and the others connected to Hedge Community, Start a Hedge Fund, and Under the Radar; (ii) held himself out as investment adviser; (iii) knowingly made false statements to investors, including false statements about purported trading returns, the use of investor funds, and Colangelo's compensation; and (iv) misappropriated investor funds.

5. On April 22, 2015, a final judgment by default was entered against Colangelo, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Stephen A. Colangelo, Jr., Civil Action Number 7:12-cv-8439, in the United States District Court for the Southern District of New York.

6. The Commission's complaint alleged that, from April 2009 to October 2011, Colangelo made numerous material misrepresentations to investors, including misrepresentations concerning the use of investor funds and historical trading returns. The complaint also alleged that, from April 2009 to January 2011, Colangelo obtained over $1 million from three investment advisory clients, on whose behalf Colangelo promised to buy and sell securities in exchange for a percentage of any profits earned, by making similar misrepresentations. The complaint further alleged that Colangelo misappropriated investor and client funds.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent Colangelo be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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

By the Commission.

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. 9900 / September 3, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75833 / September 3, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16781

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Kevin McDonnell ("McDonnell" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act and Section 15(b) of the Exchange Act, Making Findings, 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:

Respondent

A. McDonnell, age 60, is a resident of Massapequa, New York. He was listed as the secretary and principal financial officer of Caribbean Pacific Marketing, Inc. ("Caribbean Pacific") in the company's Form S-1 registration statement filed with the Commission. During the relevant period, McDonnell participated in an offering of penny stock because he engaged in activities with an issuer for the purpose of issuing, trading and/or inducing or attempting to induce the purchase or sale of Caribbean Pacific stock, which was a penny stock.

Related Entity

B. Caribbean Pacific Marketing, Inc. was a Florida corporation based in Boca Raton, Florida. The company purported to be in the business of developing a line of all natural sun-care and skin-care products. Caribbean Pacific is defunct and was administratively dissolved as a corporate entity in September 2013 by the State of Florida.

Background

C. Caribbean Pacific was formed in 2012. Although its Form S-1 registration statement stated that the company intended to market "all-natural sun care and skin care products," investors were later told that Caribbean Pacific would serve as a public shell to engage in a reverse merger with another Florida-based company called Dreamscapes International Properties, Inc. ("Dreamscapes"). Dreamscapes purportedly had land holdings in Belize that it planned to develop into a vacation and retirement community.

D. On March 9, 2012, Caribbean Pacific filed a Form S-1 registration statement with the Commission, which it amended several times between March and August 2012. The company subsequently requested acceleration of its Form S-1, which was then declared effective on August 29, 2012. Caribbean Pacific made its filings electronically via the Commission's EDGAR system.

E. According to Caribbean Pacific's registration statement and accompanying financial statements, the company had no assets of any significance or ongoing business operations. However, it sought to raise $150,000 through a self-underwritten offer and sale of up to one million shares of common stock at $0.15 per share, to conduct its business operations. Ultimately, no securities were sold pursuant to the registration statement.

F. Caribbean Pacific's registration statement listed McDonnell as the company's principal financial officer. McDonnell and the other individual listed as the company's president signed the Form S-1 registration statement. According to the registration statement, McDonnell was primarily responsible for the development of new markets, business planning, and the facilitation of a corporate strategy at Caribbean Pacific and would oversee the launch of the company's planned Internet marketing program. McDonnell and the person listed as president in the registration statement were also named as the individuals who would sell the stock on behalf of Caribbean Pacific in the self-underwritten offering.

Caribbean Pacific's False and Misleading Form S-1 Registration Statement

G. On October 29, 2012, the Commission instituted stop order proceedings pursuant to Section 8(d) of the Securities Act against Caribbean Pacific to determine whether to suspend the effectiveness of its Form S-1 registration statement based on information indicating the registration statement might contain false and misleading statements and omissions. A settled stop order was subsequently issued on December 3, 2012 based on findings that Caribbean Pacific's Form S-1 had failed to disclose material information. Specifically, Caribbean Pacific's registration statement failed to disclose to potential investors that William J. Reilly ("Reilly"), a disbarred attorney who had previously been enjoined by the Commission for federal securities law violations and was suspended from appearing and practicing before the Commission as an attorney, was acting as a de facto executive officer and control person of the company.

H. Reilly helped form Caribbean Pacific in January 2012 and he recruited McDonnell to be an executive officer of the company at or around that time. However, McDonnell was essentially a figurehead and Reilly was one of the persons running the company from behind the scenes, along with another individual, who is also a securities fraud recidivist. For example, Reilly was responsible for choosing Caribbean Pacific's business model. He also began working on Caribbean Pacific's registration statement shortly after forming the company. In addition, he was responsible for retaining the company's securities counsel and outside auditor and was the primary contact for them regarding the contents of the Form S-1.

I. McDonnell and the other individual listed as Caribbean Pacific's president had essentially no involvement in the management of the company. Although they were purportedly the only two officers and members of the board, McDonnell and the other person listed as president never met each other in person or even spoke to one another on the telephone prior to Commission instituting stop order proceedings against the company in October 2012.

J. McDonnell falsely represented to potential investors in Caribbean Pacific's Form S-1 registration statement that he was an executive in charge of the company. Specifically, he falsely represented in the Form S-1 that he would be the person primarily responsible for the development of new markets, business planning, and the facilitation of a corporate strategy at Caribbean Pacific and would oversee the launch of the company's planned Internet marketing program. McDonnell also omitted to disclose that Reilly, a securities fraud recidivist, was helping run the company's operations. McDonnell knew that Reilly was responsible for handling Caribbean Pacific's business operations and for making management decisions. McDonnell understood that he himself had no real responsibilities at the company. In addition, McDonnell knew Reilly was barred from practicing before the Commission. He was aware that Reilly was not listed on the Form S-1 registration statement as an officer or director of Caribbean Pacific because of his disciplinary history.

Violations

K. As a result of the conduct described above, Respondent McDonnell willfully committed violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act, which prohibit fraudulent conduct in the offer or sale of securities. These provisions prohibit employing devices, schemes or artifices to defraud and engaging in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon any purchaser, by the use of the mails or means or instruments of interstate commerce.

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

A. Respondent McDonnell cease and desist from committing or causing any violations and any future violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act.

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

C. Respondent McDonnell 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.

D. Respondent McDonnell shall, within 60 days of the entry of this Order, pay a civil money penalty in the amount of $7,500 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Kevin McDonnell 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 James M. Carlson, Esq., Senior Trial Counsel, United States Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, FL 33131.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75837 / September 3, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4190 / September 3, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31806 / September 3, 2015

Admin. Proc. File No. 3-15006

In the Matter of

RAYMOND J. LUCIA COMPANIES, INC.
and
RAYMOND J. LUCIA, SR.

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

Grounds for Remedial Action

Antifraud Violations

Former registered investment adviser and its owner committed securities fraud by making material misrepresentations to prospective clients about their retirement wealth management strategy. *Held*, it is in the public interest to bar the owner from associating with an investment adviser, broker, or dealer; revoke respondents' investment adviser registrations; order respondents to cease and desist from further violations of the provisions violated; and order civil penalties of $250,000 against the investment adviser and $50,000 against the owner.

APPEARANCES

Marc J. Fagel, *Jonathan C. Dickey*, and *Mark J. Schonfeld* of Gibson, Dunn & Crutcher LLP, for Respondents.

John B. Bulgozdy, *David J. Van Havermaat*, and *Peter Del Greco*, for the Division of Enforcement.

Appeal filed:	December 27, 2013
Last brief received:	July 13, 2015
Oral Argument:	July 31, 2015

I. Introduction

Respondents have appealed, and the Division of Enforcement has cross-appealed, an initial decision finding that Raymond J. Lucia Companies, Inc. ("RJLC"), violated Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 by misleading prospective clients about its Buckets of Money ("BOM") retirement wealth management strategy, and that Raymond J. Lucia, Sr. ("Lucia" and, with RJLC, "Respondents"), aided and abetted and caused RJLC's violations.[1] In particular, the Administrative Law Judge ("ALJ") found that, at seminars Respondents conducted to pitch their BOM strategy to prospective clients, Respondents misrepresented that they had performed two backtests (one from 1966 to 2003 and another from 1973 to 1994) proving that a model portfolio following the BOM strategy during difficult historical market periods would substantially increase in value while also providing annual retirement income. Respondents' statements about the backtests were misleading, the ALJ found, because Respondents did not inform prospective clients that the backtests (i) used assumed inflation and Real Estate Investment Trust ("REIT") rates that did not reflect historical rates, (ii) did not deduct advisory fees, and (iii) did not actually follow the BOM strategy by "rebucketizing" (*i.e.*, reallocating assets between "buckets" of portfolio assets). The ALJ found that Respondents did not inform prospective clients that actual backtests would have shown their model portfolio exhausting its assets before the end of the backtest periods rather than substantially increasing in value.

For these violations, the ALJ barred Lucia from associating with an investment adviser, broker, or dealer; revoked RJLC's and Lucia's investment adviser registrations; ordered RJLC and Lucia to cease and desist from further violations of the Advisers Act; and imposed civil penalties of $250,000 on RJLC and $50,000 on Lucia.

The ALJ also found that RJLC did not violate, and Lucia did not aid and abet and cause a violation of, Advisers Act Rule 206(4)-1(a)(5) concerning fraudulent advertisements by investment advisers because he found that Respondents' live slideshow presentation did not qualify as an "advertisement" under that rule. The ALJ further found that RJLC did not violate

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[1] *Raymond J. Lucia Cos., Inc.*, Initial Decision Release No. 540, 2013 WL 6384274 (Dec. 6, 2013). Lucia owned RJLC, which was registered with the Commission as an investment adviser from September 2002 through December 2011. Lucia, who was also a registered investment adviser, sold RJLC's assets in 2010 to his son, Raymond J. Lucia, Jr. RJLC is now defunct.

Advisers Act Section 204 concerning the maintenance of records by investment advisers.[2] The Division cross-appealed only the Rule 206(4)-1(a)(5) findings.

We find that RJLC violated, and Lucia aided and abetted and caused RJLC's violations of, Advisers Act Sections 206(1), 206(2), and 206(4), and Rule 206(4)-1(a)(5). For these violations, we impose the same sanctions as the ALJ imposed. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

Finally, we reject Respondents' contention that the administrative hearing was an unconstitutional procedure because the Commission ALJ who presided over this matter was not appointed in accordance with the Appointments Clause of the U.S. Constitution.[3] As we explain below, a Commission ALJ is a "mere employee"—not an "officer"—and thus the appointment of a Commission ALJ is not covered by the Clause.

II. Facts

At the center of this proceeding is a slideshow presentation[4] that Respondents projected onto a screen at seminars to pitch their BOM strategy to prospective clients; in particular, the proceeding focuses on the slideshow's discussion of two "backtests" to prove the efficacy of Respondents' BOM strategy during difficult historical market periods. At issue is, (i) whether Respondents led prospective clients to believe that they had performed backtests, as the Division claims, or hypothetical illustrations, as Respondents claim; (ii) if the former, whether Respondents had actually performed backtests; and (iii) if Respondents had not actually performed backtests but nevertheless led prospective clients to believe that they had done so, whether there is a difference between Respondents' purported backtest results and the results that actual backtests would have shown.

We begin by summarizing the undisputed facts surrounding the slideshow presentation and Respondents' calculations in support thereof. We then present the conflicting evidence regarding Respondents' assertions during that presentation, including the meaning of the term "backtest" and the parties' expert evidence on the effect that using historical inflation and REIT rates, including advisory fees, and rebucketizing would have had on Respondents' "backtest" calculations.

A. The BOM seminar presentation

The BOM strategy, which Lucia developed, generally advocates using safe portfolio assets for retirement income before depleting riskier assets, thereby giving riskier assets time to

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2 The ALJ found that Section 204 did not apply to Respondents' backtests because they did not concern the performance of specific managed accounts or specific securities recommendations.

3 *See* U.S. Const. art. II, § 2, cl. 2.

4 Lucia has been presenting a variation of the slideshow since around 2000. Lucia used the version of the slideshow discussed herein from around 2009 to 2010.

grow.[5] From approximately 2000 through 2011, Lucia pitched the BOM strategy to prospective RJLC clients at seminars across the United States.[6] As noted, Lucia used a slideshow that he projected onto a screen during his seminar presentations.[7] The slideshow consisted of four parts:[8] (i) a general discussion of investment risks and strategies; (ii) a description of various hypothetical couples following strategies purportedly inferior to BOM; (iii) a description of the BOM strategy and how it would work for a hypothetical couple dubbed the "Bold Bucketeers"; and (iv) the 1966 and 1973 backtests at issue in this proceeding.[9]

1. The three hypothetical couples

After beginning the presentation with a lengthy discussion of various investment risks and strategies, Lucia described three hypothetical couples to illustrate problems caused by following strategies purportedly inferior to BOM. For the illustrations, each couple was assumed to have a $1 million nest egg to invest with the goals of leaving $1 million to their children and producing $60,000 in annual retirement income.[10]

a. Conservative Campbells

The slideshow stated that one couple, dubbed the "Conservative Campbells," invested their $1 million nest egg in conservative investments such as CDs, bond funds, and individual

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5 The Division has not argued that the BOM strategy itself violates the securities laws.

6 Lucia estimates that he presented the BOM strategy at about forty seminars per year, and to over 50,000 total seminar attendees, the purpose of which was to generate leads for RJLC. To that end, Respondents gave prospective clients response cards to complete at the seminars to indicate their interest in a complimentary financial planning consultation with an RJLC advisor. Lucia also promoted the BOM strategy on his nationally syndicated radio show, *The Ray Lucia Show*, and in three books on investing for retirement that he authored: *Buckets of Money: How to Retire in Comfort and Safety* (2004); *Ready . . . Set . . . Retire!* (2007); and *The Buckets of Money Retirement Solution: The Ultimate Guide to Income for Life* (2010).

7 Lucia also used a similar version of the slideshow in pitching the BOM strategy in a video posted on RJLC's website on February 16, 2009 (the "Webinar"). The OIP does not mention the Webinar, but Respondents introduced it as evidence of what Lucia told prospective clients at the seminars.

8 It is undisputed that Lucia was responsible for, and approved the content of, the slideshow.

9 As noted, Respondents contend that they did not lead prospective clients to believe that they had performed backtests. But because Respondents used the word "backtest" in their seminars to describe their analysis of how the BOM strategy would have fared for a model portfolio from 1966 to 2003 and 1973 to 1994, we also use that word to describe their analysis. That word is also appropriate because, as discussed below, we find that Respondents led prospective clients to believe that they had performed backtests.

10 Most slides for this portion of the presentation included disclaimers that "[t]his is a hypothetical illustration and is not representative of an actual investment."

bonds. Their portfolio produced a hypothetical 6% annual return but the Campbells also withdrew $60,000 per year for income (*i.e.*, 6% of the portfolio). The slideshow stated that the problem with this strategy is that, assuming 3% annual inflation, the purchasing power of the Campbells' $60,000 annual income would diminish to $44,644 in ten years, $33,221 in twenty years, and $24,719 in thirty years. As a result, if the Campbells died after thirty years, their children would inherit $1 million but with the equivalent purchasing power of $411,987 from the initial retirement date. And if the Campbells indexed their $60,000 annual income to 3% assumed inflation every six years, they would run through their nest egg within twenty-seven years.[11]

b. High Rolling Hendersons

The slideshow stated that a second couple, dubbed the "High Rolling Hendersons," invested their $1 million nest egg in stocks because they believed that, since stocks average 10% in annual return, in thirty years their portfolio would be worth $4,203,320 after withdrawing $60,000 for annual inflation indexed income. But the Hendersons would have problems if they retired at the beginning of a big bear market. For example, the slideshow stated that if the Hendersons had retired on January 1, 1973, the beginning of a two-year period when the market declined by 41.13%, they would have exhausted their portfolio in seventeen years based on the performance of the S&P 500 for that period assuming that they had withdrawn $60,000 in annual income indexed by 3% annual inflation.[12]

c. Balanced Buttafuccos

The slideshow stated that a third couple, dubbed the "Balanced Buttafuccos," invested their $1 million nest egg 40% in bonds and 60% in stocks. The slides stated that the Buttafuccos have a "better more 'balanced' approach" than the Campbells and Hendersons. But when their strategy is "backtested" with a retirement date starting on January 1, 1973, the Buttafuccos are shown to have exhausted their retirement portfolio in twenty-one years. The slides stated that the "backtest" was based on the performance of the S&P 500, an assumed 6% constant bond return, and the Buttafuccos having withdrawn $60,000 annual income for the first six years, $71,500 annual income for the next six years, and $85,500 annual income for another six years.[13]

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11 For indexing, the slideshow clarified that the couple would increase the amount they withdrew for annual income every six years assuming 3% inflation for each of the six years. Thus, the Conservative Campbells would withdraw $60,000 each year for six years, and then $71,500 each year for another six years, and so on.

12 Like the Campbells, the Hendersons were assumed to have increased the amount they withdrew for income every six years assuming 3% inflation for each of the six years.

13 Although not stated explicitly in the Buttafucco slides, the annual income for each six year period in Respondents' "backtest" increased assuming 3% inflation for each of the six years (*i.e.*, $60,000 with 3% annual inflation after six years equals about $71,500).

2. Description of the BOM strategy

The slideshow then described how the BOM strategy would work for a fourth hypothetical couple, dubbed the "Bold Bucketeers," who also had a $1 million nest egg.[14] In following the BOM strategy, the Bold Bucketeers divided their portfolio into three "buckets" of assets: Bucket #1 held "[s]afe money in a self-depleting bucket aimed at providing income to live on for" six years (*e.g.*, CDs, T-bills, bonds); Bucket #2 held "[s]afe, or moderately safe, money aimed at replacing Bucket #1 with inflation indexed income for the next period (6 years)" (*e.g.*, bonds, fixed annuities); and Bucket #3 held "[h]igher risk money invested for long term growth potential" (*e.g.*, stocks and REITs).[15]

In illustrating the BOM strategy, the slideshow stated that Bucket #1 was assumed to have a 4% return, Bucket #2 a 5.5% return, and Bucket #3 a 10% stock return and 7.75% REIT dividend return, and that $60,000 income was indexed by an "[a]ssumed 3% inflation" every six years.[16] At the end of the initial six year period, Bucket #1 had been fully depleted for income, at which point the assets from Bucket #2 were used for income for the next six years. After twelve years, Bucket #2 had also been fully depleted for income. But the long term assets in Bucket #3 had grown to a value of $1.4 million which, the slideshow stated, was then "[r]e-[b]ucketize[d] for another 12 years."[17]

3. Backtest slides

Finally, Lucia discussed the backtests at issue here, beginning with the backtest from 1973 to 1994, and concluding with the backtest from 1966 to 2003.

a. 1973 backtest slides

The slideshow introduced the 1973 backtest by asking, "But Can Buckets Stand Up To The Test Of The '73/'74 Grizzly Bear?" The next slide, titled "Back Tested Buckets," set forth the assumptions for the backtest, including that (i) the Bold Bucketeers invested their $1 million portfolio beginning on January 1, 1973; (ii) the portfolio was 20% invested in REITs; (iii) "actual treasury rates of return" were used "to calculate fixed income/bond returns"; (iv) "actual S&P 500 returns" were used "to calculate growth returns"; and (v) the Bold Bucketeers withdrew annual income of $60,000 from 1973 to 1978, $71,500 from 1979 to 1984,

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14 Most slides for this portion of the slideshow included disclaimers that "[r]ates of return are hypothetical in nature and are for illustrative purposes only."

15 REITs issue equity and/or debt securities to raise capital to purchase and manage income-producing real estate, such as apartment complexes, shopping centers, and office buildings.

16 The slideshow disclaimed, inter alia, that "[i]nvesting in real estate and [REITs] involve special risk, such as: limited liquidity and demand for real property . . . ."

17 "Rebucketization" meant that portions of the assets in Bucket #3 would be reallocated to Buckets #1 and #2 after their assets had been fully depleted for income.

$85,500 from 1985 to 1990, and $96,000 from 1991 to 1994.[18] The slideshow concluded that the Bold Bucketeers' portfolio would have been worth $1,544,789 by 1994, the same point in time when the Balanced Buttafuccos' portfolio would have been worth $0.[19]

b. 1966 backtest slides

The slideshow introduced the 1966 backtest by asking, "What would have happened if you retired in 1966"?[20] The slideshow then compared 1966 backtests that Respondents calculated for three different portfolios: (i) a version of the Balanced Buttafuccos' portfolio;[21] (ii) a version of the Bold Bucketeers' portfolio without REITs; and (iii) a version of the Bold Bucketeers' portfolio with REITs. The slideshow stated that, for the 1966 backtests: (i) the "examples are based on actual market returns for the period(s) listed"; (ii) "[b]ond returns are based on US Treasury returns"; (iii) "[s]tock returns are based on S&P 500 returns"; (iv) "REIT returns are based on a 7% annual return"; and (v) "[i]nflation is based at 3% annual."[22]

For the version of the Balanced Buttafuccos' portfolio, the slideshow stated that the $1 million beginning balance was invested 60% in stocks and 40% in bonds, from which $50,000 annual income was withdrawn on a pro rata basis. The slides concluded that, by 2003, the portfolio would have been worth $30,000 with $0 remaining for annual income.

The slideshow then stated that when the BOM strategy was applied to the same $1 million portfolio invested 60% in stocks and 40% in bonds (*i.e.*, Bold Bucketeers without REITs), the $50,000 annual income was withdrawn from bonds first rather than pro rata. As a

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18 The slides did not state the inflation or REIT rates used in the 1973 backtest or whether advisory fees, such as those charged by RJLC, were factored into the 1973 backtest. Lucia testified that annual income was indexed by 3% inflation every six years for the period of 1973 to 1990, but that Respondents made an error in calculating 3% inflation indexed income for the final period of 1991 to 1994. Respondents' expert, John Hekman, calculated that 3% inflation indexed income for that period would have been $102,092, not $96,000.

19 The slides for the 1973 backtest included a disclaimer that "[r]ates of return are hypothetical in nature and are for illustrative purposes only."

20 In the Webinar, Lucia introduced the slides by stating that he "did a backtest" for his "friend," Ben Stein, who had asked him this question concerning how the BOM strategy would have fared during the market stagnation of 1966 to 1982, a period when the Dow Jones Industrial Average began and ended at around 1,000 points. Stein is an actor, writer, and economic commentator, who spoke at some of Respondents' seminars.

21 The slides for the 1966 backtests did not mention the Balanced Buttafuccos, but the first portfolio backtested used the same balanced portfolio approach (60% stocks, 40% bonds).

22 The slides did not state whether advisory fees were factored into the backtests. Also, unlike earlier slides, the 1966 backtest slides did not include disclaimers. But in the Webinar, Lucia stated: "[L]et's pretend that from that point forward [*i.e.*, 1966], inflation was three percent. We know it was more. But we wouldn't have known that at the time." Lucia testified that he presented the backtest assumptions the same way in the seminars and Webinar.

result, by 2003, the portfolio would have been worth $1.2 million with $150,000 for annual income.

Finally, the slideshow stated that when REITs were added, the $1 million portfolio following the BOM strategy became split 40% in stocks, 40% in bonds, and 20% in REITs (*i.e.*, Bold Bucketeers with REITs), and the $50,000 annual income was withdrawn from bonds and REITs first.[23] The slideshow concluded that, by 2003, the portfolio would have been worth $4.7 million with $150,000 for annual income.

B. Respondents' actual backtest calculations

1. 1973 backtest calculations

Before the hearing, Respondents produced two spreadsheets that they claimed to have used in calculating the 1966 and 1973 backtests. But during the hearing, Respondents admitted that they did not actually use the spreadsheet they produced for the 1973 backtest to perform that backtest and that the spreadsheet included some assumptions that differed from their backtest. Respondents also admitted that they have no other documentary support for the 1973 backtest.

During the hearing, Lucia also asserted that the slideshow misstated the assumptions used for the 1973 backtest.[24] Lucia testified that rather than using actual S&P 500 returns and treasury returns for the entire twenty-one year period of the 1973 backtest (as presented in the slideshow), Respondents used those returns for only the first two years and then used a flat 10% stock return and 6% bond return for the remaining years. Lucia testified that he neglected to correct the error during his seminar presentations.[25]

But using assumptions similar to those that Lucia testified Respondents actually used in performing the 1973 backtest, Respondents' expert, John Hekman, was unable to replicate the 1973 backtest result presented in the slideshow.[26] Hekman calculated that, by 1994, the Bold

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23 Lucia clarified in the Webinar that income is initially drained from the REIT "dividend yield" and bonds, and that the REIT itself is liquidated at a later point for income. Lucia referred in the Webinar to the REIT investment for the 1966 backtest as "direct ownership in real estate."

24 Lucia testified that he personally "did some of the work early on" for the 1973 backtest but that it was completed by an RJLC employee.

25 Respondents also concede that the 1973 backtest did not include advisory fees or rebucketize the stock investments after bonds and REITs were drained for income. As noted above, this information was not included in the slides for the 1973 backtest.

26 Hekman, who holds a Ph.D. in economics, is a managing director at FTI Consulting, a firm that provides consulting and expert testimony regarding financial matters. Hekman assumed a 6% bond rate, actual S&P 500 returns for the first two years, 10% stock returns for the remaining years, a 5% annual increase in REIT principal, and a REIT dividend rate ranging between approximately 6.6% and 7.76% per year. Hekman also adjusted the Bold Bucketeers' initial $60,000 annual income by 3% annual inflation every six years (*e.g.*, $60,000 for the first

Bucketeers' portfolio would have been worth $507,194, an amount substantially lower than the $1,544,789 claimed in the slideshow. Respondents offered no evidence related to this discrepancy or otherwise explained it. It is therefore unclear how Respondents arrived at $1,544,789.

2. 1966 backtest calculations

As noted, Respondents also produced a spreadsheet that they claimed to have used in calculating the 1966 backtest. Respondents specifically used that spreadsheet in calculating the 1966 backtest of the version of the Bold Bucketeers' portfolio with REITs.[27] Respondents did not produce any documentary support for the other two 1966 backtests.[28]

The spreadsheet shows that the backtest to which it was applicable used the following factors: (i) a $1 million investment beginning on January 1, 1966, split 40% in stocks, 40% in bonds, and 20% in REITs; (ii) $50,000 income withdrawn in 1966, adjusted each subsequent year by 3% inflation; (iii) actual annual S&P 500 returns as a proxy for stock returns; (iv) actual annual treasury returns as a proxy for bond returns; (v) a flat REIT principal of $200,000; and (vi) a flat 7% REIT dividend yield. During the first eleven years of the backtest, income was withdrawn from the $14,000 annual REIT dividend yield (7% on $200,000) with the remaining amount withdrawn from T-bills. At the end of the eleventh year, the $200,000 REIT principal was liquidated and reinvested in T-bills, and then from years twelve through fifteen the remainder of the T-bill investment was drained for income. Thereafter, from 1981 through 2003, the entire Bold Bucketeers' portfolio remained in stocks rather than being rebucketized. No advisory fees were factored into the backtest.[29]

C. The parties' experts agree that Respondents did not perform actual backtests.

Respondents' expert, Hekman, and the Division's expert, Steven Grenadier,[30] agreed that a backtest uses data from a specific historical period to evaluate how an investment strategy

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six years, $71,500 for the next six years, etc.), and did not deduct advisory fees or rebucketize the portfolio.

27 RJLC's Director of Financial Planning, Richard Plum, testified that he performed the 1966 backtest calculations in 2004 at Lucia's request. Lucia testified that he designed the 1966 backtest.

28 Plum testified that he created spreadsheets for the 1966 backtests of the Balanced Buttafuccos' portfolio and the Bold Bucketeers' portfolio without REITs, but Respondents did not produce these spreadsheets to the Division.

29 The spreadsheet Respondents produced as empirical evidence of the 1973 backtest used the same assumptions as the 1966 backtest spreadsheet, except that it began on January 1, 1973, rather than January 1, 1966, and assumed that an initial $60,000 rather than $50,000 was needed for annual income, with that amount adjusted each subsequent year by 3% inflation.

30 Grenadier is a Professor of financial economics at Stanford University.

would have actually performed during that period.[31] Both experts also agreed that, based on their understanding of the term, the slideshow did not present the results of actual backtests.[32] Grenadier opined that Respondents did not conduct backtests because they used assumed rather than historical inflation and REIT rates, and did not include transaction costs for implementing the BOM strategy.[33] Grenadier also concluded that, by not rebucketizing, Respondents' backtest spreadsheets "concentrate[d] assets in a manner inconsistent with the [BOM] portfolio allocation strategy as outlined in the presentation."

Nonetheless, Respondents disputed that there is an established definition of "backtest" and introduced evidence that, they claimed, showed that it is standard in the financial planning industry to use assumed rates in backtests. Lucia testified that, in the financial planning industry, backtests routinely use "not only averages, for example, inflation, but also . . . hypothetical other investment returns . . . ."[34] As an example, Respondents introduced a brochure issued by American Funds (a large mutual fund house), which used a 4% assumed inflation rate for a backtest from 1961 to 2010. Lucia testified that in addition to American Funds, "there are dozens of variable annuity companies and software companies that do the same thing."

But other than the American Funds' brochure and Lucia's testimony, Respondents did not introduce any evidence of companies using assumed rather than historical data in backtests. To the contrary, Respondents introduced into evidence brochures from Fidelity Investments and Financial Engines Income+ reporting the results of backtests that appear to have used historical stock, bond, and inflation rates.

Respondents also claimed that the American Funds brochure was an example of an industry practice not to include fees in backtests. But it is unclear from the brochure if the two backtests discussed therein included fees. The brochure does not mention fees for the first backtest but it implies that the second backtest included fees by stating that the results "are at net asset value."[35] Also, although not mentioned by Respondents as an example of industry practice concerning fees, the backtest in the Financial Engines Income+ brochure discussed above

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31 Respondents' chief compliance officer, Theresa Ochs, also testified that a backtest needs to use accurate historical data to provide an accurate indication of how a strategy may have performed in the past.

32 Hekman also testified that he understood from reviewing the slideshow that it did not purport to present the results of actual backtests.

33 Respondents' other expert, Kevin T. Gannon, also testified that he would not "use a hypothetical rate of return in a backtest" because he would use actual data in a backtest. Gannon, a Certified Public Accountant, is a managing director and president of Stanger & Co., a real estate investment banking firm.

34 Plum similarly testified that the financial planning industry has always used a mixture of "historical return rates" and "hypothetical assumed annual inflation rate[s]" in backtests.

35 "Net asset value" is "[t]he market value of a share in a mutual fund, computed by deducting any liabilities of the fund from its total assets and dividing the difference by the number of outstanding fund shares." Black's Law Dictionary 1061 (7th ed. 1999).

included fees, and the Fidelity brochure discussed above disclosed that fees were not included in its backtest.

D. The difference between Respondents' purported backtest results and what actual backtests would have shown

The Division's expert, Grenadier, analyzed the two spreadsheets Respondents produced as empirical evidence of the 1966 and 1973 backtests.[36] He concluded that the spreadsheets "use[d] important and inaccurate assumptions about inflation, investment returns and liquidity, and implementation costs that significantly affect the results and produce misleading information." Grenadier reran the calculations in the spreadsheets "[s]ubstituting actual, historical data," and produced the results discussed below showing "relatively lower ending portfolio balances than what is reflected in the presentation and spreadsheets, or portfolios that are entirely depleted resulting in substantial unmet income needs." Respondents introduced evidence, including testimony from their expert witnesses, challenging some but not all of Grenadier's findings.[37]

1. The effect from using historical inflation rates

Grenadier found that the backtest spreadsheets were significantly impacted by using a fixed and assumed 3% inflation rate rather than historical inflation for each of the years considered because many high inflation years occurred early in the backtest periods. Grenadier found that relatively higher inflation as measured by the Consumer Price Index ("CPI"),[38] such as the double-digit inflation of the late 1970s to early 1980s, would have caused the Bold Bucketeers' portfolios to deplete their assets faster in the early years "to have withdrawals that ke[pt] up with inflation," and as a result they would have had "less portfolio later to accumulate returns to consume on."[39]

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36 While, as noted above, Respondents admitted that they mistakenly produced the 1973 backtest spreadsheet, Grenadier's analysis of it is still relevant because it contains assumptions similar to those Respondents claimed to have used in the 1973 backtest. It differs only in that it used actual S&P 500 returns and treasury returns for the length of the backtest rather than 10% stock and 6% bond returns after the first two years, and that it adjusted the amount withdrawn for income by 3% inflation each year rather than by six year increments (*i.e.*, $60,000 for the first six years, $71,500 for the next six years, etc.).

37 Respondents also introduced evidence to show that their assumed 3% inflation and 7% REIT dividend rates were reasonable to use in hypothetical illustrations. But this evidence is irrelevant because, as we find below, Respondents led prospective clients to believe that they performed backtests and not hypothetical illustrations, and backtests use historical and not assumed data.

38 CPI measures inflation and is maintained by the Bureau of Labor Statistics. Grenadier specifically used CPI-U, which is a category of CPI measuring inflation for urban consumers.

39 CPI-U was 11.3% in 1979, 13.5% in 1980, and 10.3% in 1981. Lucia agreed that investors would have experienced double digit inflation during this period.

Grenadier found that by substituting annual historical inflation rates as measured by CPI-U for Respondents' fixed 3% rate, the revised 1966 backtest spreadsheet shows the BOM portfolio being "fully depleted by 1986" and the revised 1973 backtest spreadsheet shows the BOM portfolio being "fully depleted by 1989."[40]

Respondents' expert, Hekman, countered that CPI-U overstated inflation for two reasons. First, Hekman stated that a 1996 report issued by a commission appointed by the Senate Finance Committee (the "Boskin Commission"), and a subsequent paper issued ten years later by a former commission member (Robert Gordon), found that CPI-U had been overstating increases in the annual cost of living. Hekman stated that, based on those findings, CPI-U is "too high by an average of 1.2% per year through 1996 and 1.0% thereafter." Second, Hekman stated that "the most realistic inflation rate for retirees is one that accounts for [their] declining pattern of spending," and concluded that an additional 2% should be deducted from annual CPI-U on top of the corrections suggested by the Boskin Commission and Gordon.

Based on those downward adjustments to CPI-U, Hekman ran two recalculations of the 1966 backtest spreadsheet. In the first, Hekman found that by substituting annual CPI-U adjusted by the Boskin Commission corrections (*i.e.*, annual CPI-U minus 1.2% through 1996 and 1.0% thereafter) for Respondents' fixed 3% rate, the 1966 backtest spreadsheet shows the BOM portfolio running out of money in 1994. In the second, Hekman found that by reducing annual CPI-U by an additional 2% on top of the Boskin Commission corrections to account for reduced retiree spending and substituting that data for Respondents' 3% rate, the 1966 backtest spreadsheet shows the BOM portfolio increasing to a value of over $6.6 million by 2003.

While Grenadier agreed that retirees over sixty-five tend to spend less money than non-retirees, he testified that "has nothing whatsoever to do with inflation." Grenadier testified that to account for any decrease in spending in the 1966 backtest spreadsheet, the assumed $50,000 per year income—and not inflation—should be decreased.

2. The effect from using historical REIT rates of return

Respondents acknowledge that, from 1966 to 1971, REITs were not readily available to investors. For this reason, Grenadier was unable to factor historical REIT returns into the 1966 backtest spreadsheet for that period. For the period after 1971, Grenadier also found it significant in analyzing both the 1966 and 1973 backtest spreadsheets, that Respondents' slideshow did not make clear whether Respondents were using assumed returns from publicly traded REITs, public non-traded REITs, or private REITs.[41]

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[40] Lucia testified that he does not dispute that, if historical inflation as measured by CPI-U had been used in the 1966 or 1973 backtest spreadsheets, it would have resulted in the model BOM portfolios being fully depleted before the end of the backtest periods.

[41] Publicly traded REITs file with the Commission and have their shares traded on an exchange, public non-traded REITs file with the Commission but do not trade their shares on an exchange, and private REITs neither file with the Commission nor trade their shares on an exchange.

For the first category, Grenadier found that substituting annual historical returns for publicly traded REITs as measured by the National Association of Real Estate Investment Trusts ("NAREIT") All REIT Index[42] back through 1972 into the 1966 backtest spreadsheet (leaving all other data unchanged) resulted "in a total investment in REITs of only $85,646 at the time the REIT investment [was] liquidated, as compared to $200,000 in the original spreadsheet, and total assets of only $1.3 million at the end of 2003, as compared to $4.7 million in the original spreadsheet."[43] Grenadier also found that substituting such data into the 1973 backtest spreadsheet (leaving all other data unchanged) resulted "in a total investment in REITs of only $134,031 at the time the REIT investment [was] liquidated, as compared to $200,000 in the original spreadsheet, and total assets of only $2.8 million at the end of 2003, as compared to $4.1 million in the original spreadsheet."[44]

For the last two categories, Grenadier found that, to the extent Respondents were using public non-traded or private REITs, the backtest spreadsheets should have considered "the ability and potential cost to liquidate the REIT investment."[45] As noted, Respondents' 1966 backtest spreadsheet liquidated the $200,000 REIT principal at the end of the eleventh year after T-bills had been drained down to a level at which they could no longer cover income.[46] In doing so, Grenadier found that the spreadsheets "ignore that redemption of private and/or public non-traded REITs may be difficult and costly."

Gannon did not offer expert testimony concerning the effect on the backtests from using annual historical REIT returns.[47]

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42 NAREIT began maintaining indices of annual returns for publicly traded REITs in 1972.

43 Gannon testified that a more reasonable index to use for historical publicly traded REIT returns is the NAREIT Equity REIT Trust Index ("NAREIT Equity Index"), which includes REITs invested only in real estate equity, because equity REITs were the subject of Respondents' backtests. Grenadier testified that he used the NAREIT All REIT Index because it was unclear whether the REIT investment in the backtests was limited to only equity or mortgage REITs. In any event, Gannon did not analyze, and it is unclear from the record, what effect substituting data from the NAREIT Equity Index into the spreadsheets would have had on the spreadsheet results.

44 The 1973 backtest in the slideshow ended in 1994, but the 1973 backtest spreadsheet was calculated through 2003.

45 While publicly traded REITs are highly liquid, non-traded REITs are substantially less liquid because they generally have a minimum required holding period after which redemption characteristics vary by REIT. Some non-traded REITs may allow investors to redeem shares once a quarter, subject to certain requirements; others link redemption to a required liquidity event after a fixed amount of time.

46 The 1973 backtest spreadsheet liquidated the $200,000 REIT principal at the end of the ninth year.

47 Respondents retained Gannon to opine on the use of a hypothetical 7% REIT rate of return in hypothetical illustrations.

3. The effect from deducting advisory fees

Grenadier found that if a strategy has implementation costs, like BOM, it is important when backtesting the strategy to include such costs because they "may reduce, and at times eliminate, the benefits of [the] strategy." Grenadier found that, by assuming zero implementation costs, Respondents' backtest spreadsheets overstated "the ending portfolio balances." In particular, Grenadier found that the backtest spreadsheets should have included "cost[s] associated with an investment in the S&P 500 Index," T-bills, and REITs. By incorporating representative mutual fund fees on the stock portfolio into the spreadsheets (leaving all other data unchanged), Grenadier found that the value of the model portfolio dropped in the (i) 1966 backtest spreadsheet to \$2.5 million from \$4.7 million by 2003; and (ii) 1973 backtest spreadsheet to \$3.1 million from \$4.1 million by 2003.[48]

Respondents offered no expert testimony on the issue of costs. And Lucia testified that he knew fees can significantly reduce a portfolio's returns over time.

4. The effect from rebucketizing

Grenadier concluded that the 1966 and 1973 backtest spreadsheets were inconsistent with the BOM strategy presented in the seminars because they did not rebucketize after T-bills and REITs had been exhausted for income and instead left all assets in stocks. Grenadier noted that for both spreadsheets, "the average S&P 500 return over the time period in which the portfolios [were] entirely invested in stocks [was] higher than the average for the time period in which the portfolios [were] also invested in other assets besides stocks." In addition, although not directly addressed by Grenadier, from the record evidence it appears that, for the period in the 1966 backtest spreadsheet that the model portfolio was entirely invested in stocks (1981 to 2003), the average S&P 500 return was substantially higher than T-bill returns and about equivalent to publicly traded REIT returns as measured by the NAREIT Equity Index. And from 1986 to 2003, when the BOM portfolio in the 1973 backtest spreadsheet was entirely invested in stocks, the average S&P 500 return was substantially higher than T-bill returns and slightly higher than publicly traded REIT returns as measured by the NAREIT Equity Index.

Respondents conceded that they did not rebucketize the 1966 or 1973 backtests and offered no expert testimony to support their approach. Lucia also admitted at the hearing that the BOM strategy does not advocate that investors leave their assets in stocks after draining other assets for income,[49] and stated in the Webinar that investors (i) should not "put a hundred percent of [their] money into the stock market" and (ii) should "never drain that stock portfolio for

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48 Grenadier used the average equity mutual fund fee of 0.8% for 1966 to 1970 and 1% for 1971 to 1977. Thereafter he used 0.05% to match the fee charged by the least expensive mutual fund (Vanguard 500 Fund) for that period.

49 Plum similarly testified that "[p]utting a hundred percent into stocks" is "not a Buckets of Money strategy," and that RJLC did not believe investors "should be a hundred percent in stock."

income."[50] Lucia also testified that he was aware that if the 1966 backtest spreadsheet had been rebucketized, the model portfolio would have ended up with significantly less money.

Lucia testified, however, that seminar attendees would have known that the backtests were not rebucketized. While Lucia acknowledged that the slideshow made no explicit disclosure that the backtests did not rebucketize, he testified that seminar attendees would nonetheless have known that the backtests were not rebucketized because he explained to them that rebalancing is not always necessary. Lucia testified that, during the seminars, he drew out a bucket strategy by hand to show that the stock bucket does not have to be rebalanced and mentioned an academic article by Sandeep Singh, Ph.D., CFA, and John Spitzer, Ph.D., finding that retirees "could live off of the dividends and the income stream from the equity portfolio and an annuity contract" without rebalancing.

No evidence corroborates Lucia's testimony on this point. To the contrary, the Webinar shows that Lucia diagramed the bucket strategy and mentioned the Singh/Spitzer article to criticize the "rebalancing method," which involves withdrawing income from a retirement portfolio on a pro rata basis and rebalancing the entire portfolio annually. Lucia stated in the Webinar that the Singh/Spitzer article found that the "rebalancing method" is inferior to the BOM strategy. Lucia did not state in the Webinar that rebalancing was unnecessary in following the BOM strategy after Buckets #1 and #2 had been depleted.

E. Investor testimony

Two RJLC clients who had attended Respondents' seminars, Richard R. DeSipio and Dennis Wayne Chisholm, testified at the hearing.[51] DeSipio testified that, for the period of market stagnation starting in 1966, he understood that the BOM strategy was "backtested or checked out and that it held up relatively well compared to the other three investment programs," and that the 1966 backtest used "actual performance data" and "average inflation" that accurately reflected inflation during that historical era. DeSipio testified that he thought the 1966 backtest showed "that over a longer projected period of time, certainly for '66 going forward, that [the BOM strategy] held up under the various market conditions that occurred over the years."

DeSipio testified that if he knew the inflation rate used in the 1966 backtest was not the historical rate he would have "come to question" the backtest's results, and that it would have been an important factor for him to know that the model BOM portfolio would have been reduced to $0 in twenty years if Respondents had used historical inflation rates and deducted advisory fees in the backtest. DeSipio also testified that he does not recall Lucia disclosing that the 1966 backtest did not rebucketize the model BOM portfolio. DeSipio testified that he would not want his entire retirement portfolio to be invested in stocks, as was done here in backtesting the BOM strategy without rebucketizing.

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50 Lucia also wrote in a letter to RJLC clients dated October 9, 2008, that he "would never – NEVER – advocate being 100% invested in stocks."

51 DeSipio attended a seminar in Philadelphia, Pennsylvania in 2007, and Chisholm attended a seminar in Portland, Oregon in 2007.

Chisholm testified that he understood from the seminar that a bear market "would not be an issue" for the model BOM portfolio "because [the strategy] was a proven method of investing, that it had been backtested," and "would do well over good times as well as bad times." Chisholm testified that in deciding whether to become an RJLC client, it would have been important to him to know that the model BOM portfolio would have been exhausted in sixteen years if the 1973 backtest had used historical inflation. Chisholm testified that "it would have lessened his confidence in" the backtests if he had known that 3% inflation was not the historical rate.

Chisholm testified that Lucia did not say anything at the seminar about the availability of REITs in 1966 and that he would have wanted to know if REITs were not readily available in evaluating the value of the 1966 backtest. Chisholm testified that Lucia emphasized during the seminar that portfolio assets be rebucketized but did not disclose that the 1966 and 1973 backtests did not rebucketize. Chisholm testified that he assumed that the backtests rebucketized and that he would have liked to have known that they did not rebucketize. Like DeSipio, Chisholm testified that he would not want his entire retirement portfolio invested in stocks.

III. Discussion

A. RJLC willfully violated Advisers Act Sections 206(1), (2), and (4).

1. Legal Standard

Advisers Act Sections 206(1), (2), and (4) make it unlawful for an investment adviser, by jurisdictional means,[52] "directly or indirectly: (1) to employ any device, scheme, or artifice to defraud any client or prospective client; (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; . . . or (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative."[53] There is significant overlap among Sections 206(1), (2), and (4),[54] the

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52 Respondents do not dispute that RJLC was an investment adviser or that the Commission has jurisdiction by virtue of their actions in interstate commerce. Respondents also do not dispute that they acted willfully, which is shown where a person intends to commit an act that constitutes a violation; it does not require that the actor "also be aware that he is violating one of the Rules or Acts." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted).

53 15 U.S.C. § 80b-6(1), (2), & (4). Section 206(4) further provides that "[t]he Commission shall, for the purposes of this paragraph (4) by rules and regulations define . . . such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." *Id.* § 80b-6(4). But to violate Section 206(4), there is no precondition that one of its underlying rules, such as Rule 206(4)-1, have been violated. *See Warwick Capital Mgmt., Inc.*, Advisers Act Release No. 2694, 2008 WL 149127, at *8-9 (Jan. 16, 2008) (finding a violation of Section 206(4) without an associated rule violation).

54 *Cf. John P. Flannery*, Advisers Act Release No. 3981, 2014 WL 7145625, at *14 (Dec. 15, 2014) (finding the subsections of Exchange Act Rule 10b-5 "to overlap," with each

boundaries of which do not need to be delineated here. For purposes of this proceeding, it is sufficient to note that all three sections encompass the making of fraudulent misstatements of material fact and omissions of material fact necessary to make statements made not misleading.[55]

Scienter, which can be established through recklessness, is necessary to violate Section 206(1).[56] Negligence is sufficient to violate Sections 206(2) and (4).[57] Lucia's conduct and his scienter or negligence are imputed to RJLC.[58]

2. Respondents made fraudulent statements and omissions in the backtest slides.

Respondents' backtest slides were misleading because: (1) they falsely stated that Respondents had backtested a model BOM portfolio; (2) they stated that backtesting proved that such a portfolio would have withstood two difficult historical market periods when actual backtesting would have shown the opposite; and (3) even using Respondents' flawed assumptions, they overstated the 1973 backtest result by over $1 million.

First, Respondents conveyed to prospective clients that they had performed actual backtests of a model portfolio following the BOM strategy. In addition to using the word "backtest" to describe their analysis, Respondents' slideshow introduced the 1966 backtest by asking, "What would have happened if you retired in 1966[?]," and introduced the 1973 backtest by asking, "Can Buckets Stand Up To The Test Of The '73/'74 Grizzly Bear?" Because of such statements, the two seminar attendees who testified at the hearing, DeSipio and Chisholm, justifiably believed that Respondents had performed backtests.

But Respondents had not actually performed backtests. The parties' experts agreed that backtests use historical data. And instead of using historical data, Respondents' backtests used

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encompassing, among other things, making fraudulent misstatements of material fact), *appeal docketed*, No. 15-1080 (1st Cir. Jan. 16, 2015); *see also SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) ("Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but flexibly to effectuate its remedial purposes." (internal quotation omitted)).

55 *Warwick Capital Mgmt.*, 2008 WL 149127, at *8-9 (finding that an investment adviser violated Sections 206(1), (2), and (4) by making false and misleading statements about its assets and performance).

56 *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003); *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992).

57 *Steadman*, 967 F.2d at 643 n.5, 647.

58 *A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977) (holding that a firm "can act only through its agents, and is accountable for the actions of its responsible officers"); *Warwick Capital Mgmt.*, 2008 WL 149127, at *9 n.33 ("A company's scienter is imputed from that of the individuals controlling it.").

assumed inflation and REIT rates. Also, it was blatantly untrue for Respondents to claim that their backtests followed the BOM strategy when they did not rebucketize the model portfolio and instead left all of its assets in stocks after safer assets had been drained for income. The BOM strategy included rebucketization and forbade investing all portfolio assets in stocks.[59]

Second, the purported results of Respondents' backtests were misleading. Had Respondents performed actual backtests beginning in 1966 and 1973 by using historical inflation and REIT rates and rebucketizing, their model portfolio would have been shown to have exhausted its assets rather than having grown in value to $4.7 million and $1,544,789, respectively, by the end of the backtest periods.

In particular, Respondents' use of a flat 3% inflation rate made the backtest results misleading because historical inflation as measured by CPI-U was substantially higher during the backtest periods. Because annual CPI-U reached double digits in the late 1970s and early 1980s, inflation adjusted annual income would have substantially increased early in the backtest periods, thereby substantially decreasing principal and ultimately causing the model portfolio to be exhausted before the backtests ended. As discussed above, this result would not change for the 1966 backtest even using Hekman's downward adjustment to CPI-U based on the Boskin Commission corrections.[60]

In addition, Respondents' use of a flat 7% REIT dividend rate on a constant $200,000 REIT principal made the backtest results misleading because it was higher than historical REIT rates of return. As Grenadier demonstrated without contradiction, substituting data from the NAREIT All REIT Index back through 1972 resulted in REIT principal dropping to $85,646 in Respondents' 1966 backtest spreadsheet and $134,031 in Respondents' 1973 backtest spreadsheet, and lower valued portfolios as a consequence.[61] The 1966 backtest was further inflated by Respondents' use of entirely fictitious REIT rates for 1966 to 1971, a period when REITs were generally unavailable to investors.

Also, Respondents' failure to rebucketize the backtests inflated their results because, during the period when the model BOM portfolio was fully invested in stocks, S&P 500 returns were substantially higher than T-bill returns and about equivalent to publicly traded REIT

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59 As noted above, the ALJ also found that Respondents' statements about the backtests were misleading because Respondents did not inform prospective clients that the backtests did not deduct advisory fees. Given our other findings, which amply support liability and the sanctions imposed, we have determined not to reach this additional basis for liability.

60 Hekman recalculated only the 1966 backtest using the Boskin Commission corrections; he did not also recalculate the 1973 backtest. In addition, Respondents' contention, supported by Hekman's conclusion, that CPI-U should be further reduced to account for reduced retiree spending is not persuasive because, as Grenadier observed, it unjustifiably conflates spending levels with inflation.

61 Respondents did not demonstrate that Grenadier's calculations would be materially different using the NAREIT Equity Index instead of the NAREIT All REIT Index.

returns. A rebucketized model BOM portfolio would have been invested in all three assets, not just stocks.[62]

Third, Respondents overstated the 1973 backtest result by over $1 million even using their assumptions. Respondents concede that they have no documentary support for the $1,544,789 result they presented to seminar attendees, and their expert, using assumptions similar to those Respondents claim to have used, concluded that the model BOM portfolio would have been worth only $507,194 at the end of the 1973 backtest. Thus, Respondents either fabricated the 1973 backtest result or presented it to seminar attendees without ensuring its accuracy.

3. Respondents' fraudulent statements and omissions were material.

For a misleading statement 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."[63] It would have been significant to a reasonable investor in considering whether to become an RJLC client or implement the BOM strategy to know that: (i) Respondents' purported backtests did not use historical inflation or REIT rates or even follow the BOM strategy by rebucketizing; (ii) actual backtests beginning in 1966 and 1973 would have shown the model portfolio to have been exhausted by the 1980s rather than providing decades of payouts with an increase in residual principal; and (iii) Respondents presented a result for the 1973 backtest that was over $1 million higher than even their flawed assumptions would have shown.

Our conclusion is supported by testimony from prospective clients who attended Respondents' seminars. DeSipio and Chisholm testified that they would have found it important to know that Respondents' backtests did not use historical inflation and that actual backtests using historical data would have shown the model portfolio to have exhausted its assets. Chisholm also testified that he would have wanted to know that the backtests did not rebucketize and that REITs were not readily available in 1966. And DeSipio testified that that he would not want his entire portfolio to be invested in stocks, as was done here by not rebucketizing the backtests.

4. Respondents made the fraudulent misstatements and omissions with scienter.

Respondents acted at least recklessly.[64] Lucia designed the backtests and was responsible for the backtest slides. In approving and using the backtest slides, it was Lucia's decision to tell

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62 Lucia also admitted in testimony that not rebucketizing caused the backtests to show higher portfolio returns.

63 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

64 The recklessness required to violate Section 206(1) "is not merely a heightened form of ordinary negligence; it is an 'extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the actor must have been aware of it.'" *Steadman*, 967 F.2d at 641-2 (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

seminar attendees that he had backtested the BOM strategy to show how a portfolio implementing it in the past would have performed over historical time periods with specific negative market performance. But Lucia knew that the backtests were not based on historical data and did not rebucketize, and therefore knew or must have known of the risk of misleading prospective clients to believe that Respondents had performed actual backtests of a model BOM portfolio. Indeed, because Lucia admitted that the BOM strategy does not advocate keeping all portfolio assets in stocks, he knew or must have known that it was untrue to claim that the backtests followed the BOM strategy.

Also, Lucia knew or must have known that the backtest results he presented were misleading. Lucia knew that: (i) actual inflation was higher than 3% early in the backtests and fluctuated annually; (ii) REITs did not produce flat 7% dividend rates on flat principal; and (iii) not rebucketizing caused the backtests to show higher portfolio returns.

Finally, Lucia acted recklessly, at the very least, in presenting the 1973 backtest results without ensuring their accuracy. As discussed above, Respondents provided no support for their 1973 backtest and Hekman was unable to replicate its results. Lucia also admitted in testimony that the 1973 backtest slides misstated the methodology Respondents purportedly used for the backtest.

B. Lucia willfully aided and abetted and caused RJLC's violations of Advisers Act Sections 206(1), 206(2), and 206(4).

To establish aiding and abetting liability, the Commission must find: (i) a primary violation of the securities laws by RJLC; (ii) that Lucia substantially assisted RJLC's primary violation; and (iii) that Lucia provided such assistance with the requisite scienter.[65] The scienter requirement may be satisfied by evidence that Lucia knew of or recklessly disregarded the wrongdoing and his role in furthering it.[66]

Because the primary violations of Advisers Act Sections 206(1), 206(2), and 206(4) are premised on the imputation of Lucia's conduct and scienter to RJLC for the reasons discussed above, we find that Lucia satisfies the elements for aiding and abetting liability. Lucia substantially assisted RJLC's primary violations because he designed the backtests, was responsible for the backtest slides, and made the material misstatements about the backtests to seminar attendees. Lucia provided such assistance with scienter because he knew or must have known that the statements he made about the backtests to seminar attendees were misleading. Because we find that Lucia aided and abetted RJLC's primary violations, "he necessarily was a cause of the violations."[67]

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[65] *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004); *Eric J. Brown*, Advisers Act Release No. 3376, 2012 WL 625874, at *11 (Feb. 27, 2012).

[66] *Brown*, 2012 WL 625874, at *11.

[67] *Zion Capital Mgmt. LLC*, Advisers Act Release No. 2200, 2003 WL 22926822, at *7 (Dec. 11, 2003).

C. RJLC willfully violated, and Lucia willfully aided and abetted and caused RJLC's violation of, Advisers Act Section 206(4) and Rule 206(4)-1(a)(5) thereunder.

Advisers Act Rule 206(4)-1(a)(5) provides that it constitutes a fraudulent act, practice, or course of business within the meaning of Section 206(4) for an investment adviser "directly or indirectly, to publish, circulate, or distribute any advertisement . . . which contains any untrue statement of a material fact, or which is otherwise false or misleading."[68] The Rule defines "advertisement" to include "any notice, circular, letter *or other written communication* addressed to more than one person . . . which offers . . . investment advisory service[s] with regard to securities."[69] As the Ninth Circuit found, "[t]he term 'advertisement' is broadly defined in Rule 206(4)-1(b)" and includes "[i]nvestment advisory material which promotes advisory services for the purpose of inducing potential clients to subscribe to those services."[70]

Respondents urge us to apply the same reading of Rule 206(4)-1 as did the ALJ, who found that their slideshow presentation was not an "advertisement" because it did not qualify as a "written communication" under Rule 206(4)-1(b).[71] The ALJ based his finding on precedent that he understood to hold that a "written communication" includes "only traditional media, including books, newsletters, and newspaper and magazine advertisements."[72] And because "[t]here is no evidence that slideshow printouts or synopses thereof were handed out to seminar participants or otherwise published in printed or handwritten form at the seminars," the ALJ found that the slideshow presentation was not a "'written communication' as that term has been interpreted."[73]

But none of the cases cited by the ALJ, nor any other case, has held that only traditional media qualifies as a "written communication" under Rule 206(4)-1(b). To the contrary, the cases cited by the ALJ merely found that a "written communication" *includes* newsletters, newspaper advertisements, and books.[74] They did not exclusively define those words.

The plain language of Rule 206(4)-1(b) also does not limit a "written communication" to traditional media or require that a "written communication" be in hard-copy rather than

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68 17 C.F.R. § 275.206(4)-1(a)(5).

69 17 C.F.R. § 275.206(4)-1(b) (emphasis added).

70 *C.R. Richmond & Co.*, 565 F.2d at 1104.

71 *Raymond J. Lucia Cos.*, 2013 WL 6384274, at *50-51.

72 *Id.* at *51. The ALJ cited the following cases as precedent: *SEC v. Suter*, No. 81-3865, 1983 WL 1287, at *11-12 (N.D. Ill. Feb. 11, 1983), *aff'd*, 732 F.2d 1294 (7th Cir. 1984); *SEC v. Lindsey-Holman Co.*, No. 78-54-MAC, 1978 WL 1129, at *2-3 (M.D. Ga. Aug. 6, 1978); *C.R. Richmond & Co.*, 565 F.2d at 1104.

73 *Raymond J. Lucia Cos.*, 2013 WL 6384274, at *51.

74 *Suter*, 1983 WL 1287, at *11-12; *Lindsey-Holman Co.*, 1978 WL 1129, at *2-3; *C.R. Richmond & Co.*, 565 F.2d at 1104.

electronic or projected form.[75] The Rule's only limitations on what qualifies as a "written communication" are that it be "written"[76] and a "communication."[77] Both of those limitations are met here. There is no question that the slideshow was written. And its projection onto a screen along with Lucia's presentation of its contents was a communication to seminar attendees. Thus, the slideshow was a "written communication" within the meaning of Rule 206(4)-1(b).

The slideshow also meets the two additional requirements of the Rule's broad definition of "advertisement." First, the slideshow was addressed to more than one person—typically to an audience of one hundred to five hundred people. Second, the slideshow offered RJLC's investment advisory services with regard to securities. Indeed, Respondents used the slideshow presentation to generate leads for RJLC. To that end, Respondents handed out response cards for seminar attendees to complete if they wanted to meet with an RJLC advisor. Lucia also repeatedly offered RJLC's services throughout the Webinar presentation of the slideshow. And Respondents treated the slideshow as marketing and advertising material requiring review by RJLC's broker-dealers.

The remaining elements of Rule 206(4)-1 have also been satisfied. By projecting the slideshow onto a screen and presenting its contents during the seminars, Lucia published, circulated, and distributed it.[78] And as set forth above, the slideshow contained untrue statements of material fact and was misleading.

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[75] Although not specifically interpreting the phrase, "written communication," we have previously advised that, under Rule 206(4)-1, "electronically disseminated advertisements are subject to the same prohibitions against misleading disclosure as advertisements in paper." *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers*, Advisers Act Release No. 1562, 1996 WL 242059, at *6 (May 9, 1996); *see also id.* at *2 n.4 ("[T]he antifraud provisions of . . . section 206 of the Advisers Act and the rules thereunder, apply to information delivered and communications transmitted electronically, to the same extent as they apply to information delivered in paper form.").

[76] At the time we adopted Rule 206(4)-1 in 1961, Webster's Third New International Dictionary defined "written" as the past participle of "write," which it in turn defined as, *inter alia*, (i) "to set forth in written language . . . reveal, describe, treat of, or depict by means of words"; and (ii) "to form or produce letters, words, or sentences with a pen, pencil, or machine." Webster's Third New Int'l Dictionary 2640-41 (1961).

[77] Webster's Third New International Dictionary defined "communication" as, *inter alia*, (i) "the act or action of imparting or transmitting"; (ii) "facts or information communicated"; and (iii) "interchange of thoughts or opinions." *Id.* at 460.

[78] Webster's Third New International Dictionary defined "publish" as, *inter alia*: (i) "to declare publicly"; (ii) "to impart or acknowledge to one or more persons"; and (iii) "to place before the public (as through a mass medium)." Webster's at 1837. It defined "circulate" as, *inter alia*, (i) "to spread widely"; and (ii) "to cause to pass from person to person and [usually] to become widely known." *Id.* at 409. And it defined "distribute" as, *inter alia*, "to give out or deliver esp. to the members of a group." *Id.* at 660.

Accordingly, we find that RJLC willfully violated Section 206(4) on the additional ground that its conduct constitutes a fraudulent act, practice, or course of business as defined in Rule 206(4)-1(a)(5). And because that primary violation is premised on the imputation of Lucia's conduct and scienter to RJLC as discussed above, we find that Lucia willfully aided and abetted and caused RJLC's violation of Section 206(4) and Rule 206(4)-1(a)(5).

D. Respondents' arguments against liability lack merit.

1. Respondents contend that they did not mislead prospective clients.

Respondents claim that they explicitly told seminar attendees, through both the slides and the actual words spoken by Lucia, that they were presenting hypothetical illustrations using hypothetical assumptions. Respondents claim that the slides themselves "specifically and repeatedly explained that '[r]ates of return are hypothetical in nature and are for illustrative purposes only'" and that "[t]his is a hypothetical illustration and is not representative of an actual investment." And Respondents claim that Lucia, in presenting the slides, "expressly informed seminar attendees that he was using *hypothetical, pretend, assumed* rates of return."[79]

We find that such statements did not change the overall impression that Respondents had performed backtests showing how the BOM strategy would have performed during the two historical periods.[80] In addition to using the word "backtest," Respondents' slideshow introduced the 1966 backtest by asking, "What would have happened if you retired in 1966[?]," and introduced the 1973 backtest by asking, "Can Buckets Stand Up To The Test Of The '73/'74 Grizzly Bear?" And the two seminar attendees who testified understood from Lucia's

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79 Respondents also contend that seminar attendees would have understood that the inflation and REIT rates used were hypothetical because: (i) the attendees were "comprised primarily of retirees and near-retirees who had lived through periods of high inflation, [and no reasonable attendee] would have understood the 3% annual inflation rate . . . to be based on actual historical inflation"; and (ii) "a reasonable investor understands that in reality return rates fluctuate, and respondents' illustrations, rather than being based on real-life data, incorporated an assumed constant rate of return." But DeSipio and Chisholm did not make such assumptions. To the contrary, they justifiably understood from Respondents' presentation that Respondents had used historical rates in their backtests.

80 *Cf. C.R. Richmond & Co.*, 565 F.2d at 1106-07 (finding that advertisements were "deceptive and misleading in their overall effect," in violation of Advisers Act Section 206(4) and Rule 206(4)-1, "even though [it might be argued that] when narrowly and literally read, no single statement of a material fact was false" (quoting *Spear & Staff, Inc.*, Advisers Act Release No. 188, 1965 WL 88746, at *3 (1965))); *see also id.* at 1105 ("[C]onduct with respect to [Rule 206(4)-1] is to be measured from the viewpoint of a person unskilled and unsophisticated in investment matters, . . . and the terms 'fraud' and 'deceit' are used in a flexible and non-technical sense to effectuate the [Advisers] Act's remedial purposes.").

presentation that Respondents had performed backtests showing that the BOM strategy could increase a portfolio's value during the two historical periods.[81]

Moreover, regardless of Respondents' disclaimers about hypothetical rates, Respondents misled seminar attendees by not rebucketizing the 1966 and 1973 backtests. In other words, it would have been just as misleading for Respondents not to rebucketize if they had in fact stated that they were presenting a hypothetical illustration that purportedly followed the BOM strategy as it was for them not to rebucketize what was described as a backtest. Rebucketizing was a key aspect of the BOM strategy, and keeping all assets in stocks—the result of not rebucketizing—contravened the strategy (and substantially inflated the resulting returns). Thus, not rebucketizing made it untrue for Respondents to claim that their model portfolio, whether presented as a "hypothetical illustration" or a backtest, followed the BOM strategy.

Respondents' 1973 backtest results were also false regardless of disclaimers about hypothetical rates. As noted, Respondents' expert did not come within $1 million of the 1973 backtest results using Respondents' own hypothetical inflation rate and other assumptions similar to those that Respondents claim to have used. Consequently, even if Respondents were presenting hypothetical illustrations and not backtests, it was misleading for them to present such grossly inaccurate results.

Respondents contend that the only purpose of the seminar presentation was to compare BOM to three other strategies, and that the Division failed to show that, had Respondents "used historical data rather than hypothetical assumptions . . . [the BOM] strategy would have failed to outperform the other investment strategies illustrated."[82] For example, Respondents assert that they used the same 3% inflation rate for each of the strategies illustrated and there was no showing that, "under a higher inflation rate, Lucia's strategy would not have nonetheless outperformed the alternatives he illustrated."

We reject this argument because the purpose of the backtest slides was not only to compare strategies but also to show the efficacy of the BOM strategy during difficult historical market periods. Respondents misled seminar attendees to believe that, as Chisholm testified, BOM "was a proven method of investing, that it had been backtested," and "would do well over good times as well as bad times." But actual backtests would have shown that the BOM strategy would not have done well over the two historical "bad times" chosen. And again, regardless of

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81 Respondents also contend that Lucia referenced "direct ownership in real estate" when discussing the period from 1966 to 1971 in the backtest. But the 1966 backtest slides specifically stated that "*REIT* returns are based on a 7% annual return," and the 1966 backtest spreadsheet referred only to REITs. And Respondents did not clarify during the seminars that REITs were generally unavailable from 1966 to 1971 and that they actually meant "direct ownership in real estate" when discussing that period.

82 Respondents similarly argue that there can be no finding of materiality here because the Division has made no "allegation (much less an evidentiary showing) . . . that, had Mr. Lucia used actual rates of return . . . and 'rebucketized,' his recommended strategy would not have outperformed the alternative approaches illustrated in the seminar."

this contention, not rebucketizing the backtests and presenting grossly inaccurate 1973 backtest results made Respondents' representations false and misleading.

Respondents also assert four reasons why their assumptions were reasonable and not used to mislead seminar attendees. First, Respondents contend that they submitted "expert testimony supporting the reasonableness of the assumed inflation rates and REIT return rates used in the illustrations." For example, Hekman "testified that the use of a 3% inflation rate for hypothetical retirement planning calculations is universally recognized," and Gannon "testified that a 7% REIT return rate for 1966-2003 . . . was reasonable and supported by available indices." We reject this argument because Hekman and Gannon made clear that their opinions about the reasonableness of Respondents' inflation and REIT rates did not apply to backtests but rather to hypothetical illustrations, and Respondents led seminar attendees to believe that they had performed backtests.

Second, Respondents contend that it was reasonable not to rebucketize the backtests because to do so "would have been highly speculative" and potentially led to accusations of manipulating rebalancing dates because the "strategy illustrated . . . did not represent an actual portfolio with specific investments, but rather a general approach to diversification," and "[d]eciding when and how to shift asset classes would turn entirely on a client's individualized holdings and the market conditions at the time." We reject this contention because, even if Respondents genuinely held these concerns, it was misleading for them not to disclose to seminar attendees that that the backtest results were inflated because they did not rebucketize. Respondents' contention also seems insincere considering that Respondents had no apparent difficulty or reservation in shifting asset classes in the backtest spreadsheets from REITs to T-bills.

Third, Respondents contend that their assumptions were reasonable because there is no established definition of "backtest" precluding the use of assumed rates. Respondents contend that to base liability here on "a firm definition not found in the securities laws," would violate due process by denying Respondents "fair notice of what conduct is required or proscribed," and be an abuse of discretion by imposing "regulatory changes through litigation" rather than rulemaking. Respondents also contend that "[e]ven if one were to posit that Mr. Lucia misused the term 'backtest,' it cannot be denied that he informed visitors of his seminars exactly how he was using it."

We reject these arguments. In finding liability, we need not define "backtest" in all contexts, we just need to assess its use by Respondents here. That use was in conjunction with other statements that misled seminar attendees to believe that Respondents had analyzed how a model portfolio would have performed had it implemented the BOM strategy in the past. Respondents never informed attendees that their assumptions would not actually show, as they claimed, whether the model BOM portfolio could "stand up to" the market challenges starting in 1966 or 1973.[83]

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83 Respondents similarly contend that we would violate due process if we interpreted "written communication" in Rule 206(4)-1 to include their live slideshow presentation, and that

Fourth, Respondents contend that their assumptions were reasonable because it was industry practice to use assumed rates in backtests. As an example of that practice, Respondents point to the American Funds brochure "that included multiple illustrations of 'back-testing withdrawal rates,' all using hypothetical (rather than actual) inflation rates over an historical period." But Respondents introduced no expert testimony to establish industry practice, and their own inflation and REIT experts agreed that backtests use historical rates. And while the backtests in the American Funds brochure used an assumed 4% inflation rate, two other brochures in the record, from Fidelity and Financial Engines Income+, reported the results of backtests that appear to have used historical stock, bond, and inflation rates.

2. Respondents contend that their statements about the 1966 and 1973 backtests were not material.

Respondents make various other arguments that do not concern the validity of the backtests, but focus more on materiality. Respondents assert that their presentation cannot have been material because they did not recommend or sell securities at the seminars, and it is undisputed that their disclosures to attendees who eventually became Firm clients were "100% complete and accurate." But liability under Section 206 does not require that the fraudulent conduct be in connection with the offer or sale of securities.[84] To the contrary, Section 206 includes within its scope misrepresentations that are not specific to a client investment decision.[85]

Respondents also contend that they "submitted unrebutted evidence at the hearing showing that after [they] ceased using the illustrations in question once concerns were raised by the SEC examination staff [in 2010], the response rate of seminar attendees who filled out contact cards requesting to meet with an RJLC adviser did not decline." We find that the

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"the appropriate way to bring [the rule] up to date is through rulemaking." We also reject this argument because, as discussed above, Rule 206(4)-1 has discernible parameters that gave Respondents fair notice that their conduct fell within its scope. And even if we were applying a new interpretation of the rule, "[i]t is well settled that an agency 'is not precluded from announcing new principles in an adjudicative proceeding. . . .'" *Cassell v. FCC*, 154 F.3d 478, 486 (D.C. Cir. 1998) (quoting *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974)).

84 *SEC v. Lauer*, No. 03-80612-CIV, 2008 WL 4372896, at *24 (S.D. Fla. Sept. 24, 2008), *aff'd*, 478 F. App'x 550 (11th Cir. 2012); *see also Applicability of the Investment Advisers Act*, Advisers Act Release No. 1092, 1987 WL 112702, at *9 (Oct. 8, 1987) (staff interpretive release stating that the Section 206 provisions "do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client").

85 *See, e.g., SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1106 (9th Cir. 1977) (investment adviser violated Section 206 by making misrepresentations in a book and newsletter concerning its investment strategy and the results of a model portfolio); *see also Applicability of the Investment Advisers Act*, 1987 WL 112702, at *9 (staff interpretive release stating that "the Commission has applied Sections 206(1) and (2) in circumstances in which the fraudulent conduct arose out of the investment advisory relationship between an investment adviser and its clients, even though the conduct does not involve a securities transaction").

response cards are not determinative of materiality because they do not show whether attendees would have expressed interest in the Firm if they had been told that backtests showed the model BOM portfolio exhausting its assets during the two historical periods. This is because Respondents never told the truth about the backtests; they simply stopped using the backtest slides. And even if the response cards were relevant to materiality, Respondents introduced insufficient evidence to establish what the cards showed. Respondents' contention is based solely on vague testimony from Lucia's son that during the periods before and after Respondents stopped using the backtest slides, "basically the same" percentage of seminar attendees who filled out response cards checked a box to meet with a financial advisor.[86]

3. Respondents contend that they cannot have acted with scienter.

Respondents make various arguments that Lucia cannot have acted with scienter, and that he was, at worst, negligent in that his "hypothetical illustrations . . . were inartfully prepared." Respondents contend that Lucia "testified that he subjectively believed his use of the term 'backtest' encompassed the utilization of hypothetical information." We reject this self-serving contention because it is contradicted by Lucia's representations to seminar attendees that the backtest slides showed how a portfolio implementing the BOM strategy in 1966 or 1973 would have performed. In other words, our finding of liability does not hinge on Lucia's use of the word "backtest." Lucia made numerous other statements suggesting that the slides reflected historical results, and he knew or must have known that using hypothetical data in the backtests would not reflect historical results.

Respondents also deny any scienter by pointing to "third party review [of the backtest slides] by both the registered broker-dealers who had supervisory oversight" of the Firm,[87] as well as Commission staff in a 2003 examination of the Firm,[88] who never told Respondents "that the slides were in any way misleading." Respondents contend that they therefore were "not aware of red flags suggesting that the slides were misleading." We reject these arguments. First, Respondents were well aware of the facts that rendered the backtest slides misleading for the reasons discussed above, and thus any reliance they placed on third party review would not have been reasonable.[89] Second, there is no evidence that: (i) Respondents brought the backtests to

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86 Lucia's son testified that based on response card data, from January to June 2010, a period when the slides were used, about 50% of seminar attendees wanted to meet with a financial advisor, and from January to June 2011, when the slides were no longer used, about 47% of seminar attendees wanted to meet with a financial advisor.

87 Respondents' registered broker-dealers, Securities America (from 2002 to 2007) and First Allied (from 2007 to 2011), reviewed RJLC's marketing and advertising material, including the slideshow, before it was distributed publicly.

88 The examination was conducted by the Division of Investment Management's compliance office, a precursor office to the Commission's Office of Compliance Inspections and Examinations ("OCIE").

89 *Cf. Flannery*, 2014 WL 7145625, at *33 (rejecting reliance-on-counsel defense, in part, because respondent "was well aware of the facts that rendered the statements at issue misleading").

the attention of the Commission staff or broker-dealers; (ii) Respondents provided any support for the backtest slides that would have permitted a meaningful review of their content; or (iii) the Commission staff or broker-dealers addressed the backtests with Respondents. Thus, we are not presented with a situation where a third party told Respondents that the backtest slides were not misleading and Respondents relied on that advice. To the contrary, the Commission staff told Respondents in a deficiency letter dated December 12, 2003, that RJLC "should not assume that [its] activities not discussed in this letter are in full compliance with the federal securities laws."

As support for this last contention, Respondents point to *SEC v. Slocum, Gordon, & Co.*, in which the court concluded that the defendant investment adviser could not be found to have intentionally omitted material facts about its account structure (which created a potential conflict of interest by commingling firm and client funds) from its Form ADV in violation of Advisers Act Section 207 and Rule 204-1(c).[90] The court found that it was reasonable for the defendant to believe that its account structure complied with the securities laws because two Commission examinations and annual independent auditor examinations failed to identify issues with it.[91] But *Slocum* is inapposite because the defendant relied on the advice of counsel in structuring its accounts and subsequently brought its account structure to the Commission's attention.[92] Here, there is no evidence that Respondents relied on counsel or brought the backtest slides to the Commission's attention.

E. Respondents' Appointments Clause argument lacks merit.

Respondents argue that the ALJ who presided over this matter and issued the initial decision, ALJ Cameron Elliot, was not appointed in a manner consistent with the Appointments Clause of the Constitution.[93] Respondents further claim that, in light of this purported constitutional violation, the proceedings "are themselves invalid and any resulting orders should be vacated." We find that the appointment of Commission ALJs is not subject to the requirements of the Appointments Clause.[94]

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[90] 334 F. Supp. 2d 144 (D.R.I. 2004).

[91] *Id.* at 180-82.

[92] *Id.* at 160-61.

[93] Congress has empowered "[e]ach agency [to] appoint as many administrative law judges as are necessary," and it has established a comprehensive scheme to govern the details of ALJs' employment in the civil service. 5 U.S.C. §§ 3105, 1101 *et seq.*; *see also* 15 U.S.C. § 78d-1(a) (authorizing the Commission to delegate functions to "an administrative law judge"); Exchange Act Section 4(b), 48 Stat. 885 (original Exchange Act provision authorizing the Commission to appoint "examiners"). The Commission has for many decades relied upon ALJs to prepare initial decisions in its administrative proceedings.

[94] The constitutional claims raised here implicate many "threshold questions" regarding the Commission's rules and practices. *Elgin v. Dep't of Treasury*, 132 S. Ct. 2126, 2140 (2012); *see also Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 214-15 (1994). In the course of considering the constitutional claims, we address those questions and legal principles. It is important that the Commission have an opportunity to address constitutional issues in the first

Under the Appointments Clause, certain high-level government officials must be appointed in particular ways: "Principal officers" must be appointed by the President (and confirmed by the Senate), while "inferior officers" must be appointed either by the President, the heads of departments, or the courts of law.[95] The great majority of government personnel are neither principal nor inferior officers, but rather "mere employees" whose appointments are not restricted by the Appointments Clause.[96] It is undisputed that ALJ Elliot was not appointed by the President, the head of a department, or a court of law.[97] Respondents therefore contend that his appointment violates the Appointments Clause because, in their view, he should be deemed an inferior officer. The Division counters that he is an employee and thus there was no violation of the Appointments Clause.

Our consideration of this question is guided by the D.C. Circuit's decision in *Landry v. FDIC*, which addressed whether ALJs should be deemed inferior officers or employees.[98] *Landry* held that, for purposes of the Appointments Clause, ALJs at the Federal Deposit Insurance Corporation ("FDIC") who oversee administrative proceedings to remove bank executives are employees rather than inferior officers. *Landry* explained that the touchstone for determining whether adjudicators are inferior officers is the extent to which they have the power to issue "final decisions."[99] Although ALJs at the FDIC take testimony, conduct trial-like hearings, rule on the admissibility of evidence, have the power to enforce compliance with discovery orders, and issue subpoenas, they "can never render the decision of the FDIC."[100] Instead, they issue only "recommended decisions" which the FDIC Board of Directors reviews *de novo*, and "[f]inal decisions are issued only by the FDIC Board."[101] The ALJs thus function as aides who assist the Board in its duties, not officers who exercise significant authority

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instance, as it has in the past. *See, e.g.*, *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *12 (Feb. 13, 2009) (Double Jeopardy claim); *Vladen Vindman*, Securities Act Release No. 8670, 2006 WL 985308, at *11 & n.60 (Apr. 14, 2006) (Seventh Amendment claim).

95 The Clause provides that the President "by and with the advice and consent of the Senate, shall appoint . . . officers of the United States . . . but the Congress may by law vest the appointment of such inferior officers, as they think proper, in the President alone, in the courts of law, or in the heads of departments." U.S. Const. art. II, §2, cl. 2.

96 *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000) (quoting *Freytag v. Commissioner*, 501 U.S. 868, 882 (1991)); *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

97 The Commission constitutes the "head of a department" for purposes of the Appointments Clause when its commissioners act collectively. *See Free Enter. Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010).

98 *Landry*, 204 F.3d at 1130-34.

99 *Id.* at 1133-34.

100 *Id.* at 1133.

101 *Id.*

independent of the Board's supervision. Because ALJs at the FDIC "have no such powers" of "final decision," the D.C. Circuit "conclude[d] that they are not inferior officers."[102]

The mix of duties and powers of the Commission's ALJs are very similar to those of the ALJs at the FDIC. Like the FDIC's ALJs, the Commission's ALJs conduct hearings, take testimony, rule on admissibility of evidence, and issue subpoenas. And like the FDIC's ALJs, the Commission's ALJs do not issue the final decisions that result from such proceedings. Just as the FDIC's ALJs issue only "recommended decisions" that are not final, the Commission's ALJs issue "initial decisions" that are likewise not final.[103] Respondents may petition us for review of an ALJ's initial decision,[104] and it is our "longstanding practice [to] grant[] virtually all petitions for review."[105] Indeed, we are unaware of any cases which the Commission has not granted a timely petition for review. Absent a petition, we may also choose to review a decision on our own initiative,[106] a course we have followed on a number of occasions.[107] In either case, our rules expressly provide that "the initial decision [of an ALJ] shall not become final."[108] Even where an aggrieved person fails to file a timely petition for review of an initial decision and we do not order review on our own initiative, our rules provide that "*the Commission* will issue an

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102 *Id.* at 1134.

103 *See* 17 C.F.R. § 201.360(a)(1) & (d). We note that the FDIC Board has discretion to "limit the issues to be reviewed to those findings and conclusions to which opposing arguments or exceptions have been filed by the parties." 12 C.F.R. § 308.40(c)(1).

104 17 C.F.R. § 201.411(b).

105 Rules of Practice, Exchange Act Release No. 35833, 1995 WL 368865, at *80-81 (June 9, 1995); *see also* Rules of Practice, Exchange Act Release No. 33163, 1993 WL 468594, at *59 (Nov. 5, 1993) (explaining that we are "unaware of any case in which the Commission has declined to grant a petition for review"). We reiterated this policy in the context of amendments to our Rules of Practice in 2004 that eliminated the filing of oppositions to petitions for review. We deemed such oppositions pointless, "given that the Commission has long had a policy of granting petitions for review, believing that there is a benefit to Commission review when a party takes exception to a decision." Proposed Amendments to the Rules of Practice and Related Provisions, Exchange Act Release No. 48832, 2003 WL 22827684, at *13 (Nov. 23, 2003).

106 17 C.F.R. § 201.411(c); *see also* 15 U.S.C. § 78d-1(b) (providing that "the Commission shall retain a discretionary right to review the action of any . . . administrative law judge . . . upon its own initiative or upon petition").

107 *See, e.g.*, *Dian Min Ma*, Exchange Act Release No. 74887, 2015 WL 2088438, at *1 (May 6, 2015) ("determin[ing] to review the [ALJ's] decision on [our] own initiative," setting aside the initial decision in part, and providing that "as modified," the initial decision "has become the final decision of the Commission"); *Michael Lee Mendenhall*, Exchange Act Release No. 74532, 2015 WL 1247374, at *1 (Mar. 19, 2015) ("determin[ing] *sua sponte* to vacate the [ALJ's] initial decision"); *George C. Kern, Jr.*, Exchange Act Release No. 29356, 1991 WL 284804, at *1 (June 21, 1991) ("On its own initiative, the Commission ordered review of the [ALJ's] initial decision . . . .").

108 17 C.F.R. § 201.360(d)(1).

order that the decision has become final," and it "becomes final" only "upon issuance of the order" by the Commission.[109] Under our rules, no initial decision becomes final simply "on the lapse of time" by operation of law; instead, it is "the Commission's issuance of a finality order" that makes any such decision effective and final.[110] Moreover, as does the FDIC, the Commission reviews its ALJs' decisions *de novo*. Upon review, we "may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part," any initial decision.[111] And "any procedural errors" made by an ALJ in conducting the hearing "are cured" by our "thorough, de novo review of the record."[112] We may also "hear additional evidence" ourselves, and may "make any findings or conclusions that in [our] judgment are proper and on the basis of the record."[113] For this reason, although ALJs may play a significant role in helping to shape the administrative record initially, it is the Commission that ultimately controls the record for review and decides what is in the record. As we have explained before, we have "plenary authority over the course of [our] administrative proceedings and the rulings of [our] law judges—before and after the issuance of the initial decision and irrespective of whether any party has sought relief."[114]

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109 17 C.F.R. § 201.360(d)(2) (emphasis added). The effect of this rule, which was enacted pursuant to our general rulemaking authority under the securities laws, is that our ALJs' initial decisions (like the FDIC's ALJs' recommended decisions) do not become the final and effective decision of the agency without affirmative action on our part—specifically, our issuance of a finality order. *See, e.g.*, *Goolu, Inc.*, Exchange Act Release No. 71788, 2014 WL 1213742 (Mar. 25, 2014); *L. Rex Andersen, CPA*, Exchange Act Release No. 63209, 2010 WL 4256161 (Oct. 28, 2010); *David A. Zwick*, Exchange Act Release No. 56826, 2007 WL 4145827 (Nov. 20, 2007). It is not until the issuance of such an order that the Commission's "right to exercise such review [*i.e.*, review of an initial decision on our own initiative] is declined." *See* 15 U.S.C. § 78d-1(c). In short, under our rules, an ALJ's initial decision does not "become[] the decision of the agency without further proceedings," and any theoretical distinction between the potential legal effect of an initial decision as opposed to a recommended decision is immaterial. *Cf.* 5 U.S.C. § 557(b).

110 Exchange Act Release No. 49412, 2004 WL 503739, *12 (Mar. 12, 2004); *see also* 17 CFR § 201.360(d)(2) (providing that the Commission's "order of finality shall state the date on which sanctions . . . take effect").

111 17 C.F.R. § 201.411(a); *see also* 5 U.S.C. § 557(b) ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision . . . .").

112 *Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009); *see also, e.g.*, *In the Matter of Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, *20 (Feb. 20, 2015) ("[O]ur de novo review cures any evidentiary error that the law judge may have made.").

113 17 C.F.R. §§ 201.411(a), 201.452.

114 *Michael Lee Mendenhall*, 2015 WL 1247374, at *1. This includes authority over all evidentiary and discovery-related rulings. And the fact that our ALJs may rule on evidentiary matters and discovery issues (subject to our *de novo* review) does not distinguish them from the

Notwithstanding the direct relevance of *Landry*, Respondents claim that the decision should not control here because, in their view, it "was wrongly decided." They claim that *Landry* "is inconsistent with" *Freytag v. Commissioner*, in which the Supreme Court deemed a Tax Court "special trial judge" to be an inferior officer.[115] But, as *Landry* recognized, ALJs are different from those special trial judges.[116] The far greater role and powers of the special trial judges relative to Commission ALJs, in our view, makes *Freytag* inapposite here.

First, unlike the ALJs whose decisions are reviewed *de novo*, the special trial judges made factual findings to which the Tax Court was required to defer, unless clearly erroneous.[117] *Second*, the special trial judges were authorized by statute to "render the [final] decisions of the

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FDIC's ALJs in *Landry*. *See* 204 F.3d at 1134 (observing that the FDIC's ALJs make rulings on the "admissibility of evidence" and "discovery order[s]").

115 *Freytag*, 501 U.S. at 880-82. Respondents insist that Judge Randolph's concurring opinion in *Landry* had the better reading of *Freytag*. For the reasons given in text, we reject this argument. And in any event, Respondents would not be entitled to relief even under the reasoning of the *Landry* concurrence. Our review of ALJ's decisions—like that performed by the FDIC—is *de novo*; thus, given our "*de novo* review" and our "thorough rejection of [Respondents'] various claims of error" on the merits, Respondents "suffered no prejudice" from the manner of appointment of our ALJs. *Landry*, 204 F.3d at 1144 (Randolph, J., concurring).

116 *Landry*, 204 F.3d at 1133 (explaining that the special trial judges at issue in *Freytag* exercised "authority . . . not matched by the ALJs. . . .").

117 *See Landry*, 204 F.3d at 1133. Respondents argue that Commission ALJs exercise significant authority because the Commission accords "considerable weight" to those ALJ credibility findings that are based on witness demeanor. *Kenneth R. Ward*, Exchange Act Release No. 47535, 2003 WL 1447865, at *10 (Mar. 19, 2003), *aff'd*, 75 F. App'x 320 (5th Cir. 2003). We do not view the fact that we accord Commission ALJs deference in the context of demeanor-based credibility determinations to afford our ALJs with the type of authority that would qualify them as inferior officers. *First*, as we have repeatedly made clear, we do not accept such findings "blindly," and we will "disregard explicit determinations of credibility" when our *de novo* review of the record as a whole convinces us that a witness's testimony is credible (or not) or that the weight of the evidence warrants a different finding as to the ultimate facts at issue. *Ward*, 2003 WL 1447865, at *10; *accord Francis V. Lorenzo*, Exchange Act Release No. 74836, 2015 WL 1927763, at *10 n.32 (Apr. 29, 2015); *Ofirfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 WL 3199181, at *8 n.46 (Nov. 3, 2006); *see also Kay v. FCC*, 396 F.3d 1184, 1189 (D.C. Cir. 2005) ("The law is settled that an agency is not required to adopt the credibility determinations of an administrative law judge."). *Second*, our practice in this regard is no different from the FDIC's and so does not warrant a departure from *Landry*. *Compare [Redacted] Insured State Nonmember Bank*, FDIC-82-73a, 1984 WL 273918, at *5 (June 18, 1984) (stating, "as a general rule," that "the assessment of the credibility of witnesses" by the ALJ is given "deference" by the FDIC) *with Ramon M. Candelaria*, FDIC-95-62e, 1997 WL 211341, at *3-4 (Mar. 11, 1997) (noting that the FDIC's ALJ found respondent to be "entirely credible" but the Board rejected respondent's testimony "in light of the entire record").

Tax Court" in significant, fully-litigated proceedings involving declaratory judgments and amounts in controversy below $10,000.[118] As discussed above, our ALJs issue initial decisions that are not final unless the Commission takes some further action. *Third*, the Tax Court (and by extension the court's special tax judges) exercised "a portion of the judicial power of the United States," including the "authority to punish contempts by fine or imprisonment."[119] Commission ALJs, by contrast, do not possess such authority.[120]

Based on the foregoing, we conclude that the mix of duties and powers of our ALJs is similar in all material respects to the duties and role of the FDIC's ALJs in *Landry*.[121] Accordingly, we follow *Landry*, and we conclude that our ALJs are not "inferior officers" under the Appointments Clause.[122]

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118 *Freytag*, 501 U.S. at 882.

119 *Id.* at 891.

120 *See* 17 C.F.R. § 201.180. The Commission's rules provide ALJs with authority to punish contemptuous conduct only in the following ways. If a person engages in contemptuous conduct before the ALJ during any proceeding, the ALJ may "exclude that person from such hearing or conference, or any portion thereof," or "summarily suspend that person from representing others in the proceeding in which such conduct occurred for the duration, or any portion of the proceeding." *Id.* 201.180(a). Finally, if a party fails to make a required filing or to cure a deficiency with a filing, then a Commission ALJ may enter a default, dismiss the case, decide the particular matter at issue against the person, or prohibit the introduction of evidence or exclude testimony concerning that matter." *Id.* 201.180(c). Any such decision would, of course, be subject to *de novo* Commission review. And while Commission ALJs may issue subpoenas to compel noncompliance, they are powerless to enforce their subpoenas. The Commission itself would need to seek an order from a federal district court to compel compliance. *See* 15 U.S.C. § 78u(c). In this respect, too, our ALJs are akin to the FDIC's ALJs that *Landry* found to be mere employees. *See* 12 C.F.R. §§ 308.25(h), 308.26(c), 308.34(c) (providing that an aggrieved party must apply to a federal district court for enforcement of a subpoena issued by a FDIC ALJ).

121 Beyond *Landry*, we believe that our ALJs are properly deemed employees (rather than inferior officers) because this is how Congress has chosen to classify them, and that decision is entitled to considerable deference. *See Burnap v. United States*, 252 U.S. 512, 516 (1920). For example, Congress created and placed ALJ positions within the competitive service system, just like most other federal employees. *See infra* footnote 93. Like most other employees, an ALJ who believes that his employing agency has engaged in a prohibited personnel practice can seek redress either through the Office of Special Counsel or the Merit Systems Protection Board. *See* 5 U.S.C. §§ 1204, 1212, 1214, 1215, 1221. And ALJs—like other employees—are subject to reductions-in-force. *See id.* § 7521(b).

122 We do not find any relevance in the fact that the federal securities laws and our regulations at times refer to ALJs as "officers" or "hearing officers." There is no indication that Congress intended "officers" or "hearing officers" to be synonymous with "Officers of the United States," U.S. Const. art. II, § 2, cl. 2, and the word "officer" in our regulations has no such meaning. We also note in this regard that the Administrative Procedure Act "consistently

IV. Sanctions

The Division requests that we affirm the sanctions imposed below, including that (i) Lucia be barred from associating with an investment adviser, broker, or dealer; (ii) Respondents' investment adviser registrations be revoked; (iii) Respondents be ordered to cease and desist from further violations of the Advisers Act; and (iv) RJLC pay civil penalties of $250,000 and Lucia pay civil penalties of $50,000. We do so for the following reasons.

A. Bar from associating with an investment adviser, broker, or dealer

We may suspend or bar Lucia from associating with an investment adviser, broker, or dealer under Advisers Act Section 203(f) if we find that (i) he was associated with an investment adviser during the relevant period, (ii) he willfully violated, or willfully aided and abetted the violation of, the Advisers Act or its rules, and (iii) the sanction is in the public interest.[123] In addition, if we find that the latter two elements have been established, we may also suspend or bar Lucia from associating with a broker or dealer under Section 15(b)(6) of the Securities Exchange Act of 1934.[124]

There is no question that Lucia was associated with an investment adviser, and, as discussed above, we find that he willfully aided and abetted and caused RJLC's violations of Advisers Act Sections 206(1), (2), and (4) and Rule 206(4)-1(a)(5). Thus, we must determine whether a bar is in the public interest.

In assessing whether an associational bar would be in the public interest, we consider: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the respondent's recognition of the wrongful nature of his or her conduct, the sincerity of the respondent's assurances against future violations, and the likelihood that the respondent's occupation will present opportunities for future violations.[125] The remedy is intended to "protect[] the trading public from further harm," not to punish the respondent.[126] Our inquiry is flexible, and no one factor is dispositive.[127]

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uses the term 'officer' or the term 'officer, employee, or agent'" to "refer to [agency] staff members." Kenneth Culp Davis, *Separation of Functions in Administrative Agencies,* 61 HARV. L. REV. 612, 615 & n.11 (1948); *see also* 1 U.S.C. § 1 ("'officer' includes any person authorized by law to perform the duties of the office"). *Cf.* 5 U.S.C. §§ 556, 557 (referring to official who presides over evidentiary hearing as the "presiding employee").

123 15 U.S.C. § 80b-3(f).

124 15 U.S.C. § 78o(b)(6)(A)(i).

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

126 *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005).

127 *Kornman*, 2009 WL 367635, at *11.

Lucia's misconduct was egregious. As an investment adviser, Lucia owed fiduciary duties to his prospective clients.[128] Lucia violated those duties, and betrayed the trust and confidence of his prospective clients, by making the material misrepresentations and omissions discussed above. We have repeatedly stated 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."[129]

Lucia's misconduct was recurrent: he made the material misrepresentations and omissions in the slideshow at dozens of seminars every year during the relevant period. Lucia also acted with a high degree of scienter as he knowingly or recklessly misled prospective clients for the purpose of increasing RJLC's client base and the fees generated therefrom. Thus, Lucia repeatedly and intentionally placed his and RJLC's own interests over those of his prospective clients.

Lucia has not recognized the wrongful nature of his misconduct, and his failure to do so casts doubt on his assurances against future violations. In addition, because Lucia disregarded his fiduciary duties in the past in the manner shown here there is reason to believe that he will disregard them in the future.

Lucia's various arguments do not undermine the need for a bar or argue for a lesser remedy. Lucia contends that the credibility of his assurances and his recognition of wrongdoing are demonstrated by his decision to immediately stop using the backtest slides and withdraw his books from circulation after receiving the deficiency letter from OCIE on December 17, 2010, that outlined the deficiencies forming the basis of this proceeding.[130] These actions do weigh in Lucia's favor but they do not outweigh the concerns raised by his intentional and recurrent fraud.[131]

Lucia asserts that his occupation will not present opportunities for future violations because he has left the securities industry.[132] Lucia states that he wound down RJLC's

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128 *Capital Gains*, 375 U.S. at 194.

129 *Marshall E. Melton*, Advisers Act Release No. 2151, 2003 WL 21729839, at *9 (July 25, 2003); *Justin F. Ficken*, Advisers Act Release No. 2803, 2008 WL 4610345, at *3 (Oct. 17, 2008).

130 Lucia argues that his actions are comparable to those at issue in *Steadman*, in which the court vacated an injunction against an investment adviser in part because the alleged violations "were corrected immediately after the SEC notified the appellants that charges were pending." 967 F.2d at 648. But unlike our findings here, the *Steadman* court found that the defendants did not act with scienter and therefore did not violate federal securities antifraud provisions.

131 *Cf. Kornman*, 2009 WL 367635, at *11 (stating that assurances against future misconduct "are not an absolute guarantee against misconduct in the future"; the Commission weighs them against the other *Steadman* factors in assessing the public interest.).

132 Lucia claims that he "simply desires to continue serving as an in-demand public speaker, consultant, and media personality on retirement planning and other topics," and invites us to make clear that, if we impose a bar, such activity would not violate the bar. Lucia contends that

operations, sold its assets, and withdrew its investment adviser registration. Lucia also states that he is no longer associated with an investment adviser or broker-dealer, no longer holds a license as a registered representative, withdrew his own personal investment adviser registration, and has no intention of ever again being an investment adviser or registered representative of a broker-dealer. He also does not challenge the permanent revocation of his and RJLC's investment adviser registrations. Lucia contends that he has therefore demonstrated that his assurances against future violations are credible and that his occupation will not present opportunities for future violations.

But taking these steps does not ensure that Lucia will not seek to become associated again with an investment adviser, broker, or dealer. And like Lucia's decision to stop using the backtest slides, these steps do not make his assurances sufficient considering that he intentionally and repeatedly misled prospective clients to whom he owed fiduciary duties.[133] Thus, there is a reasonable likelihood that, without a bar, Lucia will again threaten the public interest by reassociating with an investment adviser, broker, or dealer.

Lucia asserts that several mitigating factors justify a lesser remedy. He contends that a bar would deter businesses from working with him in his career as a public media personality and therefore "propel[] him towards personal bankruptcy." But "[f]inancial loss to a wrongdoer as a result of his wrongdoing does not mitigate the gravity of his conduct."[134]

Lucia contends that he is a "40-year industry veteran with no disciplinary record." But his lack of previous securities law violations does not outweigh the concern that, for the reasons discussed above, Lucia will pose a continuing danger to investors if a bar is not imposed. Lucia's repeated misconduct for a prolonged period demonstrates that he has a propensity for conduct that would subject the investing public to future harm.

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such work is protected by the publisher exclusion to the definition of "investment adviser" in Advisers Act Section 202(a)(11), 15 U.S.C. § 80b-2(a)(11)(D), and is thus outside the scope of an associational bar. But because of "the inherent difficulty of enumerating every position that [Lucia] could take that would be prohibited by, or consistent with," a bar order, granting Lucia's request would undermine the remedial purpose of imposing a bar. *See James M. Schneider, CPA*, Exchange Act Release No. 69922, 2013 WL 3327751, at *5-6 (July 2, 2013) (order denying request that the Commission clarify that its Rule 102(e) suspension order did not preclude movant from accepting non-accounting positions). In any event, we note that the publisher exclusion concerns only who is considered an investment adviser, and not whether a person is *associated with* an investment adviser. The definition for "person associated with an investment adviser" is set forth in Adviser Act Section 202(a)(17), 15 U.S.C. § 80b-2(a)(17).

[133] Also, according to FINRA's BrokerCheck, Lucia did not end his association with investment adviser RJL Wealth Management, LLC, the successor firm to RJLC, until the initial decision was first issued in July 2013, thus casting further doubt on his intention to not reenter the industry. We may take official notice of this information on BrokerCheck, available at www.finra.org/Investors/ToolsCalculators/BrokerCheck. *See* 17 C.F.R. § 201.323 (rule of practice relating to official notice).

[134] *Kornman*, 2009 WL 367635, at *9 (internal quotation and citation omitted).

Lucia contends that there are no allegations of misappropriation, investor losses, or complaints by any seminar attendees about the presentation. But the absence of injury to RJLC's clients or prospective clients is not mitigating because our public interest analysis "focus[es] . . . on the welfare of investors generally and the threat one poses to investors and the markets in the future."[135]

Lucia argues that the initial decisions in *Corbin Jones*[136] and *Joseph C. Lavin*[137] demonstrate that investor losses are an important consideration. But these cases are inapposite because they involved findings that the respondents' violations were egregious, in part, because they caused investor losses.[138] While the absence of investor injury is not mitigating, its existence may be considered in determining the egregiousness of the respondent's actions.[139] Here, even without investor injury as an aggravating factor, Lucia's misconduct was egregious and a bar is in the public interest.

As an alternative to a bar, Lucia contends that it would be more appropriate to impose a censure and require undertakings such as "retain[ing] a monitor to ensure that any public presentations he makes do not utilize 'backtests' or hypothetical illustrations of relative strategy performance." Lucia contends that such remedies would be more in line with the lesser remedies imposed in seven settled Commission proceedings.[140] But we have repeatedly found that the remedies imposed in settled actions are inappropriate comparisons because pragmatic

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135 *Kornman*, 2009 WL 367635, at *9; *vFinance Invs., Inc.*, Exchange Act Release No. 62448, 2010 WL 2674858, at *17 (July 2, 2010); *see also Christopher A. Lowry*, Advisers Act Release No. 2052, 2002 WL 1997959, at *5 n.21 (Aug. 30, 2002) (finding that respondent's repayment to clients of funds he diverted from them did not "excuse[] his initial misrepresentations"), *aff'd*, 340 F.3d 501 (8th Cir. 2003); *James C. Dawson*, Advisers Act Release No. 3057, 2010 WL 2886183, at *3 (July 23, 2010) (barring respondent in part because his "dishonesty in defrauding his clients breached the trust that is the underpinning of the fiduciary relationship, regardless of whether there was any net loss of money to his clients").

136 Initial Decision Release No. 568, 2014 WL 668853 (Feb. 21, 2014).

137 Initial Decision Release No. 373, 2009 WL 613543 (March 10, 2009).

138 *Jones*, 2014 WL 668853, at *4; *Lavin*, 2009 WL 613543, at *5.

139 *See, e.g., Dawson*, 2010 WL 2886183, at *3 ("[O]ur finding that Dawson's conduct was egregious is based on the nature of the violation itself, not solely on any calculation of financial harm to his clients.").

140 Lucia cites *New England Inv. and Retirement Group, Inc.*, Advisers Act Release No. 3516, 2012 WL 6591597 (Dec. 18, 2012); *Modern Portfolio Mgmt., Inc.*, Advisers Act Release No. 3702, 2013 WL 5740461 (Oct. 23, 2013); *Equitas Capital Advisors, LLC*, Advisers Act Release No. 3704, 2013 WL 5740460 (Oct. 23, 2013); *Independent Fin. Group*, Advisers Act Release No. 1891, 2000 WL 1121531 (Aug. 8, 2000); *William J. Ferry*, Advisers Act Release No. 1747, 1998 WL 487681 (Aug. 19, 1998); *Meridian Inv. Mgmt. Corp.*, Advisers Act Release No. 1779, 1998 WL 898489 (Dec. 28, 1998); *LBS Capital Mgmt., Inc.*, Advisers Act Release No. 1644, 1997 WL 401055 (July 18, 1997).

considerations "such as the avoidance of time-and-manpower-consuming adversary proceedings," justify accepting lesser remedies in settlement.[141] In addition, the appropriate remedy depends on the facts and circumstances presented and cannot be determined precisely by comparison with actions taken in other cases.[142] Here, the alternative remedy that Lucia proposes do not provide sufficient protection for investors given the nature of his misconduct and the opportunity that continued association with an investment adviser, broker, or dealer would present for future violations.

Accordingly, we find that it is in the public interest to bar Lucia from associating with any investment adviser, broker, or dealer. A bar will prevent Lucia from putting investors at further risk and serve as a deterrent to others from engaging in similar misconduct.

B. Revocation of Respondents' investment adviser registrations

Under Advisers Act Section 203(e), we may suspend or revoke an investment adviser's registration if we find that (i) the investment adviser, or any person associated with it, willfully violated, or willfully aided and abetted the violation of, any provision of the Advisers Act and (ii) the sanction is in the public interest.[143] We consider the same public interest factors discussed above for determining whether to revoke an investment adviser's registration.[144]

Lucia states in his brief that "he makes no challenge to . . . ordering the registrations of [Respondents] as investment advisers permanently revoked." The evidence amply supports such revocation, for the reasons discussed above, as being necessary to protect the public interest.[145]

C. Cease-and-desist orders

Advisers Act Section 203(k) authorizes us to issue cease-and-desist orders for violations of the Advisers Act.[146] Such orders must be in the public interest, which we determine by

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141 *Michael C. Pattison, CPA*, Exchange Act Release No. 67900, 2012 WL 4320146, at *11-12 (Sept. 20, 2012) (quoting *Nassar and Co., Inc.*, 47 SEC 20, 26 & n.37 (1978)); *Ficken*, 2008 WL 4610345, at *4. We also note that settlements are not precedent. *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at *5 n.27 (June 29, 2012). The remedies imposed on Respondents are amply justified by our findings of violations, as discussed.

142 *Ficken*, 2008 WL 4610345, at *4; *see also Butz v. Glover Livestock Comm'n Co., Inc.*, 411 U.S. 182, 187 (1973) (holding that a sanction imposed within the authority of an administrative agency is "not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases"); *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) (holding that, because the "Commission is not obligated to make its sanctions uniform," the court would not compare the sanctions imposed in the case to those imposed in previous cases).

143 15 U.S.C. § 80b-3(e).

144 *See Sherwin Brown*, Advisers Act Release No. 3217, 2011 WL 2433279, at *6 (June 17, 2011).

145 Again, Lucia's conduct and level of intent are imputed to RJLC.

looking to whether there is some risk of future violation.[147] The risk "need not be very great" and is ordinarily established by a single past violation absent evidence to the contrary.[148] We also consider whether other factors demonstrate a risk of future violations, including the factors discussed above concerning Lucia's bar as well as whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought.[149] This inquiry is flexible, and no single factor is dispositive.[150]

Here, Respondents' violations, the egregiousness of their misconduct, and the other public interest factors discussed above establish a risk of future violations. Accordingly, we find that it is in the public interest to order Respondents to cease and desist from committing or causing any violations or future violations of Advisers Act Sections 206(1), 206(2), and 206(4) and Rule 206(4)-1.

D. Civil penalties

We may impose civil penalties under Advisers Act Section 203(i) if we find that Respondents willfully violated the Advisers Act and such penalties are in the public interest.[151] Both factors are satisfied here. Respondents repeatedly made fraudulent misstatements and omissions in willful violation of the Advisers Act and their fiduciary duties. Their conduct was egregious and thus warrants the imposition of penalties as a deterrent to Respondents and others against committing similar violations. Such considerations are not outweighed by Respondents' clean disciplinary history or the lack of evidence concerning investor loss or unjust enrichment.

Also, because Respondents' violations involved fraud and were in reckless disregard of a regulatory requirement, we find that second-tier penalties are warranted.[152] Therefore, because

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146 15 U.S.C. § 80b-3(k).

147 *Robert L. Burns*, Advisers Act Release No. 3260, 2011 WL 3407859, at *8 n.34 (Aug. 5, 2011).

148 *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *24 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

149 *Id.* at *26.

150 *Id.*

151 15 U.S.C. § 80b-3(i). In determining whether penalties are in the public interest, we consider: (i) whether the act or omission involved fraud; (ii) whether the act or omission resulted in harm to others; (iii) the extent to which any person was unjustly enriched; (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. *Id.*

152 Section 203(i) establishes a three-tier system for calculating penalties: (i) first-tier penalties are permissible for securities law violations; (ii) second-tier penalties are permissible for securities law violations involving "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement"; and (iii) third-tier penalties are permissible for violations that satisfy the second-tier penalty requirements and "directly or indirectly resulted in substantial

the amounts imposed by the ALJ ($250,000 upon RJLC and $50,000 upon Lucia) are within the permissible second-tier range,[153] and are in the public interest, we grant the Division's request and impose those same amounts upon Respondents.[154]

Respondents contend that penalties are unwarranted against RJLC because it has no assets or operations, is no longer registered as an investment adviser, and is a dormant corporate shell. Respondents also contend that imposing an uncollectable penalty against RJLC will prejudice Lucia without any benefit to the public interest. These contentions are meritless. If RJLC lacked the ability to pay penalties, it was required under Commission Rule 630(a) to present evidence thereof.[155] It has failed to do so.[156] Respondents also have not explained how Lucia would be prejudiced if we order RJLC to pay penalties.

Accordingly, we find that it is in the public interest to impose second-tier penalties of $250,000 upon RJLC and $50,000 upon Lucia.

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losses or created significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission." *Id.*; 17 C.F.R. § 201.1004.

153 The maximum second-tier penalty the Commission could impose for a single act of misconduct is $375,000 for RJLC and $75,000 for Lucia. 17 C.F.R. § 201.1004 & Pt. 201, Subpt. E, Tbl. IV.

154 Although the amounts imposed by the ALJ are within the second-tier range, he categorized them as third-tier penalties. We find that this categorization was unwarranted because the Division did not establish: (i) that Respondents' clients or prospective clients suffered any losses or were at significant risk of suffering substantial losses or (ii) whether Respondents' gain from the fraud was substantial. For the latter consideration, while the Division introduced evidence showing that Respondents' business was profitable, it did not demonstrate the extent to which Respondents' misconduct was responsible for that profit. In any event, we find that the amounts imposed are warranted as second-tier penalties for the reasons discussed above.

155 17 C.F.R. § 201.630(a).

156 Respondents also have waived their right to assert the defense of inability to pay because they did not raise the issue before the ALJ. *David Henry Disraeli*, Advisers Act Release No. 2686, 2007 WL 4481515, at *19 (Dec. 21, 2007), *aff'd*, 334 F. App'x 334 (D.C. Cir. 2009).

An appropriate order will issue.[157]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN); Commissioners GALLAGHER and PIWOWAR, dissenting. A dissenting opinion will issue separately.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75837 / September 3, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4190 / September 3, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31806 / September 3, 2015

Admin. Proc. File No. 3-15006

In the Matter of

RAYMOND J. LUCIA COMPANIES, INC.
and
RAYMOND J. LUCIA, SR.

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Raymond J. Lucia, Sr. be barred from association with any investment adviser, broker, or dealer; and it is further

ORDERED that the investment adviser registrations of Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr. are revoked; and it is further

ORDERED that Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr. cease and desist from committing or causing any violations or future violations of Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-1; and it is further

ORDERED that Raymond J. Lucia Companies, Inc. pay a civil money penalty of $250,000; and it is further

ORDERED that Raymond J. Lucia, Sr. pay a civil money penalty of $50,000.

Payment of the civil money penalty shall be (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK

73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Commissioner Aguilar
Not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75838 / September 3, 2015

Admin. Proc. File No. 3-15916

In the Matter of the Application of

DENISE M. OLSON
c/o Bruce M. Bettigole, Esq.
Sutherland Asbill & Brennan LLP
700 Sixth Street, NW, Suite 700
Washington, DC 20001-3980

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Conversion of firm funds

Associated person of member firm of registered securities association falsified an expense report and converted firm funds. *Held*, association's findings of violation and imposition of sanctions are sustained.

APPEARANCES:

Bruce M. Bettigole, Esq., of Sutherland Asbill & Brennan LLP, for Denise M. Olson.

Alan Lawhead, Esq., *Andrew Love, Esq.*, and *Gary Dernelle, Esq.*, for FINRA.

Appeal filed: June 9, 2014
Last brief received: September 9, 2014

Denise M. Olson, formerly a general securities representative and general securities sales supervisor associated with Wells Fargo Advisors, LLC ("Wells Fargo" or the "Firm"), a FINRA member, seeks review of FINRA disciplinary action based on findings that she violated FINRA Rule 2010. Rule 2010 requires that FINRA members and their associated persons "observe high standards of commercial honor and just and equitable principles of trade."[1] Olson admits that she violated the Rule by falsifying an expense report and converting Firm funds. But she challenges the bar imposed and seeks "a reduced sanction."[2] We sustain FINRA's findings of violation and the sanctions imposed based on our independent review of the record.

I. Background

Olson was associated with Wells Fargo from September 2004 to June 2010, serving as the branch manager of its Bloomington, Minnesota office. In that position, Olson was issued a corporate credit card through Wells Fargo. Under the Firm's expense allowance policy, Olson was permitted to use the corporate credit card for both business and personal expenses, but was wholly responsible for any personal expenses charged to the card.

It is undisputed that, on April 2, 2010, Olson used her corporate credit card to purchase two Apple iPods as gifts for her niece and nephew. The total charge for the iPods was $740.10. Although the charge was unquestionably personal, Olson accounted for it in Wells Fargo's expense management system as a business expense. She falsely claimed that it was incurred to purchase office equipment, entering the description "branch equip for new cof room" in the space provided to justify the outlay as a business expense. Consequently, the Firm paid the $740.10 charge.

As Olson later testified, her falsification of the expense report was "intentional," and done because she had a "fleeting thought" while completing the expense report that she had purchased two refrigerators a few months earlier for the Firm but had never sought reimbursement.[3] Olson felt that, if Wells Fargo paid for the iPods, it would compensate for the refrigerators.

Shortly thereafter, in May 2010, Wells Fargo's corporate security division began an investigation into Olson's use of the credit card when it noticed "discrepancies" in Olson's expense report. As a result, on June 2, 2010, a Firm auditor met with Olson to review the descriptions Olson had entered for each of her charges during an eight-month period (including the iPod purchase). Olson testified that when the auditor reached the $740.10 charge for the iPods, Olson read the description she had entered for it ("branch equip for new cof room"), and repeated that it was a business expense for branch office equipment that she had purchased for a

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1 Although Rule 2010 applies to FINRA members, FINRA Rule 0140(a) provides that "[p]ersons associated with a member shall have the same duties and obligations as a member under the Rules."

2 Olson does not challenge FINRA's order that she pay costs totaling $3,378.56, which we also sustain.

3 Olson testified that she bought the refrigerators as a way "of giving back to the branch" and that she never sought reimbursement because she "didn't have any intention of being reimbursed for them."

conference room. But, according to Olson, when the auditor then asked her which conference room, Olson "looked at the dollar amount and . . . realized that [it] was actually [her] iPod purchase." Olson testified that she then volunteered that the charge was actually for a personal expense and, at the auditor's request, wrote and signed a statement to that effect.[4] Wells Fargo then immediately terminated Olson. Olson also reimbursed the Firm, at the Firm's request, for the $740.10 charge.

The Firm reported Olson's termination to FINRA, which instituted its own investigation. On October 7, 2011, FINRA's Department of Enforcement filed a complaint alleging that Olson violated Rule 2010 by filing a false expense report and converting firm funds. Because Olson conceded that she violated Rule 2010 and largely admitted the facts alleged in the complaint, the subsequent disciplinary hearing was limited to the issue of sanctions.

On January 4, 2013, a FINRA hearing panel issued a decision finding that Olson had engaged in the alleged violation and barring Olson from further association with any FINRA member firm. Olson appealed and FINRA's Board of Governors affirmed the hearing panel decision.[5] This appeal followed.

II. Olson violated FINRA Rule 2010.

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization disciplinary actions.[6] Pursuant to Section 19(e)(1) of the Securities Exchange Act of 1934, in reviewing an SRO disciplinary action, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violates the SRO's rules, and whether such SRO rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[7]

As noted, Rule 2010 requires that FINRA members and associated persons "observe high standards of commercial honor and just and equitable principles of trade."[8] Falsification of

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4 Olson also wrote in her statement that she had paid for items "for the branch and not charged the office for them," including "two [n]ew [r]efrigerators at a [c]ost of [a]pproximately $2,000," and that she "felt that in the end it would have possibly balanced itself out."

5 Olson's appeal of the hearing panel decision was to FINRA's National Adjudicatory Council, but the Board exercised its discretion to call the proceeding for review under FINRA Rule 9351(a).

6 *See Gregory Evan Goldstein*, Exchange Act Release No. 71970, 2014 WL 1494527, at *3 (Apr. 17, 2014).

7 15 U.S.C. § 78s(e)(1). Olson does not argue, and the record does not support a finding, that Rule 2010 is, or FINRA's application of it was, inconsistent with the purposes of the Exchange Act.

8 Rule 2010 encompasses "business-related conduct that is inconsistent with just and equitable principles of trade, even if that activity does not involve a security," and misconduct that "reflects on the associated person's ability to comply with the regulatory requirements of the securities business and to fulfill his fiduciary duties in handling other people's money." *Daniel*

expense reports and conversion are inconsistent with those requirements.[9] Here, Olson admitted that she falsified an expense report and converted $740.10 from Wells Fargo in violation of Rule 2010, and her admission is supported by the record evidence. The record includes, among other things, Olson's testimony admitting that she intentionally caused Wells Fargo to pay for her purchase of iPods by falsifying an expense report, Olson's handwritten statement admitting the same to Wells Fargo, and a copy of the falsified expense report. Accordingly, we find that Olson engaged in the conduct found by FINRA, and that such conduct violates Rule 2010.

III. The bar imposed is neither excessive nor oppressive.

A. Standard of review

Olson does not dispute the relevant facts or, as mentioned, that she violated Rule 2010. Rather, she asserts that the sanction is too harsh for what she describes as a "single fleeting mistake." Pursuant to Exchange Act Section 19(e)(2), we will sustain a FINRA sanction unless we find it is "excessive or oppressive" or imposes an unnecessary or inappropriate burden on competition.[10] As part of this review, we consider any aggravating or mitigating factors[11] and whether the sanctions imposed by FINRA are remedial in nature and not punitive.[12]

B. A bar is a standard sanction for conversion under FINRA's Sanction Guidelines.

FINRA's Sanction Guidelines state that "a bar is standard" for conversion "regardless of [the] amount converted."[13] This approach reflects the judgment that, absent mitigating factors,[14]

D. Manoff, Exchange Act Release No. 46708, 2002 WL 31769236, at *4 (Oct. 23, 2002) (internal quotation omitted).

9 *E.g., John M.E. Saad*, Exchange Act Release No. 62178, 2010 WL 2111287, at *4-5 (May 26, 2010), *rev'd on other grounds*, 718 F.3d 904 (D.C. Cir. 2013), *see also* Guidelines, at 36 (considering falsification of records and conversion to be Rule 2010 violations).

10 15 U.S.C. § 78s(e)(2). Olson does not claim, and the record does not show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

11 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

12 *Paz Sec., Inc.*, 494 F.3d at 1065; *see also* Guidelines, at 2 ("Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.").

13 Although we are not bound by FINRA's Sanction Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2).[13] *John Joseph Plunkett,* Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013). In considering the Guidelines, we note that they "do not prescribe fixed sanctions for particular violations" and "are not intended to be absolute."

We further note that the Board applied the Guidelines issued in 2013, while the hearing panel applied the Guidelines issued in 2011. But that discrepancy presents no issue here because conversion "poses so substantial a risk to investors and/or the markets as to render the violator unfit for employment in the securities industry."[15] Indeed, conversion is antithetical to the basic requirement that customers and firms must be able to trust securities professionals with their money.[16]

C. Aggravating factors

The Board identified four aggravating factors that further supported its determination to impose a bar: (i) Olson's misconduct was intentional; (ii) Olson attempted to conceal her misconduct and deceive the Firm; (iii) Olson's misconduct resulted in injury to the Firm; and (iv) Olson's misconduct resulted in her monetary gain.

First, Olson admits that her misconduct was intentional and that this factor is considered aggravating under Principal Consideration 13 of the Guidelines.[17] But Olson contends that her misconduct nevertheless was done in a "foolish, fleeting moment" and was "of far less consequence than circumstances involving careful pre-meditation and elaborate planning." While it is true that Olson's misconduct did not require elaborate planning, this does not diminish Olson's high level of scienter. We also reject Olson's characterization of her misconduct and mental state as "fleeting," considering that Olson allowed her deception to continue for over a month until she was caught. If Olson's intentional misconduct was "fleeting," she would have recognized her wrongdoing and corrected it. Instead, as Olson testified, she had no concerns about what she had done between the time she submitted the false expense report and her meeting with the Firm auditor.

Second, Olson admits that she attempted to conceal her misconduct and deceive Wells Fargo. She contends, however, that this should not be considered aggravating under Principal

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the sections applied from those versions are identical. For ease of reference, we cite to only the 2013 version of the Guidelines.

14 The Guidelines include a list of non-exhaustive aggravating and mitigating factors (*i.e.*, "Principal Considerations"), and state that, "as appropriate, Adjudicators should consider case-specific factors in addition to those listed." Guidelines, at 6-7.

15 *Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 WL 3306105, at *5 n.27 (Nov. 8, 2007).

16 *See John Edward Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at *18 (Feb. 10, 2012) (Conversion "is extremely serious and patently antithetical to the high standards of commercial honor and just and equitable principles of trade that underpin the self-regulation of the securities markets." (internal quotation omitted)); *Joseph H. O'Brien II*, Exchange Act Release No. 34105, 1994 WL 234279, at *3 (May 25, 1994) ("In converting [customer] funds, O'Brien abused the trust that is the cornerstone of the relationship between a securities professional and his customer.").

17 *See* Guidelines at 7 (listing as Principal Consideration 13, "Whether the respondent's misconduct was the result of an intentional act, recklessness or negligence"); *see also Mullins*, 2012 WL 423413, at *18 (finding that the seriousness of respondent's conversion was aggravated because he "acted with intent when he used the Foundation's property for himself").

Consideration 10 of the Guidelines[18] because deception is a component of conversion, not separate from it. Rather, Olson contends that the focus of Principal Consideration 10 is on attempts to mislead firm investigators and FINRA, and that "[f]ar from such evasion of responsibility, she cooperated with the investigations by Wells Fargo prior to detection. . . ." We reject these contentions.

Although deception is often present in conversion cases, it is not an element of conversion.[19] There is also no reason to believe that Principal Consideration 10 covers only concealment from firm investigators or FINRA because (i) it does not draw such a distinction; and (ii) a separate Principal Consideration—No. 12—covers attempts to conceal information from FINRA "in its examination and/or investigation of the underlying misconduct."[20] And we have previously found conversion to have been aggravated when respondents concealed it from their victims.[21] Accordingly, because Olson concealed her misconduct from the Firm for over a month, we find her deception to be a significant factor supporting a bar.[22]

Third, Olson admits that her misconduct resulted in harm to Wells Fargo and monetary gain to herself, and that these factors are considered aggravating under Principal Considerations 11 and 17.[23] But while Olson acknowledges that she was not entitled to convert Wells Fargo's money to receive reimbursement for her other purchases, she attempts to downplay the harm she caused by pointing out that she paid more for the two refrigerators and "many other purchases" for the Firm than the $740.10 that she converted from it. We do not dismiss the harm to Wells Fargo so easily.

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18 *See* Guidelines at 6 (listing as Principal Consideration 10, "Whether the respondent attempted to conceal his or her misconduct or to lull into inactivity, mislead, [or] deceive . . . the member firm with which he or she is/was associated").

19 Guidelines, at 36 ("Conversion generally is an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it."); *see also O'Brien*, 1994 WL 234279, at *1-3 (finding that respondent converted funds from a customer's securities account where respondent informed his customer that he was taking the funds, against the customer's wishes, to cover a disputed fee for bookkeeping services).

20 Guidelines, at 7.

21 *See Mission Sec. Corp.*, Exchange Act Release No. 63453, 2010 WL 5092727, at *13 (Dec. 7, 2010).

22 Olson also contends that her submission of a false expense report was the only act of concealment, and that "[t]here was no prolonged, elaborate subterfuge." Even assuming that this is true, that one act is sufficient to bring Principal Consideration 10 into play.

23 *See* Guidelines at 6 (listing as Principal Consideration 11, "[W]hether the respondent's misconduct resulted directly or indirectly in injury to [the member firm], and . . . the nature and extent of the injury"); *see id.* at 7 (listing as Principal Consideration 17, "Whether the respondent's misconduct resulted in the potential for the respondent's monetary or other gain").

At no time in this proceeding has Olson established that she was entitled to reimbursement for any purchases she made for the Firm. As to the refrigerators, it appears from Olson's testimony that she made a unilateral decision to purchase them without seeking prior authorization.[24] And because Olson decided not to submit an expense report for the purchase, it is unclear whether Wells Fargo would have reimbursed her. Olson also has not introduced evidence to establish specific "other purchases" she made for the Firm or their dollar amounts. We therefore find no basis for offsetting the $740.10 that she converted by the cost of the refrigerators or any other purchases she may have made. Moreover, even if Olson had established that Wells Fargo owed her money, we would not offset such amounts against the $740.10 that she converted because, as we have held, securities professionals are not entitled to self-help in this manner.[25] To do so would be to countenance conversion under such circumstances. Thus, we consider as aggravating that Wells Fargo was harmed by, and Olson was enriched by, the misconduct.

D. Mitigating factors

Olson points to several mitigating factors and we find that four of them weigh in her favor.[26] But considering the severity of Olson's intentional misconduct, and the deception involved in carrying it out, the mitigating factors here taken together do not outweigh the continuing danger that Olson poses to investors. We discuss each of Olson's contentions concerning mitigation in turn, beginning with the four in her favor.

First, Olson contends, and we agree, that the Board erred when it declined to consider as mitigating that Wells Fargo terminated her prior to regulatory detection. Principal Consideration 14 of the Guidelines specifically states that, in imposing sanctions, adjudicators must consider "[w]hether the member firm . . . disciplined the respondent for the same misconduct at issue prior to regulatory detection." Principal Consideration 14 appears to apply here because Olson's termination occurred as a result of her misconduct and because FINRA opened its investigation subsequent to the termination.

In its opinion, the Board acknowledged Principal Consideration 14 but stated that, as a general matter, it "give[s] no weight to the fact that a respondent was terminated by a firm when

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24 Olson testified that she "made a decision to go buy new refrigerators" on the last day of office renovations because the refrigerator in storage "was filled with mold," and that she had no intention of being reimbursed. Olson's supervisor testified that when the Firm remodels an office, they "have a division at the corporation that takes care of getting chairs and appliances and TVs and everything else." The supervisor further testified that he was unaware that Olson had purchased the refrigerators.

25 *See O'Brien*, 1994 WL 234279, at *2 (finding that the president of a member firm did not have authority to remove funds from a customer's account simply because the customer owed him money).

26 Olson contends that FINRA "effectively ignored any and all mitigating factors because of excessive focus on the fact that the Guideline for 'conversion' states that a bar is 'standard' regardless of the amount converted."

determining the appropriate sanction in a disciplinary case."[27] But because that general policy contradicts FINRA's published Guidelines, we find Olson's termination by Wells Fargo to be mitigating.[28] We also find, however, that the mitigating effect from Olson's termination is no guarantee of changed behavior, and it is not enough to overcome our concern that Olson poses a continuing danger to investors and other securities industry participants (including would-be employers) for the reasons discussed above.[29]

Second, we agree with Olson that she should have received credit under Principal Considerations 8 and 9 because her single act of misconduct "was of short duration" and "did not involve a pattern of wrongdoing."[30] The Board found that, while the presence of the factors in Principal Considerations 8 and 9 might be aggravating, "their absence does not draw an inference of mitigation."[31] But the Board's finding conflicts with precedent in which we sustained a decision of the NASD, FINRA's predecessor, that credited as mitigating misconduct that was

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27 *Denise M. Olson*, Complaint No. 2010023349601, 2014 WL 1878984, at *7 n. 19 (FINRA Bd. of Governors May 9, 2014). The Board stated that it also gave Olson no credit for her termination because "Wells Fargo terminated Olson for what it termed a 'violation of company policy,'" whereas the Board was "imposing sanctions for conversion." *Olson*, 2014 WL 1878984, at *7 n. 19. But that is a distinction without a difference because conversion was the "violation of company policy" for which Olson was terminated. Thus, Wells Fargo disciplined Olson "for the same misconduct at issue" here as contemplated by Principal Consideration 14.

28 *See Saad*, 718 F.3d at 913 (remanding in part because the Commission did not consider that "Saad's firm . . . disciplined him by terminating his employment in September of 2006, prior to regulatory detection").

29 Olson also notes certain collateral consequences of her termination. In particular, Olson states that she "is a single mother whose ex-husband provides no financial support," and that after her termination "she was unemployed for nine months, depleted her 401(k) account to pay monthly expenses for her daughter and herself, and ultimately moved in with her parents." Olson also states that when she was eventually hired as a recruiter at Ameriprise Financial, she earned substantially less—"$70,000 plus the possibility of small bonuses"—than her approximately $200,000 annual income at Wells Fargo. But we agree with the Board that such collateral consequences are not mitigating "because they are a result of [her] misconduct." *Olson*, 2014 WL 1878984, at *7 n.19 (quoting *Jason A. Craig*, Exchange Act Release No. 59137, 2008 WL 5328784, at *7 (Dec. 22, 2008)); *see also Kent M. Houston*, Exchange Act Release No. 71589A, 2014 WL 936398, at *8 (Feb. 20, 2014) (finding that collateral consequences from respondent's misconduct were not mitigating factors).

30 Guidelines, at 6 (listing as Principal Considerations 8, "Whether the respondent engaged in numerous acts and/or a pattern of misconduct"; and listing as Principal Consideration 9, "Whether the respondent engaged in the misconduct over an extended period of time"). In seeking mitigation under Principal Considerations 8 and 9, Olson also asserts that her misconduct "represented an aberrant lapse in judgment." We reject this characterization of Olson's misconduct considering that it was committed with scienter and deceit.

31 *Olson*, 2014 WL 1878984, at *7 n.18 (quoting Guidelines, at 6).

"neither numerous nor made over an extended period of time."[32] That being said, we give little weight to the mitigating effect of these factors because we agree with the Board that "[t]he Guideline for conversion, which states that a bar is standard 'regardless of [the] amount converted,' obviously indicates that a single instance of theft provides ample justification to bar an individual from the securities industry, no matter the sum involved."[33] We also find that the mitigating effect of these factors does not outweigh our concern discussed above that Olson poses a continuing danger to investors.

Third, we agree with Olson that the Board should have considered as mitigating that she has repeatedly admitted her misconduct and expressed remorse from the time she was questioned by the Firm auditor through the present, and that she promises not to repeat her misconduct.[34] While the Guidelines do not address these factors,[35] we consistently have sustained FINRA's decision to consider them mitigating.[36] Nonetheless, given the circumstances of Olson's deceit for her own profit, we find that Olson's admissions, expressions of remorse, and assurances do not outweigh our concern that she presents a continuing threat to investors.

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32 *Michael Frederick Siegel*, Exchange Act Release No. 58737, 2008 WL 4528192, at *12 (Oct. 6, 2008), *pet. granted in part on other grounds*, 592 F.3d 147, 157 (D.C. Cir. 2010) ("Siegel does point to a number of factors that the Commission concluded had some mitigating impact: that his acts of misconduct were neither numerous nor made over an extended period of time. . . ."). If FINRA has decided to change its approach to applying Principal Considerations 8 and 9, it will need to revise its Guidelines.

33 *Olson*, 2014 WL 1878984, at *7 n.18.

34 Olson contends that her genuine remorse is uncontested, that she "was in tears for most of the hearing," and that a dissenting hearing panelist "noted [that] Ms. Olson was 'extremely credible,' 'truly remorseful,' and 'genuinely ashamed of her behavior.'" The panel's majority, however, concluded that Olson's repayment of Wells Fargo for the iPods "was a result of being caught, not of being honest or remorseful." *Dep't of Enforcement v. Olson*, No. 2010023349601, 2013 WL 2146648 (FINRA Hearing Panel Jan. 4, 2013). In any event, as discussed above, we give Olson credit for expressing remorse.

35 We consider these factors to be separate from Principal Consideration 2 concerning acceptance of responsibility. The latter concerns situations where a firm or regulator has not detected a person's misconduct, but the person nonetheless turns herself in. It generally demonstrates a much deeper understanding by the person of the wrongfulness of her conduct and ownership over it.

36 *E.g., Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 WL 32128, at *9 (Jan. 6, 2012) (sustaining FINRA's sanctions assessment, including that "it provide[d] some measure of mitigation that DiFrancesco ha[d] been forthcoming in admitting throughout these proceedings that he" committed the alleged misconduct); *Alvin W. Gebhart, Jr.*, Exchange Act Release No. 58951, 2008 WL 4936788, at *12 (Nov. 14, 2008) ("NASD also gave only little mitigative value to the Gebharts' professed remorse, which NASD found to be 'dampened' by the Gebharts' attempts to shift blame to others involved . . . . We conclude that NASD appropriately weighed the aggravating and mitigating factors relevant to imposing sanctions for fraud under its Sanction Guidelines."), *pet. denied*, 595 F.3d 1034 (9th Cir. 2010).

Olson's remaining contentions concerning mitigation lack merit. Olson contends that she has accepted responsibility for and acknowledged her misconduct as contemplated by Principal Consideration 2, which considers acceptance of responsibility to be mitigating if made to the individual's firm or a regulator "prior to detection and intervention by the firm . . . or a regulator."[37] Olson contends that her admission came before the Firm detected her misconduct because, when the Firm auditor questioned her about the iPod charge, the auditor did not "indicat[e] any awareness that the $740.10 charge was really a personal expense" or "confront[] her with any accusation." Thus, Olson contends that she volunteered her wrongdoing without being confronted. We reject this contention.

At no point did Olson, realizing that what she had done was wrong, turn herself in to Wells Fargo in an attempt to rectify the situation and accept responsibility. To the contrary, Olson testified that between the time she submitted the false expense report and the time she was questioned by the Firm auditor, she was neither concerned nor bothered by her wrongdoing.[38] The record is also clear that Wells Fargo detected Olson's misconduct and intervened before Olson's admission. Indeed, the Firm's corporate security division contacted Olson's supervisor, Frank Mirabella, in May 2010 because it had identified "discrepancies" in Olson's expense report, and requested that Mirabella set up a meeting with Olson so that the auditor could question her. Olson testified that, when she arrived at Mirabella's office for the meeting on June 2, 2010, she did not know the purpose for the meeting and was diverted from Mirabella's office "into a room where there was an auditor and another person waiting for" her.[39] Olson testified that, after she admitted her misconduct, the auditor "left the room" and "a few moments later [Mirabella] came back and read . . . a prepared statement that [Olson] was being terminated."[40] The statement, which the Firm's human resources department apparently prepared in advance of the meeting, stated that the Firm had "been conducting an investigation into [Olson's] use of the Corporate Card" and "uncovered . . . certain personal expenses that make it clear that [Olson had] submitted a personal charge on the Corporate Card as a business expense."

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37 Guidelines, at 6. Again, we consider Principal Consideration 2 to be separate from Olson's admissions, expressions of remorse, and assurances against future violations after she was caught. Acceptance of responsibility goes beyond these factors.

38 Olson also testified: "[W]hile I'm being terminated I realized that [the Firm] took it much more serious[ly]. I mean, obviously, I was terminated for it, so, yes, I realized when I was terminated that I should never have marked it as a business expense, whether I had paid for refrigerators out of my own pocket or not."

39 Olson testified that she arrived at Mirabella's office assuming that Mirabella wanted to discuss an upcoming meeting that Olson was hosting for advisors.

40 Olson argues that Mirabella was given the statement only after Olson admitted her misconduct, thus demonstrating no detection or intervention by the Firm before Olson's admission. But the human resources department's very preparation of the statement in advance of the meeting is strong evidence that the Firm had detected the conversion and decided to terminate Olson for it.

Thus, we find that Olson's admission came too late to be mitigating under Principal Consideration 2 because the Firm had already detected the misconduct and intervened.[41] We also find that Principal Consideration 2 is unavailable to Olson to the extent she is arguing that, regardless of whether the Firm detected her misconduct, she should receive credit for confessing without being aware of the Firm's suspicions. Considering that Olson intentionally converted her Firm's money by filing a false expense report, it seems likely that she had her misconduct in mind, and the possibility that her Firm may be suspicious, when she was being questioned about that false expense report. There is also no reason to believe that Olson would have confessed her misconduct if she had not been questioned by the auditor.

Olson contends that we should consider as mitigating her voluntary repayment to Wells Fargo, even though Wells Fargo "should have viewed [her purchase of refrigerators] as a sufficient set off" against the iPod purchase. We reject this contention because voluntary repayment is only considered mitigating under the Guidelines when made "prior to detection and intervention."[42] Here, because Olson reimbursed Wells Fargo only after it detected her misconduct and intervened, and only because it requested that she do so, we find that such reimbursement does not mitigate her misconduct. Also, we have no reason to believe that Olson would have reimbursed Wells Fargo had it not detected her misconduct. To the contrary, Olson's assertion that Wells Fargo should not have sought reimbursement indicates that she only paid back the $740.10 because she got caught.[43]

Olson contends that we should consider as mitigating that she is not motivated by greed and therefore is not at risk of committing future violations. Olson contends this is demonstrated by her "generosity regarding the refrigerators, as well as the many other times that she paid out of her own pocket to benefit the firm."[44] We disagree. Even if Olson purchased the refrigerators

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41 Olson also disputes the Board's finding that, when questioned by the auditor, Olson "initially clung to the falsehood that the expense in question was a business expense," and that "[i]nstead of accepting responsibility, she resisted it until her lie became undeniable." Olson contends that she admitted her misconduct without evasion. But we need not decide this factual issue because we find that Olson's admission of wrongdoing came too late to be mitigating under Principal Consideration 2.

42 Guidelines, at 6 (Principal Consideration No. 4); *see, e.g., Eliezer Gurfel*, Exchange Act Release No. 41229, 1999 WL 172666, at *4 (March 30, 1999) (sustaining bar for conversion and noting that the "NASD was unimpressed by Gurfel's repayment of funds to IMMG, since Gurfel gave back the money only after he was caught, and there was no evidence suggesting Gurfel otherwise would have repaid IMMG"), *pet. denied*, 205 F.3d 400 (D.C. Cir. 2000).

43 To the extent that Olson is arguing that she should receive credit for paying Wells Fargo substantially more than she owed it, as discussed above, Olson has not established that she was entitled to reimbursement for the refrigerators. And even if she had established that fact, we still would give her no mitigation credit by setting off those amounts. To do so would be akin to finding that Olson's conversion was to some degree justified.

44 Olson states that she also "paid out of her own pocket to buy decorative items and furniture for the office and meals for the staff" and "used her own money to pay bonuses to the staff."

because she wanted to be generous with her Firm, Olson clearly had a change of heart when she decided to submit a false expense report to recoup money that she thought the Firm owed her for the purchase. And as Olson's contention above makes clear, she still believes the Firm owes her money for the refrigerators. As a result, we give Olson no credit for her purported generosity.[45]

Olson contends that she should receive credit because she did not harm any investors. But we agree with the Board that "Olson's misconduct was no less serious because it did not involve customers."[46] Moreover, our assessment of the future threat Olson poses to customers does not turn on whether she converted funds from Wells Fargo or an investor.[47]

Finally, Olson contends that her lack of disciplinary history should be considered mitigating.[48] But the Guidelines reject this factor as mitigating[49] because an associated person should not be rewarded for acting in accordance with her duties as a securities professional.[50]

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45 *Cf. Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 WL 358737, at *26 (Feb. 1, 2010) ("Katz's assertion that she was a nice person who did a good job for her clients . . . do not warrant a lesser sanction, as her misconduct demonstrated a readiness to put her own interests ahead of her clients."), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011). In any event, to the extent that Olson is entitled to any credit for generosity she has shown her Firm, such credit does not outweigh our concern discussed above that she poses a risk of committing future violations.

46 *Olson*, 2014 WL 1878984, at *7 n.17 (citing *Richard Dale Grafman*, Exchange Act Release No. 21648, 1985 WL 548687, at *2 n.2 (Jan. 14, 1985) ("[W]e do not agree with Grafman that his misconduct was somehow less serious because it did not involve public customers. The fact that he defrauded a brokerage firm instead is hardly a factor in his favor.").

47 *Blair Alexander West*, Exchange Act Release No. 74030, 2015 WL 137266, at *13 (Jan. 9, 2015) ("The absence of . . . customer harm is not mitigating, as our public interest analysis focus[es] . . . on the welfare of investors generally."). Olson notes that, at the time of the hearing, she "was employed as a recruiter for Ameriprise Financial, where she had no client contact." To the extent Olson contends that this is mitigating, we find that Olson's current employment does not guarantee that she will not have client contact in the future.

48 Olson made two additional contentions during oral argument before the NAC that she did not repeat in her briefing to us, and that are accordingly waived: (1) FINRA could have devised a sanction less than a bar, such as requiring "close heightened supervision," to ensure that Olson does not "steal money from customers"; and (2) two of Olson's supervisors (one at Wachovia Securities, Inc. before the events at issue and one at Ameriprise after) testified that Olson "is not the kind of person that . . . was ever going to do anything wrong again." Moreover, as to the former contention, Exchange Act Section 19(e)(2) requires that we determine whether the bar imposed is "excessive or oppressive," not whether a lesser sanction could have been imposed. 15 U.S.C. § 78s(e)(2); *see also PAZ Sec., Inc. v. SEC*, 566 F.3d 1172, 1176 (D.C. Cir. 2009) ("[T]he petitioners err in arguing the Commission must, in order to justify expulsion as remedial, state why a lesser sanction would be insufficient."). And as to the latter contention, we have considered the testimony from Olson's character witnesses, but find that it is outweighed by Olson's actions here, which convince us that she poses a continuing danger to investors.

E. Comparisons to other cases do not support a lesser sanction.

Olson argues that the bar imposed is more severe than the sanctions FINRA imposed for misconduct in three other cases that, while charged by FINRA as "falsification of records" rather than conversion, "easily could have been labeled [by FINRA as] 'conversion.'"[51] Olson also points to two cases in which FINRA specifically charged conversion but where, in one case, the decision to impose a bar was remanded for further consideration, and in the other case, the bar was reduced to a suspension.[52] Olson argues that the conduct in all of these cases was "considerably more egregious" and involved "less compelling" mitigating factors than here, thus demonstrating that Olson's bar was excessive, oppressive, and punitive.

The appropriate sanction, however, "depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with action take in other proceedings."[53] Moreover, the cases that Olson cites are distinguishable. As to the three cases

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49 Guidelines, at 6 ("[W]hile the existence of a disciplinary history is an aggravating factor when determining the appropriate sanction, its absence is not mitigating.") (citing *Rooms v. SEC*, 444 F.3d 1208, 1214-15 (10th Cir. 2006)); Guidelines at 2 ("An important objective of the disciplinary process is to deter and prevent future misconduct by imposing progressively escalating sanctions on recidivists beyond those outlined in these guidelines. . . .").

50 *E.g., Houston*, 2014 WL 936398, at *7; *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 WL 1697153, at *8 (Apr. 11, 2008), *pet. denied*, 566 F.3d 1172 (D.C. Cir. 2009). For the same reason, we give Olson no credit for being, as she claims, an "exemplary employee" for her post-termination employer, Ameriprise, with "no issues regarding her honesty or her expense reimbursements." *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 WL 32121, at *16 (Jan. 6, 2012) ("Applicants also assert that they 'have been operating World Trade without further problems . . . for the last 7 years.' We have repeatedly stated that a 'lack of disciplinary history is not a mitigating factor' because 'firms and their associated persons should not be rewarded for acting in accordance with their duties.'" (quoting *Rooms*, 444 F.3d at 1214)), *pet. denied*, 739 F.3d 1243 (9th Cir. 2014). Moreover, even if we gave Olson credit for her lack of disciplinary history before and after her conversion, such credit would not outweigh our concern that she poses a continuing danger to investors.

51 *Department of Enforcement v. McCartney*, Complaint No. 2010023719601, 2012 WL 6969529 (FINRA NAC Dec. 10, 2012) (imposing six month suspension and $5,000 fine); *Department of Enforcement v. Leopold*, Complaint No. 2007011489301, 2012 WL 641038 (FINRA NAC Feb. 24, 2012) (imposing one year suspension and $25,000 fine); *Department of Enforcement v. Hunt*, Complaint No. 2009018068701, 2012 WL 6969528 (FINRA NAC Dec. 18, 2012) (imposing six month suspension and $10,000 fine).

52 *Saad*, 718 F.3d at 907; *Department of Enforcement v. Foran*, Complaint No. C8A990017, 2000 WL 1299577 (NASD NAC Sept. 1, 2000) (imposing two year suspension with requirement to requalify and $35,000 fine).

53 *Carl M. Birkelbach*, Exchange Act Release No. 69923, 2013 WL 3327752, at *28 (July 2, 2013) (quoting *PAZ Sec., Inc.*, 2008 WL 1697153, at *9), *pet. denied*, 751 F.3d 472 (7th Cir. 2014); *see also Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("The

that did not charge conversion—*McCartney*, *Leopold*, and *Hunt*—it is true that, like Olson, the respondents submitted false expense reports to their firms for a financial benefit to which they were not entitled. It is also true that in at least one of those cases, *McCartney*, the respondent could conceivably have been charged with conversion because, by submitting the false expense report, he obtained a $500 reimbursement from his firm for fabricated expenses from a seminar that did not occur.[54] But because FINRA only charged the respondents in these cases with "falsification of records," FINRA's National Adjudicatory Council ("NAC") was constrained to apply the more lenient Guidelines' recommendation for that charge.[55] To do otherwise might have raised fairness concerns under Exchange Act Section 15A(h)(1).[56] Here, Olson was charged with conversion and the Board therefore properly applied the Guidelines for conversion.[57]

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employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases.").

54 *McCartney*, 2012 WL 6969529, at *2-3. On the other hand, it appears that FINRA could not have charged the respondents in *Leopold* and *Hunt* with conversion. In *Leopold*, the parties "stipulated that Leopold did not convert [his firm's] funds or property." *Leopold*, 2012 WL 641038, at *1. This is likely because although the respondent submitted false expense reports to reduce his federal tax liability, the respondent did not receive a reimbursement from his firm. *Id.* at *3. In *Hunt*, the respondent submitted false expense reports to obtain unauthorized advance reimbursement from his firm "for real costs that he had incurred, but had not yet paid." *Hunt*, 2012 WL 6969528, at *2.

55 *See McCartney*, 2012 WL 6969529, at *4 n.9 ("The complaint did not allege conversion, and we therefore do not find that McCartney 'converted' firm funds and have not imposed sanctions based on such a finding."); *Leopold*, 2012 WL 641038, at *7 ("Enforcement . . . stipulated that it does not contend that Leopold converted [the firm's] funds or property. The absence of th[is] factor[] colors our evaluation and further supports a reduction of Leopold's sanctions" from a bar.); *Hunt*, 2012 WL 6969528, at *4 (applying Guidelines for "falsification of records"). For "falsification of records," the Guidelines recommend "suspending respondent in any or all capacities for up to two years" where mitigating factors exist, and a bar in "egregious cases." Guidelines, at 37. The Guidelines also recommend a fine ranging from $5,000 to $100,000 for "falsification of records." *Id.*

56 15 U.S.C. § 78*o*-3(h)(1) (ensuring fairness in FINRA disciplinary proceedings by requiring that FINRA "bring specific charges, notify such member or person of, and give him an opportunity to defend against, such charges, and keep a record"); *see also id.* § 78*o*-3(b)(8) (requiring FINRA to "provide a fair procedure for the disciplining of members and persons associated with members").

57 Olson notes another case, *James A. Goetz*, which also does not appear to involve a charge of conversion or an application of the Guidelines for conversion. *James A. Goetz*, Exchange Act Release No. 39796, 1998 WL 130849 (March 25, 1998) (finding that the respondent obtained a donation from his firm for his daughter's private school, for which he received a tuition offset, by misrepresenting to the firm's matching gifts program that he had contributed funds in the same amount). We also find *Goetz* distinguishable because we modified the NASD's bar upon finding

The two cases in which FINRA specifically charged conversion also are distinguishable. In *Saad v. SEC*, the D.C. Circuit remanded a decision in which we sustained a bar imposed by FINRA because the Court found that we did not "address all potentially mitigating factors."[58] But in remanding, the Court specifically took "no position on the proper outcome of th[e] case."[59] And in *Foran*, the NAC made a vague and conclusory decision to reduce the bar imposed by the hearing panel to a two-year suspension with a requirement to requalify "[b]ased on the unique facts and circumstances of th[e] case."[60] *Foran* therefore provides little guidance for our sanctions analysis.

In any event, if we were to look to other conversion cases for guidance on sanctions, we would find ample support for barring Olson. Indeed, we have consistently sustained FINRA's decision to impose a bar for conversion.[61]

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that it was imposed for "Goetz's 'fraudulent actions'" even though Goetz "was not charged with fraud." *Id.* at *4.

58 *Saad*, 718 F.3d at 907.

59 *Id.*

60 *Foran*, 2000 WL 1299577, at *6. The respondent in *Foran* was found to have converted funds from his firm, of which he was a part owner, by misdirecting mutual fund trail commissions away from the firm's "house account" to his own commission account. *Id.* at 3.

61 *See, e.g., Mullins*, 2012 WL 423413, at *19-20; *Mission Sec. Corp.*, 2010 WL 5092727, at *13-14; *Gurfel*, 1999 WL 172666, at *4; *Ernest A. Cipriani, Jr.*, Exchange Act Release No. 33675, 1994 WL 62106, at *3 (Feb. 24, 1994); *O'Brien*, 1994 WL 234279, at *3; *Joel Eugene Shaw*, Exchange Act Release No. 34509, 1994 WL 440927, at *2 (Aug. 10, 1994).

*   *   *

We agree with FINRA that Olson's conversion of Firm funds through deception and with a scienter raises significant doubts about her integrity and fitness to remain associated with any FINRA member firm. Her misconduct demonstrates that Olson cannot be entrusted with firm or customer money, and that she therefore poses a continuing threat to investors. Imposing a bar appropriately addresses that threat. The sanction also furthers the public interest by deterring other securities professionals from engaging in similar misconduct.[62]

An appropriate order will issue.[63]

By the Commission (Chair WHITE and Commissioners GALLAGHER, STEIN, and PIWOWAR; Commissioner AGUILAR not participating).

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

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62 *See Mullins*, 2012 WL 423413, at *20 (finding that the bar imposed by FINRA for conversion was "necessary to deter [respondent] and others similarly situated from engaging in similar misconduct"); *see also Siegel*, 592 F.3d at 158 (noting that deterrence may be considered as part of the overall remedial inquiry in determining sanctions).

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75838 / September 3, 2015

Admin. Proc. File No. 3-15916

In the Matter of the Application of DENISE M. OLSON c/o Bruce M. Bettigole, Esq. Sutherland Asbill & Brennan LLP 700 Sixth Street, NW, Suite 700 Washington, DC 20001-3980 For Review of Disciplinary Action Taken by FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the findings by FINRA that Denise M. Olson violated FINRA Rule 2010 are SUSTAINED; and it is further

ORDERED that the sanction imposed by FINRA against Denise M. Olson, and its assessment of costs, is SUSTAINED.

By the Commission.

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

Commissioner Aguilar
Not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75839 / September 3, 2015

Admin. Proc. File No. 3-16230

In the Matter of the Application of

ANTHONY A. GREY

For Review of Disciplinary Action Taken By

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Securities Laws and Conduct Rules

Unfair and Fraudulent Markups

Interpositioning

Registered securities association found that registered representative, while associated with a member firm, interpositioned personal accounts between member firm and its customers, resulting in excessive and, in some instances, fraudulent markups to the customers. *Held*, registered securities association's findings of violations and sanctions are *sustained.*

APPEARANCES:

Peter J. Aldrich, Palm Beach Gardens, FL, for Anthony A. Grey

Alan Lawhead and *Lisa Jones Toms*, for the Financial Industry Regulatory Authority, Inc.

Appeal filed: October 31, 2014
Last brief received: February 23, 2015

I. Introduction

Anthony A. Grey, a registered General Securities Representative holding Series 3, 4, 5, 8, 24, 53, and 63 licenses,[1] formerly associated with Gardnyr Michael Capital, Inc. ("GMCI" or the "Firm"),[2] a FINRA member, appeals from FINRA disciplinary action based on his sales of municipal bonds to three retail customers between October 2008 and July 2009.

FINRA found that, with respect to each of the ten transactions involved, Grey violated MSRB[3] Rule G-17 by interpositioning and failing to disclose his deceptive and unfair practices and MSRB Rules G-17 and G-30 by charging customers unfair prices and excessive markups (ranging from 5.36% to 19.12%). In seven of those transactions, FINRA found that Grey also violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder[4] by charging fraudulently excessive markups (ranging from 8.62% to 19.12%) that he willfully failed to disclose to customers.

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1 National Commodities Futures (Series 3); Registered Options Principal (Series 4); Interest Rate Option (Series 5); General Securities Sales Supervisor (Series 8); General Securities Principal (Series 24); Municipal Securities Principal (Series 53); Uniform Securities Agent (Series 63).

2 Grey is no longer registered with any FINRA member firm. He nonetheless remains subject to FINRA's jurisdiction for purposes of this proceeding pursuant to Article V, Section 4 of FINRA's By-Laws, because: (1) he was registered and associated with GMCI when the Complaint was filed; and (2) the Complaint charges him with misconduct committed while he was registered and associated with GMCI.

3 Rules of the Municipal Securities Rulemaking Board ("MSRB") apply because this case involves municipal securities subject to MSRB regulation. The MSRB is the self-regulatory organization charged with primary rulemaking authority for the municipal securities activities of broker-dealers, municipal securities dealers and municipal advisors. The MSRB does not have enforcement authority. FINRA administers and enforces its members' compliance with the MSRB Rules. FINRA's By-Laws provide that its members and persons registered with members agree to comply with MSRB Rules, and FINRA is authorized to impose sanctions for violations of MSRB Rules. Article IV, § 1(a)(1) (agreement by firms); Article V, § 2(a)(1) (agreement by registered persons); Article XIII, § 1(b) (authorization to impose sanctions for violation of MSRB Rules). The MSRB Rules are found at www.msrb.org.

4 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

For these violations, FINRA suspended Grey from associating with any FINRA member firm in any capacity for eighteen months, fined him $30,000, and ordered him to disgorge $15,750 (plus prejudgment interest) to FINRA.[5]

On appeal, Grey argues that he sold the bonds to customers at "wholesale" prices that were fair and reasonable and that he purchased the bonds at such distressed prices in unusual market conditions that his acquisition costs could not have represented the true prevailing market price. Grey asserts that the prevailing market price of the bonds should be based on the yield curve of bonds of like quality, rather than contemporaneous cost.

We base our findings on an independent review of the record. For the reasons set forth below, we sustain FINRA's findings and the sanctions imposed.

II. Factual Background

Grey entered the securities industry in the early 1980s and, in May 1994, became associated with the Winter Park, Florida office of GMCI. Grey was registered with GMCI until October 2012.[6] During his tenure at GMCI, Grey spearheaded the Firm's municipal bond practice, engaging in thousands of bond transactions a year and generating approximately half of his income from his personal bond trading.[7] Between October 2008 and July 2009, he conducted 99% of GMCI's municipal bond business.

In 2009, FINRA's Department of Member Regulation conducted a routine cycle examination that reviewed GMCI's municipal business from August 2008 through September 2009. During the exam, a FINRA examiner discovered a pattern of trades Grey had routed to retail customers through two personal accounts—a personal prime brokerage account with Triad Securities Corporation and an IRA account with GMCI. The examination revealed that in ten

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5 Because FINRA found that Grey's misconduct was willful, he is also statutorily disqualified. *See* 15 U.S.C. § 78c(a)(39)(F) (an applicant who "has willfully violated any provision of the Exchange Act" is subject to statutory disqualification). FINRA also assessed hearing costs.

6 Grey voluntarily ended his employment with GMCI on October 25, 2012 and, since then, has not been associated with a FINRA member firm.

7 When asked what percentage of his income he attributed to his personal bond trading in 2008 and 2009, Grey testified, "somewhere in the vicinity of 50/50, 40/60, depending upon, you know, the month."

transactions involving six municipal bonds,[8] Grey followed the same three or four-step pattern of intermediate activity before selling the bonds to three retail customers.

The pattern began with Grey purchasing the bonds from the street either for his personal account, or through GMCI at a designated price, generally as odd-lot purchases in bid-wanted auctions. If he had originally purchased the bonds through GMCI, he then sold the bonds to his own personal account at a higher price within one business day of his initial wholesale purchase.[9] Next, Grey sold the bonds from his personal account (back) to GMCI at a higher price. Finally, on the same day, he sold the bonds from GMCI to his retail customers[10] at an even higher price. Grey alone determined the price for each transaction, and, in each transaction, the customers purchased the bonds at prices 5.36% to 22.92% higher than what Grey had paid for them no more than five trading days earlier.[11]

For each of the six bonds at issue, Grey levied the bulk of the cumulative increase in price in the sale of bonds from his personal account back to GMCI, and that sale immediately preceded his sale of the bonds to the relevant retail customer.[12] In doing so, Grey created the

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8 The transactions at issue involved six different municipal bonds: (1) OCALA FL UTILITY SYSTEM (674564CZ0) (hereinafter, "Ocala"); (2) OSCEOLA CNTY FL IDA IDR (19464HBV2) (hereinafter, "Osceola"); (3) COLLIER CNTY FL HSG FIN (19464HBV2) (hereinafter, "Collier"); (4) FLORIDA ST MUN LN (342815KE6) (hereinafter, "Florida State"); (5) HIGHLANDS CNTY FL HEALTH (431022PT3) (hereinafter, "Highlands (Health)"); and, (6) HIGHLANDS CNTY FL SCH (43102DDK1) (hereinafter, "Highlands (School)"). FINRA examiner Barbara Walley, who discovered the pattern, testified to producing a schedule of customer transactions involving 36 municipal bonds that were executed through Grey's personal accounts during the review period. FINRA's Division of Enforcement determined to charge Grey in connection with the six municipal bonds listed on the schedule.

9 Grey purchased Osceola from the "street" through GMCI on Wednesday, October 22, 2008, at $71.250 and sold the bonds to his personal account that same day at $72.250. He purchased Collier on the "street" through GMCI on Thursday, November 6, 2008, at $76.880 and sold the bonds to his personal account that same day at $77.880. He purchased Florida State from the "street" through GMCI on Tuesday, December 16, 2008, at $59.000 and sold the bonds to his personal account that same day at $60.000. Finally, he purchased Highlands (School) from the "street" on Thursday, July 23, 2009, at $85.569 and sold the bonds to his personal account the following day (Friday, July 24, 2009) at $91.250.

10 Grey actively recruited the customers for the relevant bond investments and in some cases had discretionary authority to buy bonds from, and sell bonds to, the customers' accounts without speaking with them first.

11 Grey sold the bonds to customers one to five business days after he purchased them in inter-dealer trades on the open market.

12 For instance, the markup in price in the sale of bonds from his personal account back to GMCI constituted : (1) 12.35% of the 18.13% cumulative increase on Osceola; (2) 2.99% of the 5.36% cumulative increase on Ocala; (3) 15.79% of the 19.89% cumulative increase on Collier;

(continued . . .)

illusion that he (through GMCI) was selling the bonds to customers with markups at or around three percent, consistent with GMCI's written supervisory procedures ("WSPs").[13]

Grey conceded that he never disclosed to customers that his personal accounts were interpositioned between the interdealer market and their retail purchases, and that, as a result, he was charging much higher prices than he had paid in interdealer transactions a few days earlier. No significant movements in the prices of any of the bonds at issue or the market at large occurred between Grey's acquisition of the bonds and the sale to retail customer, nor did any interdealer trades occur on any of the bonds during the interim period.

III. Procedural Background

On December 2, 2011, FINRA's Division of Enforcement ("Enforcement") filed a complaint alleging that Grey engaged in interpositioning and charged unfair and unreasonable markups without disclosing that he had done so in violation of MSRB Rule G-17 (fair dealing) and MSRB Rule G-30 (fair pricing).[14] Enforcement further alleged that Grey's actions violated the antifraud provisions of Exchange Act Section 10(b) and Rule 10b-5.

FINRA held a hearing on February 5 and 6, 2013, before a three-person Hearing Panel. Both Enforcement and Grey presented numerous witnesses and exhibits, and Grey was called to testify. On June 20, 2013, the Hearing Panel found that Grey committed the alleged violations and imposed sanctions including a two-year suspension, fines, disgorgement, and costs. Grey timely appealed the Hearing Panel decision to the National Adjudicatory Council ("NAC").

On October 3, 2014, the NAC issued a decision affirming the findings of violations and imposing modified sanctions. The NAC reduced the term of Grey's suspension from two years to 18 months, reduced the disgorgement amount from $16,000 to $15,750 (plus prejudgment interest), and affirmed the Hearing Panel's order for Grey to pay a fine of $30,000 and hearing costs of $5,267.32.

(. . . continued)
(4) 17.54% of the 22.94% cumulative increase on Florida State; (5) 6.99% of the 9.88% cumulative increase on Highlands (Health); and (6) 4.93% of the 6.64% cumulative increase on Highlands (School).

[13] *See* text accompanying note 48, *infra*.

[14] In addition to Grey, Enforcement alleged violations against GMCI and two other general securities representatives who eventually settled the proceedings. *See Gardnyr Michael Capital, Inc.*, No. 2009016034101 (OAO Dec. 19, 2012), *available at* http://disciplinaryactions.finra.org.

IV. Analysis

A. Standard of Review

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization ("SRO") disciplinary actions.[15] Pursuant to Exchange Act Section 19(e)(1),[16] in reviewing an SRO disciplinary action, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violates the relevant provisions, and whether the relevant provisions are, and were applied in a manner, consistent with the purposes of the Exchange Act.[17] We may sustain the judgment upon our independent review of the record, notwithstanding any deficiencies in the SRO's analysis.[18]

B. Grey's undisclosed interpositioning of his personal accounts to inflate the sales prices of the bonds violated MSRB Rule G-17's fair dealing requirements.

We sustain FINRA's findings that Grey willfully engaged in interpositioning in violation of MSRB Rule G-17, which provides that municipal securities dealers "shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." Grey violated that Rule in each of the ten municipal bond transactions at issue when he interposed accounts controlled and maintained by him between his retail customer and the intermarket seller of the bonds without disclosing his personal involvement to the customers. In each step of the transactions, Grey incrementally increased the prices as the bonds were moved to and from his personal accounts, and ultimately sold them to his retail customers at prices 5.36% to 22.92% above his initial purchase prices. These trades are outlined in *Table I* below.

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15 *See David M. Levine*, Exchange Act Release No. 48760, 81 SEC 1782, 2003 WL 22570694, at *9 n.42 (Nov. 7, 2003).

16 15 U.S.C. § 78s(e)(1).

17 *See, e.g., Steven Robert Tomlinson*, Exchange Act Release No. 73825, 2014 WL 6985131, at *5 (Dec. 11, 2014).

18 *See Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009) ("[B]ecause the SEC conducted a thorough, de novo review of the record, any procedural errors that may have been committed by the Chief Hearing Officer are cured."); *McCarthy v. SEC*, 406 F.3d 179, 187 (2d Cir. 2005) ("The Commission independently evaluated the extensive factual record developed by the Hearing Panel and the Board and provided a lengthy analysis of [the] case, ultimately reaching a reasoned decision upholding the Board's decision. There is thus no need for us to review the lack of reasons for the Board's decision, because the due process afforded [respondent] before the Commission cured any alleged defect.").

Table I								
Bond	**Seller**	**Buyer**	**Date**	**Par**	**Price**	**Total Cost**	**Step Increase**	**Cumulative Increase**
Osceola	Street	GMCI	W 10/22/08	20000	$71.250	$14250.00	N/A	N/A
	GMCI	Grey	W 10/22/08	20000	$72.250	$14450.00	1.40%	1.40%
	Grey	GMCI	M 10/27/08	20000	$81.170	$16234.00	12.35%	13.92%
	GMCI	Customer	M 10/27/08	20000	$84.170	$16834.00	3.70%	18.13%
Ocala	Street	Grey	W 10/29/08	50000	$84.250	$42125.00	N/A	N/A
	Grey	GMCI	Th 10/30/08	50000	$86.770	$43385.00	2.99%	2.99%
	GMCI	Customer	Th 10/30/08	10000	$88.770	$8877.00	2.30%	5.36%
	GMCI	Customer	Th 10/30/08	40000		$35508.00		
Collier	Street	GMCI	Th 11/06/08	35000	$76.880	$26908.00	N/A	N/A
	GMCI	Grey	Th 11/06/08	35000	$77.880	$27258.00	1.30%	1.30%
	Grey	GMCI	Tu 11/11/08	35000	$90.174	$31560.90	15.79%	17.29%
	GMCI	Customer	Tu 11/11/08	10000	$92.174	$9217.40	2.22%	19.89%
	GMCI	Customer	Tu 11/11/08	25000		$23043.50		
Florida State	Street	GMCI	Tu 12/16/08	5000	$59.000	$2950.00	N/A	N/A
	GMCI	Grey	Tu 12/16/08	5000	$60.000	$3000.00	1.69%	1.69%
	Grey	GMCI	M 12/22/08	5000	$70.525	$3526.25	17.54%	19.53%
	GMCI	Customer	M 12/22/08	5000	$72.525	$3626.25	2.84%	22.92%
Highlands (Health)	Street	Grey	Th 12/18/08	80000	$69.194	$55355.20	N/A	N/A
	Grey	GMCI	M 12/22/08	80000	$74.030	$59224.00	6.99%	6.99%
	GMCI	Customer	M 12/22/08	40000	$76.030	$30412.00	2.70%	9.88%
	GMCI	Customer	M 12/22/08	15000		$11404.50		
	GMCI	Customer	M 12/22/08	25000		$19007.50		
Highlands (School)	Street	GMCI	Th 07/23/09	15000	$85.569	$12835.35	N/A	N/A
	GMCI	Grey	F 07/24/09	15000	$86.250	$12937.50	.80%	.80%
	Grey	GMCI	M 07/27/09	15000	$90.500	$13575.00	4.93%	5.76%
	GMCI	Customer	M 07/27/09	15000	$91.250	$13687.50	0.83%	6.64%

Grey neither disclosed to the customers that his personal accounts were involved, nor that the customers were paying a much higher price than he had paid one to five trading days earlier. To the contrary, Grey actively concealed the true size of the markups. As illustrated in *Table I* above, Grey invariably charged the bulk of the markups on the step of the transaction immediately preceding the sale of the bonds to a retail customer (*i.e.*, when Grey sold the bonds from his personal account back to GMCI). This practice made it appear as though GMCI had sold the bonds to customers with markups of around three percent—consistent with the stated maximum in the firm's WSPs.[19] Because the customer account statements for these transactions provided only the price that the customers paid for the bonds, the customers remained unaware of the markups.

Grey does not dispute his pattern of trading in these transactions, the prices he charged, or that trading in this manner generated profits for him. He also admits that he did not disclose to the customers that he routed the bonds through his personal accounts or that he incrementally increased the prices of the bonds at intermediate steps of the transactions. Instead, Grey asserts that he routed the bonds through his personal accounts only because GMCI did not have a proprietary trading account. He maintains that his interpositioning was the economic equivalent of a firm trading through a proprietary trading account. Grey argues that it is "unfair" to label his interpositioning a "scheme" when "the undisputed evidence was that the routing was the [F]irm's decision to avoid exposure [and t]here was not one particle of evidence that interpositioning was [his] idea."

We are unpersuaded by this argument. We find that Grey executed an interpositioning scheme through a series of successive, intermediate transactions designed to incrementally increase—and artificially inflate—the price of the bonds and conceal the true size of the markups he charged his retail customers. The Firm's WSPs explicitly prohibited both interpositioning and the sale of municipal securities to customers with markups exceeding three percent. Indeed, even if GMCI had a proprietary account, the trading would not have followed this pattern. If Grey's personal accounts were merely serving the Firm's need for a place to hold the bonds, as Grey states, the markups should have been in line with what the Firm would have charged—*i.e.*, a three-percent maximum markup without any of the intermediate markups—and Grey should not have enjoyed the added advantage over his customers by virtue of his concealed conflict of interest.[20]

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[19] *See* text accompanying note 48, *infra*.

[20] Equally unpersuasive is Grey's suggestion that unlawful interpositioning could not have occurred because his practice "was fully disclosed to the [F]irm and to FINRA through years of audits." Grey does not provide any evidence that he had previously disclosed his interpositioning scheme to either the Firm or FINRA, but even if he had, such disclosure would not have absolved him of his continuing obligations under the Exchange Act or the MSRB rules. We have consistently rejected similar arguments because "associated persons cannot shift their compliance burden to FINRA." *Robert Marcus Lane*, Exchange Act Release No. 74269, 110 SEC 17, 2015 WL 627346, at *13 (Feb. 13, 2015) (rejecting argument that a firm's written

(continued . . .)

C. Grey charged the Firm's retail customers excessive markups in violation of MSRB Rules G-17 and G-30.

We sustain FINRA's findings that Grey charged his retail customers excessive markups in violation of MSRB Rules G-17 and G-30, which require municipal securities dealers to charge customers fair and reasonable prices. Rule G-30(a) provides: "No broker, dealer or municipal securities dealer shall purchase municipal securities for its own account from a customer or sell municipal securities for its own account to a customer except at an aggregate price (including any mark-down or mark-up) that is fair and reasonable, taking into consideration all relevant factors . . . ."[21] Similarly, under the duty of fair dealing imposed by Rule G-17, dealers are prohibited from charging retail customers "prices not reasonably related to the prevailing market price at the time of sale."[22]

Determining whether a dealer charged customers markups that exceeded fair and reasonable prices requires a two-step analysis. First, because "[t]he markup on a security is the difference between the price charged to the customer and the prevailing market price,"[23] we must determine the appropriate prevailing market price. When a dealer acquired the bonds in inter-dealer trades closely related in time to the customer transactions, we assume the dealer's contemporaneous cost is the best measure of prevailing market price, and it is the dealer's burden to overcome that presumption.[24]

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policies could not have been deficient because they "had been tested and approved by the NASD District Office in its Annual Examinations"); *cf. Rita H. Malm*, Exchange Act Release No. 35000, 58 SEC 131, 1994 WL 665963, at *8 n.40 (Nov. 23, 1994) (rejecting contention that "because the NASD noted no markup, pricing, or other 'exceptions' during its audit . . . NASD was subsequently precluded from bringing markup or supervisory charges").

21 MSRB Manual (CCH) ¶ 3646, p. 5159 (1989). On May 8, 2014, we approved a rule filing to amend MSRB Rule G-30. *See* Exchange Act Release No. 72129 (May 8, 2014), File No. SR-MSRB-2014-01 (Jan. 29, 2014). The amendments were designed to streamline and codify existing guidance regarding MSRB fair-pricing standards previously set forth in MSRB Rules G-30 and G-18 and in interpretive guidance under those rules and Rule G-17 into a single fair-pricing rule, MSRB Rule G-30. As amended, MSRB Rule G-30 includes language similar to the above quoted text under Supplementary Material .01(d): "As part of the aggregate price to the customer, the mark-up or mark-down also must be a fair and reasonable amount, taking into account all relevant factors."

22 *SFI Inv., Inc.*, 2000 WL 33299598, at *10.

23 *Grandon v. Merrill Lynch & Co., Inc.*, 147 F.3d 184, 189 (2d Cir. 1998) (citations omitted).

24 *See, e.g., Alstead, Dempsey & Co., Inc.*, Exchange Release Act No. 20825, 47 SEC 1034, 1984 WL 50800, at *1 (Apr. 5, 1984).

Second, we must determine whether the markups, as calculated based on prevailing market price, were fair and reasonable. Once the relevant enforcement party presents evidence demonstrating that the markups were excessive, the dealer may introduce evidence to attempt to justify the markups.[25] Under Rule G-30(a), we must "tak[e] into consideration all relevant factors" in assessing whether the dealer has met this standard.

1. Contemporaneous cost is the best measure of prevailing market price for the transactions at issue in this matter.

The main dispute in this appeal is the appropriate measure of prevailing market price. Absent countervailing evidence, the prevailing market price is "the price at which dealers trade with one another, *i.e.*, the current inter-dealer market."[26] We consider "a dealer's contemporaneous cost" to be "the best evidence of the current market" because "prices paid for a security by a dealer in actual transactions closely related in time to its sales are normally a highly reliable indication of the prevailing market."[27] We have looked to a dealer's purchases occurring within five business days of the retail transaction at issue for determining contemporaneous

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25 *See Donald T. Sheldon*, Exchange Act Release No. 31475, 51 SEC 59, 1992 WL 353048, at *12 (Nov. 18, 1991) (holding that once the Division of Enforcement presented evidence of excessive markups on municipal bonds, the burden shifted to respondent to introduce evidence refuting the excessiveness), *aff'd* 45 F.3d 1515 (11th Cir. 1995).

26 *Alstead, Dempsey & Co.*, 1984 WL 50800, at *1; *accord Michael H. Novick*, Exchange Act Release No. 34640, 51 SEC 1258, 1994 WL 499291, at *3 (Sept. 2, 1994) ("[T]he prevailing market price (on the basis of which retail markups are computed) means the contemporaneous price at which dealers are trading with one another (*i.e.*, the current inter-dealer market).").

27 *First Honolulu Sec., Inc.*, Exchange Act Release No. 32933, 51 SEC 695, 1993 WL 380039, at *2 (Sept. 21, 1993). *See also Grandon*, 147 F.3d at 189 ("When a dealer is not a marketmaker, and absent countervailing evidence, the SEC has announced that: 'a dealer's contemporaneous cost is the best evidence of the current market. That standard, which has received judicial approval, reflects the fact that prices paid for a security by a dealer in actual transactions closely related in time to his retail sales are normally a highly reliable indication of prevailing market price.'" (citing *Alstead, Dempsey & Co.*, 1984 WL 50800, at *1; *Nicholas A. Codispoti*, Exchange Act Release No. 24946, 48 SEC 842, 1987 WL 755546, at *3 (Sept. 29, 1987) ("[W]e have consistently held that, absent countervailing evidence, a dealer's contemporaneous cost is the best evidence of [the current, inter-dealer] market, a standard that has received judicial approval."))). "Contemporaneous cost" is generally defined as "the retail market price that the dealer paid for the securities in actual transactions close in time to its retail sales." *Grandon*, 147 F.3d. at 187.

costs.[28] When a dealer asserts a different prevailing market price for a bond sold to a customer, the dealer must provide sufficient evidence to overcome the presumption that contemporaneous cost is the best measure of prevailing market price.[29]

Grey argues that because he purchased the bonds at such distressed prices in unusual market conditions, it is inconceivable that his acquisition costs could have represented the true prevailing market value. Under the circumstances, he contends that the prevailing market price of the bonds should be based on the yield curve of other bonds of like quality and not contemporaneous cost. Nevertheless, we agree with the NAC that Grey failed to provide sufficient evidence that the prevailing market price differed from his contemporaneous cost, and thus, he failed to overcome the presumption that contemporaneous cost should determine the prevailing market price.

a. The circumstances of this case do not warrant a deviation from contemporaneous cost as the best measure of prevailing market price.

Grey acknowledges that "[o]rdinarily, the prevailing market price to the customer is deemed to equal the price paid by the seller (Grey) when the seller acquired the bond." He claims that a "more reliable metric" is necessary in this case, however, because "the purchase of the disputed bonds during the financial crisis in bid-wanted auctions, in odd-lots, presented a challenge for determining market value which cost-basis valuation does not answer." We disagree. As discussed below, the circumstances here unambiguously favor contemporaneous cost as the best measure of prevailing market price.

First, Grey argues that "he was able to buy the bonds below their market value" because the transactions "took place in the midst of the financial crisis when price discovery was very difficult." The tumultuous financial climate in 2008 and 2009 may well have affected the value the market ascribed to various assets—but it did not alter the fundamental concept that the *market* dictates prevailing market price.[30] We assume that prices accurately reflected the market

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28 *See e.g.*, *Codispoti*, 1987 WL 755546, at *1. *See also SFI Inv., Inc.*, 2000 WL 33299598, at *10 ("The Commission has looked to a dealer's purchase occurring within five business days either before or after the retail transaction at issue for determining contemporaneous costs.") (quoting *Escalator Secs., Inc.*, Complaint No. C07950049, 1997 NASD Discip. LEXIS 78, at *20 (NBCC Dec. 31, 1997))).

29 *E.g.*, *Andrew P. Gonchar*, Exchange Act Release No. 60506, 96 SEC 1845, 2009 WL 2488067, at *7 n.25 (Aug. 14, 2009) ("[O]nce NASD presents evidence of contemporaneous cost, the burden shifts to Applicants to refute that evidence."); *Powell & Assocs., Inc.*, Exchange Act Release No. 18577, 47 SEC 746, 1982 WL 32339, at *1–2 (Mar. 22, 1984).

30 Yields lost much of their predictive value during this period because the financial crisis introduced new risks for which the standard models did not account. For example, while the risk levels associated with municipal bonds are ordinarily reflected in the interest rate, many bonds became riskier investments on account of the financial crisis without any corresponding interest

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demand at the time, taking into account market uncertainties, risk tolerance, liquidity, and other variables. The crisis did not unseat contemporaneous cost as the appropriate measure of prevailing market price. If anything, the financial crisis bolstered contemporaneous cost as the best evidence of prevailing market price, since interdealer trades provided the only objective measure at a time when the assumptions underlying external models were suspect and, as Grey notes, price discovery was unusually difficult.

Second, Grey argues that "[t]he very nature of the bid-wanted process precludes conclusive reliance on the auction pricing as equaling market value." Despite Grey's contention to the contrary, we treat bid-wanted auction transactions as we would any other interdealer trades when assessing contemporaneous cost. MSRB Rule G-13 provides: "If a . . . municipal securities dealer is distributing or publishing a quotation . . . such . . . dealer shall have no reason to believe that the price stated in the quotation is not based on the best judgment of the fair market value of the securities . . . ." Municipal bond dealers generally have access to firm bid and ask quotations for bonds purchased through bid-wanted auction and rely on that information to assess prevailing market price.[31] Bid-wanted auctions function as a free-market system and are designed to solicit the highest market bidder. Grey's own account of the auction process for the relevant bonds underscores its competitive nature. Grey submits that he bid on hundreds of bonds and only a tiny percentage of his bids—"perhaps 4%"—were actually accepted.

Third, Grey argues that contemporaneous cost is an improper measure of prevailing market price because he purchased the bonds in odd-lots (quantities of less than 100 bonds), and odd-lots are undesirable and difficult to sell. Even accepting Grey's argument that odd-lots trade at a discount, however, contemporaneous cost would remain the best measure of prevailing market price. Grey purchased the bonds at issue in odd-lots and sold them to retail customers in odd-lots. Any discount should have carried through to the customers because those customers would experience the same disadvantages associated with odd-lot trades if they chose to liquidate the bonds down the line.

Finally, Grey failed to demonstrate how market conditions at the time he sold the bonds to his customers changed the prevailing market price of the bonds as measured by

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rate adjustment. The risks accompanying municipal bonds increased with the onset of the credit crisis as major bond issuers suffered ratings downgrades and default rates tripled. *See* SEC, Report on the Municipal Securities Market, at 23 nn.119–21, 49 (July 31, 2012), *available at* http://www.sec.gov/news/studies/2012/munireport073112.pdf.

31 *See, e.g.*, SEC, Report on the Municipal Securities Market, at 114 n.693, 121, 128 n.769 (July 31, 2012); United States Government Accountability Office, Report to Congressional Committees, *Municipal Securities: Overview of Market Structure, Pricing, and Regulation*, GAO-12-265, at 8 (Jan. 2012).2012), *available at* http://www.gao.gov/assets/590/587714.pdf.

contemporaneous cost.[32] Grey purchased all of the bonds in interdealer trades within five business days of the customer transaction—a period we consider close enough in time for determining contemporaneous cost in this case.[33] He presented no evidence of any major market changes during the time he held the bonds or intermediate interdealer trades at competing price points. Accordingly, Grey failed to demonstrate any need to deviate from the contemporaneous cost standard.

Grey further argues that Enforcement's expert on the issue of municipal bond pricing, James McKinney,[34] did not do enough to determine the fair market value or properly consider the extraordinary conditions of the market at the time. As an initial matter, we reiterate that Grey bore the burden of rebutting the presumption in favor of contemporaneous cost—Enforcement need not account for every potential market variable to a respondent's personal satisfaction.[35] In any event, we find McKinney's testimony to be fair, thorough, and credible. McKinney testified that a maximum markup of three percent represented the industry standard. He used Electronic Municipal Market Access ("EMMA") and Municipal Market Data ("MMD") to review the ratings and other characteristics of the relevant bonds. He noted that no intervening trades occurred in the market for the relevant bonds and testified that the prevailing market price for the bonds was the last interdealer trade (*i.e.*, the price at which Grey had acquired the bonds).

Even though no intervening trades occurred in the market for the relevant bonds following Grey's purchases, McKinney adjusted the prevailing market price for the bonds to give Grey "any benefit of any market movement" that he could glean from the MMD scale. As McKinney explained, these adjustments cut exclusively in Grey's favor: "In the cases where the market went down, I didn't nick him on that, but when the market would improve, I gave him the full benefit of the market movement during those days." The adjustments lowered the markup calculations as illustrated in *Table II* below:

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32 *LSCO Sec., Inc.*, Exchange Act Release No. 28994, 50 SEC 518, 1991 WL 296502, at *2 (Mar. 21, 1991) ("[A]bsent some showing of a change in the prevailing market, a dealer's inter-dealer cost may be used to establish market price for a period up to five business days from the date of the dealer's purchase.").

33 We and FINRA (formerly NASD) have looked to a dealer's purchases occurring within five business days of the retail transaction at issue for determining contemporaneous costs. *See* note 28 *supra*.

34 Grey maintains that McKinney used a flawed "best execution" standard in pricing the municipal bonds based on occasions in which McKinney used that term in his testimony. While "best-execution obligations and fair-pricing obligations are closely related," Exchange Act Release No. 72956, 109 SEC 14, 2014 WL 4352319, at *2 (Sept. 2, 2014) (proposing SR-MSRB-2014-07), we independently apply existing fair pricing standards under MSRB Rule G-30 in reviewing McKinney's testimony and in determining whether Grey sold the subject bonds at prices that were fair and reasonable.

35 *See, e.g.*, *Gonchar*, 2009 WL 2488067, at *7 ("[O]nce NASD presents evidence of contemporaneous cost, the burden shifts to Applicants to refute that evidence.").

Table II		
Bond	**Raw Markup**	**McKinney Adjusted Markup**
Osceola	18.13%	**14.38%**
Ocala	5.36%	**5.36%**
Collier	19.89%	**19.12%**
Florida State	22.92%	**16.88%**
Highlands (Health)	9.88%	**8.62%**
Highlands (School)	6.64%	**6.64%**

These prevailing market price valuations—which were accepted by FINRA—are, at a minimum, reasonable.

b. Grey failed to meet his burden of proving a superior metric for prevailing market price.

In any event, we reject Grey's proposed alternative means of determining prevailing market price based on yield to customers at the time of sale. His approach, which he describes as "multi-faceted," "conscientious," and "practical," is a survey of cherry-picked data, including yield curves of unrelated bonds, historical trading points, and actual profits realized.

Grey relies heavily on the testimony of his expert, John Bagley, to argue that the yield curve, which he claims Enforcement ignored, was a better measure of where the market was at the points of sale to the customers.[36] Bagley testified that the yields for the bonds at the time of sale were "very attractive" based on his "analysis on whether [he] *felt* these bonds were sold at a fair and reasonable price." But his analysis was not scaled to any existing objective criteria that Grey should have consulted at the time of the transactions. Even though Grey purchased all of the bonds in interdealer trades within five business days of the respective customer transactions and presented no evidence of any major market changes during the time he held the bonds, Bagley generally ignored Grey's wholesale purchase prices (*i.e.*, the most recent interdealer trades) when analyzing the fair market value of the bonds at the time of the customer transactions. He explained: "I didn't look at what the fair price was between two interdealer brokers. I looked at the price [Grey's] client paid. That's what I looked at as relevant." He continued: "When I did my analysis, there were many times I threw out interdealer trades because I didn't think they were relevant or the price was wrong. So just because they are interdealer trades doesn't mean they are right."

[36] Grey also claims that unrebutted testimony indicated that "he could have sold the bonds to the street at higher prices." Aside from his own testimony before the Hearing Panel to that effect, Grey presented no evidence that he sought or received contemporaneous bids from outside dealers on any of the bonds—let alone that other dealers were ready to pay higher prices than those at which he sold the bonds to his customers.

Bagley's subjective assessment of whether Grey's customers received a good deal on the bonds—armed with the benefit of hindsight—is irrelevant to the objective question of whether Grey charged his customers prices that were reasonably related to the prices the market set for the bonds at the time of the retail sales. Grey's belief that certain bonds were sound investments did not permit him to supplant the market's price with his own assessment of value or relieve him of his responsibilities to his customers.

In sum, Grey failed to present sufficient evidence to overcome the presumption in favor of contemporaneous cost as the best measure of prevailing market price.

2. Grey's aggregate markups on the bonds were excessive, unfair, and unreasonable, and violated MSRB Rules G-17 and G-30.

Based on the contemporaneous costs of the bonds at issue, Grey charged his customers markups ranging from 5.36% to 19.12% above the prevailing market price.[37] MSRB Rule G-30 requires municipal securities dealers to charge prices that are "fair and reasonable, taking into consideration all relevant factors."[38] The MSRB lists numerous factors that may be relevant in

[37] Specifically, Grey charged cumulative markups of 5.36% on the two Ocala bond trades, 6.64% on the Highlands (School) bond trade, 8.62% on the three Highlands (Heath) bond trades, 14.38% on the Osceola bond trade, 16.88% on the Florida State bond trade, and 19.12% on the two Collier bond trades. *See Table II.* Our finding on this point refutes Grey's argument that the interpositioning was "inconsequential" because "each customer paid approximately 3% or less over the prevailing market value."

[38] MSRB Interpretations of Rule G-30, "Report on Pricing," (Sept. 26, 1980), MSRB Manual (CCH) ¶ 3646, at 5157 (hereinafter, "MSRB 'Report on Pricing'"); *accord Press v. Chemical Inv. Servs. Corp.*, 166 F.3d 529, 535 (2d Cir. 1999); *Grandon*, 147 F.3d at 190, 193; *Banca Cremi, S.A. v. Alex Brown & Sons, Inc.*, 132 F.3d 1017, 1033 (4th Cir. 1997).

Although MSRB Rule G-30 provides no percentage guideline as to what constitutes a reasonable markup, we have repeatedly stated that markups on municipal securities should fall below five percent absent exceptional circumstances. *First Honolulu*, 1993 WL 380039, at *3 ("[A]lthough some markups on municipal bonds may reach 5%, that figure might be acceptable in only the most exceptional cases." (citing *SEC v. Charles A. Morris & Assoc., Inc.*, 386 F. Supp. 1327, 1334 n.5 (W.D. Tenn. 1973) ("It is the practice in the municipal bond industry to charge retail customers a price which is no more than one quarter of one per cent to five per cent over a bond's current market price."))); *see also, e.g.*, *Investment Planning, Inc.*, Exchange Act Release No. 32687, 51 SEC 592, 1993 WL 289728, at *1–2 (July 28, 1993) (finding markups 4% and above on various corporate bonds and municipal securities improper, stating that such markups "represent extraordinary charges for ordinary transactions"); *Zero-Coupon Secs.*, Exchange Act Release No. 24368, 38 SEC 158, 1987 WL 756237, at *2 (Apr. 21, 1987) (the Commission "consistently has taken the position that mark-ups on debt securities, including municipal securities, generally are expected to be lower than mark-ups on equity securities, and has upheld NASD decisions finding mark-ups as low as 5.1% to violate the rules of the MSRB"); *Staten Secs. Corp.*, Exchange Act Release No. 18628, 47 SEC 766, 1982 WL 32503, *1 (Apr. 9,

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determining the fairness and reasonableness of municipal securities transaction prices, including: (1) the best judgment of the broker or dealer as to the fair market value of the securities at the time of the transaction; (2) the expense involved in effecting the transaction; (3) the fact that the broker or dealer is entitled to a reasonable profit; (4) the expertise provided by the broker or dealer; (5) the total dollar amount of the transaction; (6) the availability of the security in the market; (7) the price or yield of the security; (8) the resulting yield after the subtraction of the markup compared to the yield on other securities of comparable quality, maturity, availability; (9) the risk and the role played by the broker or dealer; and (10) the nature of the professional's business.[39] "Of the many possible relevant factors," the MSRB has stated that "resulting yield to a customer is the most important one in determining the fairness and reasonableness of price in any given transaction."[40]

In its case in chief, Enforcement presented extensive evidence that Grey engaged in a pattern of excessive markups. This included the testimony of FINRA examiner Barbara Walley, who discovered the pattern and testified to producing a schedule of customer transactions involving 36 municipal bonds that were executed through Grey's personal accounts during the review period. Enforcement also presented the expert testimony of James McKinney, who not only testified that, under standard industry practice, three percent is generally the maximum permissible markup on municipal securities, but also individually assessed the value of the relevant bonds at the time of sale.

After the presentation of Enforcement's case in chief, Grey failed to refute evidence that the markups were excessive, or to present evidence that would justify the markups. Specifically, Grey did not challenge Enforcement's evidence regarding industry practice or otherwise argue

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1982) ("As a general rule, markups on municipal bonds are significantly lower than those for equities securities."); *id.* at *2 n.9 ("This does not mean that markups of 5% or less are necessarily 'fair and reasonable.' We note that markups on municipal securities are often as low as one or two percent in frequently traded issues, such as those in the instant case."); *SFI Inv., Inc.*, 2000 WL 33299598, at *10 (Mar. 28, 2000) ("Based on the contemporaneous costs of the bonds at issue, the prices charged to SFI's retail customers resulted in 174 transactions with excessive markups ranging from over 4% to over 8%. Absent exceptional circumstances, this is well above any acceptable benchmark for markups on municipal bonds.").

We also note that in this matter, GMCI's WSPs prohibited the Firm from selling municipal securities to customers with a markup exceeding three percent, noting that "[FINRA] will take exception to and may attempt to charge fraud for any mark-up . . . in excess of" that amount.

[39] MSRB "Report on Pricing" ¶ 3646, at 5158. We note that MSRB G-30, as amended in a consolidated fair-pricing rule, preserves the substance of dealers' existing fair-pricing obligations, and includes as Supplementary Material .02 a list of eleven relevant (but non-exclusive) factors.

[40] *Id.* at 5160.

that markups of 5.36% to 19.12% were fair and reasonable under the circumstances.[41] In fact, Grey conceded that "markups exceeding three percent are suspect and probably excessive" and that "markups well under 5% are the norm."

Furthermore, our review of the relevant facts in the record establishes that Grey has failed to demonstrate that the markups he charged the customers were fair and reasonable under the circumstances. Grey did not present persuasive evidence that the resulting yields to the customers justified the markups he charged. His expert, John Bagley, failed to compare the yield of the relevant bonds "to the yield of other securities of comparable quality, maturity, and availability."[42] Instead, Bagley concluded that the yields of the relevant bonds "were very attractive" based on his comparison of those bonds to unrelated bonds that were not actually "comparable." For example, the unrelated bonds, which Grey had personally selected for Bagley, were general obligation bonds based on round-lot trades rather than revenue bonds in odd-lot trades like the ones at issue here,[43] and many of the "comparable" trades occurred weeks after the relevant transactions.[44] Bagley also relied on MMD yields, which are equally inapposite because (1) the MMD, like the unrelated bonds Grey selected, provides yields based on general obligation bonds in round-lot transactions; and (2) MMD yields are based on bonds throughout the United States (unlike the bonds at issue here, which were all issued in Florida).

Moreover, Grey did not present evidence to establish that he was entitled to the markups he charged based on the services he provided to the customers, the risks or expenses he incurred in executing the transactions, or any other relevant factor. First, Grey purchased the bonds in bid-wanted auctions in odd-lot quantities. The record indicates that odd-lots flooded the market during the relevant period and were not in short supply. Second, to the extent Grey was exposed to risk during the periods he held the bonds in his personal accounts, those periods were brief (lasting no more than two business days), and Grey testified that he did not believe the relevant bonds were risky investments. Third, although a low dollar value transaction relative to the expense involved in effecting the transaction may, in some instances, justify a higher markup to permit a dealer to receive a reasonable profit,[45] Grey did not introduce any evidence to suggest

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41 Grey's opening brief before us states: "Grey has never disagreed with the idea that markups exceeding 3% are suspect and probably excessive. What he has always disagreed with here is the contention that the markups actually exceeded 3%."

42 MSRB "Report on Pricing" ¶ 3646, at 5158.

43 Yields are typically lower on general obligation bonds and round-lot bonds, as compared to revenue bonds and odd-lot bonds. For this reason, Bagley's testimony that the yield curves on the bonds at issue here were higher than the "comparable" bonds is immaterial.

44 For example, the "comparable" trades Bagley considered in connection with the Ocala bond occurred more than three weeks after the subject trade. As Bagley conceded, Grey would not have had an opportunity to consider those as-yet future trades in pricing the bonds.

45 Retail-size trades of $20,000 or below tend to incur higher transactional costs and incur higher markups. *See* SEC, Report on the Municipal Securities Market, at 122–23 (July 31, 2012).

that his transaction costs were high, as was his burden if he wished to justify the markups on that basis.[46] We also observe that Grey charged his customers the same unit price for the bonds, regardless of the dollar value of the transaction, suggesting that the size of the transaction was not a factor in the markups.[47]

In addition, the nature of Grey's business as a municipal securities dealer at GMCI does not warrant the unusually high markups—in fact, GMCI's WSPs prohibited the Firm from selling municipal securities to customers with a markup exceeding three percent.[48] Nor do we credit Grey's testimony that he based the prices on his expertise, experience, and best judgment of the fair value of the bonds at the time of the sale—Grey was incapable of providing a fair assessment of value on account of his undisclosed personal interest in the transactions. Indeed, Grey's elaborate interpositioning scheme, designed to conceal the true size of the markups, reveals his implicit acknowledgement that the cumulative markups were excessive.

D. Grey's excessive markups on seven of the transactions were fraudulent and violated Exchange Act Section 10(b) and Rule 10b-5 thereunder.

We sustain FINRA's findings that, with respect to the seven customer transactions with aggregate markups of eight percent or higher (ranging from 8.62% to 19.12%),[49] Grey violated the antifraud provisions of Exchange Act Section 10(b) and Rule 10b-5 thereunder, which prohibit any person, acting with scienter, from misrepresenting or omitting a material fact in connection with the purchase or sale of a security.[50]

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46 *See Investment Planning*, 1993 WL 289728, at *3 n.19 ("We reject applicants' argument[] . . . that it was necessary for the NASD to elicit evidence of applicants' expenses in executing each order.").

47 *See Table I.* For example, Grey charged two separate retail customers the same price for Ocala bonds on October 30, 2008—$88.77—notwithstanding the fact that one customer purchased a block of 10,000 bonds for a cost of $8,877 and the other customer purchased a block of 40,000 bonds for a cost of $35,508.

48 This portion of the WSP specifically addressed and parroted the MSRB Rules, including Rules G-17 and G-30. The WSP also prohibited interpositioning.

49 Specifically, we sustain FINRA's finding that the following markups violate the antifraud provisions: 8.62% on three of the Highlands (Health) trades, 14.38% on the Osceola trade, 16.88% on the Florida State trade, and 19.12% on two of the Collier trades.

50 *See, e.g.*, *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999); *Lane*, 2015 WL 627346, at *10; SEC, Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Exchange Act Release No. 7049, 56 SEC 479, 1994 WL 73628, at *4 (Mar. 9, 1994). Rule 10b-5 provides, "It shall be unlawful for any person, directly or indirectly, . . . (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not

(continued . . .)

Grey concedes he did not disclose: that his personal accounts were involved in intermediary transactions before the sales; that his customers were paying higher prices as a result of those intermediary transactions; or the amount of the markups. These omitted facts were material and their omission was misleading. Under any circumstances, it would be important to investors in making their investment decision that their broker was interposing his own accounts between them and the market and causing them to pay higher prices than they would otherwise pay. This is particularly true in the seven transactions with markups between 8.62% and 19.12%—markups ranging from three to six times the industry standard.[51]

The omission of these material facts was particularly misleading because Grey actively concealed the true size of the markups by concentrating his profits in the sale of the bonds from his personal account to GMCI immediately before the retail transactions. This practice made it appear as though GMCI had sold the bonds to customers with standard markups.

The record supports a finding that Grey omitted these material facts with scienter. Scienter is "a mental state embracing intent to deceive, manipulate or defraud."[52] It may be inferred from circumstantial evidence and need not be conceded by the respondent.[53] "Where a dealer knows the circumstances indicating the prevailing market price for the securities, knows the retail price that it is charging the customer, and knows or recklessly disregards the fact that its markup is excessive, but nonetheless charges the customer the retail price, the scienter requirement is satisfied."[54] Interpositioning is widely recognized as a form of securities fraud in violation of Section 10(b).[55]

Grey acted with scienter when he intentionally routed the bonds through his personal accounts before he sold them to GMCI's retail customers with excessive and undisclosed

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(. . . continued)
misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5.

51 *See, e.g.*, *Sheldon*, 1992 WL 353048, at *12 & nn.67–68 (affirming finding that undisclosed markups ranging from 6 percent to as high as 15 percent violated Rules G-17 and G-30 of the MSRB, and, to the extent the markups exceeded 8 percent, they violated Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act, and Rules 10b–5 and 15c1–2 thereunder).

52 *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1975).

53 *See, e.g.*, *Meyer Blinder*, Exchange Act Release No. 31095, 52 SEC 1145, 1992 WL 216702, at *9 (Aug. 26, 1992).

54 *Id.*; *Powell*, 1982 WL 32339, at *1–2.

55 *See, e.g.*, *David A. Finnerty*, Exchange Act Release No. 56849, 92 SEC 9, 2007 WL 4180387, at *3 (Nov. 27, 2007).

markups.[56] Grey was aware of his contemporaneous costs and personally set the prices at each step of the transactions. The interpositioning served no purpose other than to enrich himself and deceive GMCI, GMCI's customers, and other market participants. As part of his interpositioning scheme, Grey arranged the transactions to make it appear as though the Firm charged markups of around three percent and failed to disclose the hidden markups created by his successive intermediate trades. His actions reveal his intent to deceive, manipulate, and defraud the Firm's retail customers into paying inflated prices in the relevant transactions.[57]

Grey mainly argues that he could not have acted with scienter in the disputed trades because Enforcement brought charges based on only a small number of isolated transactions. Grey contends that he could not have possessed the requisite intent to defraud with respect to the bond trades at issue because he had charged equally high markups in numerous other transactions during the same time period, sometimes with the same clients, none of which were challenged. These other excessive markups to which Grey refers—although not at issue here—hardly undermine our finding of scienter as to the ten transactions in this case. In declining to bring charges relating to these other transactions, Enforcement has not condoned these transactions, but has rather exercised its prosecutorial discretion in deciding which transactions to pursue.[58]

Similarly, Grey argues that it is "incongruous to think that [he] would simultaneously cheat the customers on one bond for insignificant compensation, while selling them numerous bonds at the same time at prices which have not been challenged as fraudulent." But there is no requirement or expectation that fraudulent transactions exclusively accompany other fraudulent transactions. In fact, fraudsters may intentionally bury fraudulent transactions among legitimate trades in an effort to avoid detection. Further, although Grey argues that his compensation was "insignificant," there is no *de minimis* exception to fraudulent conduct. It is irrelevant whether his violations impacted only a few of GMCI's customers, a random set of trades, or what he considers to be an inconsequential sum of ill-gotten gains.[59]

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[56] *See, e.g.*, *Gonchar*, 2009 WL 2488067, at *9 (finding that applicants acted with scienter where customers relied on applicants' pricing and applicants exacerbated the lack of transparency by not disclosing the interpositioning and markups).

[57] Although Enforcement limited its charge of fraudulently excessive markups to seven transactions with markups above eight percent, we have previously noted that "undisclosed, excessive markups constituting any percentage may be fraudulent if done with scienter." *Lane*, 2015 WL 627346, at *10 n.56.

[58] This prosecutorial discretion—which is not at issue in this case—is immaterial to Grey's misconduct. *See Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993) ("NASD disciplinary proceedings are treated as an exercise of prosecutorial discretion.").

[59] *Tellabs*, 551 U.S. at 325("While it is true that motive can be a relevant consideration, and personal financial gain may weigh heavily in favor of a scienter inference, we agree . . . that the absence of a motive allegation is not fatal.").

Accordingly, we sustain FINRA's finding that Grey willfully violated Exchange Act Section 10(b) and Rule 10b-5 when he charged markups exceeding eight percent, and failed to disclose those excessive markups and his interpositioning to his GMCI's customers.[60]

E. FINRA's sanctions are neither excessive nor oppressive.

Exchange Act Section 19(e)(2) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[61] For Grey's interpositioning, excessive markups, and fraud violations, the NAC fined Grey $30,000, ordered him to disgorge $15,750 (plus prejudgment interest) to FINRA, and suspended him from associating with any FINRA member firm in any capacity for eighteen months. We find the sanctions imposed on Grey to be consistent with the statutory requirements, and we sustain them.

For excessive markups, FINRA's Sanction Guidelines recommend a fine of $5,000 to $100,000, plus the gross amount of the excessive markups, as well as suspension for up to 30 days.[62] In egregious cases of excessive markups, the Guidelines permit suspension of up to two

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60 Grey claims that "[d]ue to the findings on the 10b-5 charge, in effect [he] has been banned from the industry for life." But his statutory disqualification is not a FINRA-imposed penalty or remedial sanction. Rather, FINRA found that Grey was subject to statutory disqualification under Exchange Act Section 3(a)(39)(F) because he willfully violated Section 10(b) and Rule 10b-5. An applicant is subject to statutory disqualification where, as here, the applicant "has willfully violated any provision of the Exchange Act," 15 U.S.C. § 78c(a)(39)(F). *See, e.g.*, *Lane*, 2015 WL 627346, at *1 n.2; *Richard A. Neaton*, Exchange Act Release No. 65598, 101 SEC 1009, 2011 WL 5001956, at *7–10 (Oct. 20, 2011); *Scott Mathis*, Exchange Act Release No. 61120, 97 SEC 1195, 2009 WL 4611423, at *12 & n.40 (Dec. 7, 2009), *aff'd*, *Mathis v. SEC*, 671 F.3d 210 (2d Cir. 2012). Willful violation of the securities laws means "intentionally committing the act which constitutes the violation" and does not require that the actor "also be aware that he is violating one of the Rules or Acts." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks omitted). The record firmly establishes that Grey intentionally applied the markups to the transactions at issue without disclosing the details of those markups. We therefore agree with FINRA that he acted willfully and sustain FINRA's finding that he is subject to statutory disqualification.

61 15 U.S.C. § 78s(e)(2). Grey does not allege, and the record does not show, that FINRA's sanctions imposed an undue burden on competition.

62 *See FINRA Sanctions Guidelines*, at 6 (2013). FINRA revised its sanctions guidelines in May 2015, increasing specific fines and penalties that, if applied in this case, could warrant imposing greater fines and penalties against Grey. FINRA intended the 2015 guidelines to supersede prior versions of the guidelines, even for "pending matters." *See FINRA Sanctions Guidelines*, at 8 (2015) ("These guidelines supersede prior editions of the *FINRA Sanction Guidelines* . . . . These guidelines are effective as of the date of publication, and apply to all disciplinary matters, including pending matters"). We apply the 2013 guidelines, here, however, because they were in effect when the NAC reached the decision from which Grey appeals. *Cf.*

(continued . . .)

years or a bar.[63] For intentional or reckless misrepresentations or material omissions of fact, the Guidelines recommend a fine of $10,000 to $100,000, a suspension of up to two years, and, in egregious cases, a bar.[64]

As an initial matter, we agree with the NAC's characterization of Grey's excessive markups and misrepresentations as egregious. As we have stated, "[t]he charging of excessive markups [i]s a serious breach of [a broker's] obligation to deal fairly with its customers."[65] Grey demonstrated a complete disregard for this obligation when he repeatedly interposed himself between GMCI and his retail customers, causing them to pay markups that greatly exceeded industry standards and GMCI's internal policies, while concealing the excessive markups through his interpositioning scheme.[66] And, moreover, Grey has yet to acknowledge that his misconduct constituted a violation of the securities laws.[67] No mitigating circumstances warrant reducing the sanctions FINRA imposed. Under the circumstances, neither the $30,000 fine nor the 18-month suspension[68] is excessive or oppressive.[69]

(. . . continued)
Kent M. Houston, Exchange Act Release No. 71589, 2014 WL 651953, at *3 n.23 (Feb. 20, 2014) (noting that the NAC applied 2007 Sanction Guidelines on remand, notwithstanding FINRA's 2011 revisions, because the 2007 version was "in effect at the time [the NAC] issued its initial decision").

63 *FINRA Sanctions Guidelines*, at 90 & n.1 (2013).

64 *Id.* at 88 & n.1.

65 *Codispoti*, 1987 WL 755546, at *4.

66 *See, e.g.*, *Sheldon*, 1992 WL 353048, at *13 (finding that "interpositioning of favored accounts between the dealer market and non-favored accounts [that] resulted in fraudulent, excessive markups of as much as 10 percent" was "particularly egregious"); *Frank L. Palumbo*, Exchange Act Release No. 46427, 60 SEC 1473, 1995 WL 630926, at *9 (Oct. 26, 1995) (stating that recklessly overcharging customers without justification demonstrates "a marked insensitivity to [the] obligation to deal fairly with customers").

67 We reject Grey's argument that FINRA punished him for defending himself in a disciplinary action. The acceptance or acknowledgment of misconduct is a principal consideration in tailoring appropriate sanctions to deter future conduct. *See FINRA Sanctions Guidelines*, at 2 (2013); *Kevin Lee Otto*, Exchange Act Release No. 43296, 73 SEC 751, 2000 WL 1335346, at *4 (Sept. 15, 2000) (adjusting sanctions upward because respondent's "refusal to acknowledge his misconduct and actions demonstrate a serious misunderstanding of the obligations he owes to a customer as a registered representative," and questioning "his commitment to the high standards demanded by the securities industry"), *aff'd* 253 F.3d 960 (7th Cir. 2001).

68 Grey claims that the NAC decision, which reduced his suspension from two years to 18-months, actually lengthened his suspension for nearly a year, because the Hearing Panel originally scheduled his suspension to run from August 19, 2013 to August 18, 2015, but the
(continued . . .)

We also sustain FINRA's order for Grey to disgorge $15,750 in unlawful profits plus prejudgment interest as of July 27, 2009. Grey challenges this calculation because it includes his entire profit and not just the excessive portion (*i.e.*, the markup in excess of three percent). Although Grey is correct that the disgorgement sum includes his entire profit from the series of transactions at issue, its calculation was neither an error nor an injustice. In egregious cases involving intentional or reckless misconduct, FINRA may require respondents to disgorge their entire financial benefit.[70] We find this disgorgement sum appropriate in light of the egregious nature of Grey's misconduct.[71]

V. Conclusion

Over a period of several months, Grey repeatedly interposed his personal accounts between his customers and the market, causing his customers to pay unfair and unreasonable markups ranging from 5.36% to 19.12% above the prevailing market price. These markups were unfair and unreasonable under the circumstances of the case. Grey consistently concealed the excessive markups by using intermediate trades, routed through his personal accounts, to artificially increase the Firm's purchase price. Grey also failed to disclose to his customers that he was personally involved in the transactions and profited from the excessive markups they

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(. . . continued)
NAC decision (dated October 3, 2014) rescheduled it for December 1, 2014 to May 31, 2016. Of course, the "'reduction' of the suspension by six months" did not "result[] in an extension of the suspension for nearly a year," as Grey claims. Rather, his choice to appeal the Hearing Panel's decision to the NAC delayed the start of the suspension. *See* FINRA Rule 9311(b) ("An appeal to the National Adjudicatory Council . . . shall operate as a stay of that decision until the National Adjudication Council issues a decision . . . ."). Grey's suspension is likewise stayed pending his application of review before this Commission. *See* FINRA Rule 9370(a) ("The filing with the SEC of an application for review by the SEC shall stay the effectiveness of any sanction, other than a bar or an expulsion, imposed in a decision constituting a final disciplinary action of FINRA . . . .").

69 All of the cases Grey cites to support his claim that the sanctions are improperly punitive are distinguishable from this case and have minimal relevance because most were settled, *see FINRA Sanctions Guidelines*, at 1 (2013) (settled cases often impose lesser sanctions), and none involved fraud (which warrants higher sanctions).

70 *See id.* at 5 ("In cases in which the record demonstrates that the respondent obtained a financial benefit from his or her misconduct, where appropriate to remediate misconduct, Adjudicators may require the disgorgement of such ill-gotten gains by fining away the amount of some or all of the financial benefit derived, directly or indirectly."); *id.* at 88 n.2 ("As set forth in General Principal No. 6, Adjudicators may increase the recommended fine amount by adding the amount of respondent's financial benefit.").

71 We likewise sustain the order for Grey to pay $5,267.32 in hearing costs.

were charged. For all of these reasons, we sustain FINRA's sanctions for Grey's violations of MSRB Rules G-17 and G-30 and Exchange Act Section 10(b).

An appropriate order will issue.[72]

By the Commission (Chair WHITE and Commissioners GALLAGHER, STEIN and PIWOWAR; Commissioner AGUILAR not participating).

Brent J. Fields

Secretary

By: Lynn M. Powalski
Deputy Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75839 / September 3, 2015

Admin. Proc. File No. 3-16230

In the Matter of the Application of

ANTHONY A. GREY

For Review of Disciplinary Action Taken By

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION

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

ORDERED that the disciplinary action taken by FINRA against Anthony A. Grey, and the assessment of costs imposed, be, and they hereby are, sustained.

By the Commission.

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75840 / September 4, 2015

Admin. Proc. File No. 3-15993

In the Matter of

Accredited Business Consolidators Corporation

OPINION OF THE COMMISSION

SECTION 12(j) PROCEEDING

Grounds for Remedial Action

Failure to Comply with Periodic Filing Requirements

Company failed to timely file periodic reports in violation of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13. *Held*, it is necessary and appropriate for the protection of investors to revoke the registration of the company's securities.

APPEARANCES:

Elisa Corea, Vice President, for Accredited Business Consolidators Corporation.

Thomas Bednar and *Neil J. Welch, Jr.*, for the Division of Enforcement.

Appeal filed: December 24, 2014
Last brief received: March 16, 2015

17 of 147

Accredited Business Consolidators Corp. appeals an administrative law judge's decision to revoke the registration of its common stock pursuant to Securities Exchange Act Section 12(j).[1] The law judge revoked the registration after finding that Accredited violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13[2] by failing to file any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012.[3] Accredited admits that it has not filed any periodic reports since the Form 10-Q for the period ended September 30, 2012, but contends that the law judge erred by revoking its registration rather than suspending it for less than twelve months. Accredited also contends that revocation is not justified because its securities are traded on the over-the-counter market in the same manner as companies whose securities are not registered and that are not required to file periodic reports. Based on an independent review of the record, we have determined that revocation of Accredited's securities registration serves the public interest and is necessary for the protection of investors.

I. Background

Accredited is a Pennsylvania corporation located in Managua, Nicaragua with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Its stock is currently traded in the over-the-counter markets under the symbol ACDU. Accredited is delinquent in its periodic filings with the Commission, not having filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which it filed on November 20, 2012. Accredited last filed a Form 10-K annual report for the year ended December 31, 2011, on March 8, 2012.[4] Accredited has not filed any Forms 12b-25 seeking an extension of time to make its periodic filings since August 16, 2013.

On July 31, 2014, we issued an Order Instituting Proceedings alleging that Accredited failed to file quarterly and annual reports as required under Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 and instituting proceedings to determine whether revocation or suspension of the registration of the company's securities was necessary or appropriate to protect investors.[5] Accredited filed an answer on August 21, 2014, admitting that it was delinquent in the filing of its reports and stating that it "can and will bring the filings current as soon as practicable."

The Division of Enforcement filed a motion for summary disposition on October 6, 2014. The law judge granted the Division's motion in a December 1, 2014 initial decision. The law judge found that Accredited violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13, and determined that revoking Accredited's securities registration was in the public interest.

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1 15 U.S.C. § 78*l*(j).

2 15 U.S.C. § 78m(a); 17 C.F.R. §§ 13a-1 and 13a-13.

3 *Accredited Bus. Consolidators Corp.*, Release No. 712, 2014 WL 6737052, at *1 (Dec 1, 2014).

4 Accredited filed an amendment to this 10-K on January 28, 2013.

5 On July 31, 2014, we also issued an order pursuant to Exchange Act Section 12(k) suspending trading in Accredited's securities from July 31 through August 13, 2014.

The Commission's EDGAR database shows that Accredited continues to be delinquent in its periodic reports and has not filed the required Form 8-K announcing the engagement of an auditor, which would be necessary for the company to file its delinquent audited periodic reports.[6]

II. Analysis

A. Accredited violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13.

Exchange Act Section 13(a) requires issuers of securities registered under Exchange Act Section 12 to file with the Commission annual and quarterly reports "for the proper protection of investors and to insure fair dealing" in the company's securities.[7] Exchange Act Rules 13a-1 and 13a-13 set forth the requirements for those reports.[8] Accredited concedes that it has not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which it filed on November 20, 2012. Accordingly, we find that the company violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13.

B. The *Gateway* factors justify revocation under these circumstances.

Exchange Act Section 12(j) authorizes us, as we deem necessary or appropriate for the protection of investors, to either suspend the registration of a security for a period not exceeding twelve months or to revoke it if an issuer fails to comply with any provision of the Exchange Act or its rules and regulations.[9] In determining the appropriate sanctions under Section 12(j), we are guided by the non-exclusive public interest factors first set forth in *Gateway International Holdings, Inc.*[10] They include (i) the seriousness of the issuer's violations; (ii) the isolated or recurrent nature of the violations; (iii) the degree of culpability involved; (iv) the extent of the issuer's efforts to remedy its past violations and ensure future compliance; and (v) the credibility of its assurances, if any, against further violations.[11] We find that, based on these factors, it is necessary and appropriate for the protection of investors to revoke Accredited's securities registration.

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[6] On March 16, 2015, the Division filed a motion to adduce additional evidence. The Division seeks to adduce all EDGAR filings for Accredited as of March 16, 2015, and the trading status for Accredited's securities as of March 16, 2015. Because the additional evidence is material and was not available at the hearing, we will grant the motion. 17 C.F.R. § 201.452. We take official notice of the EDGAR filings cited in this opinion pursuant to Rule of Practice 323, 17 C.F.R. § 201.323 (permitting the Commission to take official notice of, for example, "any matter in the public official records of the Commission," such as periodic reports filed in the EDGAR database).

[7] 15 U.S.C. § 78m(a).

[8] 17 C.F.R. §§ 240.13a-1, 13a-13.

[9] 15 U.S.C. § 78*l*(j).

[10] 2006 WL 1506286, at *4.

[11] *Id.*

Accredited violations are serious, recurrent, and extend over a lengthy period. The company has not filed any periodic reports for over two years. By failing to comply with its reporting obligations, Accredited has violate[d] a central provision of the Exchange Act. It has deprived both existing and prospective holders of its registered stock of the ability to make informed investment decisions based on current and reliable information, including audited financial statements, about the Company's operations and financial condition.[12]

That Accredited knew of its reporting obligations but failed to comply with them is evidence of a high degree of culpability. Since it last filed a periodic report in 2012, Accredited has filed a number of Forms 8-K pursuant to Exchange Act provisions requiring it to report material events. It also filed several Forms 12b-25 seeking extensions of time to make its periodic filings, but has not done so since August 16, 2013, despite its continued delinquency. This shows that Accredited understands the Exchange Act reporting obligations yet has failed to make its required filings anyway. That the company has repeatedly ignored its Exchange Act reporting obligations is further evidence of a high degree of culpability. [13]

Accredited has made no credible effort to remedy its past violations or provided any credible assurance against future violations. According to a Form 8-K/A filed on May 29, 2014, Accredited dismissed its previous auditor on May 9, 2014, after that auditor's registration with PCAOB was revoked. Based on Accredited's EDGAR filings, the company thus far has failed to hire a new auditor to help it prepare its delinquent periodic reports, and it has not filed any of its delinquent periodic reports.

We have previously stated that we consider a "recurrent failure to file periodic reports as so serious that only a strongly compelling showing with respect to the other factors . . . would justify a lesser sanction than revocation."[14] Accredited has not made such a showing.

First, we reject Accredited's argument that a lesser sanction is warranted because it is traded on the over-the-counter markets "along with companies that have no registration statement and publish no information about their operations—yet the companies that publish no information are allowed to trade." As we have previously held, the "only matters relevant to [a 12(j)] proceeding" are "the fact of [an issuer's] failure to file its quarterly and annual reports" and "its present inability to cure these deficiencies." [15] The fact that companies with unregistered securities trade on the same market as Accredited is beside the point.

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12 *See Impax Lab., Inc.*, Exchange Act Rel. No. 57864, 93 SEC Docket 6241, 6256, 2008 WL 2167956, at *7 (May 23, 2008).

13 *See America's Sports Voice, Inc.*, Exchange Act Rel. No. 55511, 90 SEC Docket 1225, 1228, 2007 WL 858747, at *3 (Mar. 22, 2007).

14 *Impax*, 2008 WL 2167956, at *8.

15 *Eagletech Commc'n, Inc.*, Exchange Act Rel. No. 54095, 88 SEC Docket 1225, 1228, 2006 WL 1835958, at *2 (July 5, 2006).

Second, we find no merit in Accredited's argument that the Division has failed to establish that revocation is necessary or appropriate for the protection of investors and that a suspension of up to twelve months is a "more appropriate remedy." Exchange Act reports are designed to provide the public with information that is "material, timely, and accurate." [16] For over two years, Accredited has failed to file its required periodic reports.[17] Nor, despite its purported willingness to return to compliance, has the Company provided a credible basis to conclude that it is capable of doing so. Revocation under such circumstances "further[s] the public interest by reinforcing the importance of full and timely compliance with the Exchange Act's reporting requirements."[18] Under the circumstances, we believe that revoking the Section 12(g) registration of the Company's common stock is warranted for the protection of investors.

An appropriate order will issue.[19]

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

Brent J. Fields
Secretary

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

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16 *America's Sports Voice*, 2007 WL 858747, at *4 (citing *SEC v. Beisinger Indus. Corp.*, 552 F.2d 15, 18 (1st Cir. 1977) (stating that the reporting requirements are "the primary tool[s] which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities.")); *see also United States v. Arthur Young & Co.,* 465 U.S. 805, 810 (1984) (observing that "[c]orporate financial statements are one of the primary sources of information available to guide the decisions of the investing public.").

17 In assessing the appropriate sanction, we also consider Accredited's failure to file Forms 12b-25 in connection with delays in its periodic reports, which the Company does not deny. See *Nature's Sunshine Products, Inc.*, Exchange Act Release No. 59268, 95 SEC Docket 26, 2009 WL 137145, at *6 (noting that the Commission may consider subsequent filing failures and other "matters that fall outside the [order instituting proceedings], in assessing appropriate sanctions.").

18 *Id. at *9.* Even had Accredited filed all of its delinquent reports, we may well have found revocation to be appropriate in order "to deter [Accredited] and other issuers from disregarding their obligations to present accurate and timely information to the investing public until spurred by the institution of proceedings. Deterrence is meaningful only if a lengthy delinquency, in the absence of strongly compelling circumstances regarding the other Gateway factors, results in revocation." *Absolute Potential, Inc.,* Exchange Act Rel. No. 71866, 2014 WL 1338256, at *6 (Apr. 4, 2014).

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75840/September 4, 2015

Admin. Proc. File No. 3-15993

In the Matter of

Accredited Business Consolidators Corporation

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that the registration of all classes of the registered securities of Accredited Business Consolidators Corporation under Section 12(g) of the Securities Exchange Act of 1934 is hereby revoked pursuant to Exchange Act Section 12(j).

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. 75842 / September 4, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16782

In the Matter of MOSHE YEHUDA DUNOFF, 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 Moshe Yehuda Dunoff ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Respondent admits the facts set forth in Section III. below, acknowledges that his conduct 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 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. Dunoff, age 28, is a resident of West Palm Beach, Florida. From January 2009 through December 2010, Dunoff was associated with an unregistered broker-dealer operating under the name of Gruber and Green, Inc.

2. On August 21, 2015, a judgment was entered by consent against Dunoff, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled *Securities and Exchange Commission v. Moshe Yehuda Dunoff*, Civil Action No. 2:15-cv-04738, in the United States District Court for the Eastern District of Pennsylvania.

3. The Commission's complaint alleged that, from January 2009 through December 2010, Dunoff participated in a fraudulent offering scheme. As part of the scheme, Dunoff set up several U.S. based bank accounts through which he funneled more than $1.5 million in illicit proceeds obtained from defrauded investors for the purchase of securities. The complaint further alleged that Dunoff never used any of these funds to purchase securities but, instead, retained between six and ten percent of the funds as a fee for his services and diverted the remainder to accounts in the Philippines, Thailand and Indonesia, controlled by individuals operating in the name of Gruber and Green, Inc.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Dunoff 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 Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75843 / September 4, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3681 / September 4, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16783

In the Matter of **RAYMON HOLMDAHL, CPA, and** **KANAKO MATSUMOTO, CPA,** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 4C[1] of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e) of the Commission's Rules of Practice[2] against Raymon Holmdahl, CPA, and Kanako Matsumoto, CPA (collectively, "Respondents").

[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 . . . 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.

II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[3] that:

A. SUMMARY

1. These proceedings arise out of Respondents' improper professional conduct during Peterson Sullivan, LLP's ("Peterson Sullivan") audit of a private investment fund's financial statements for fiscal year 2013 ("FY2013"). Raymon Holmdahl and Kanako Matsumoto served as the partner and manager, respectively, on this engagement to audit the financial statements of Summit Stable Value Fund ("SSVF"), a private pooled investment vehicle advised by Summit Asset Strategies Investment Management, LLC ("Investment Management").

2. SSVF's audited financial statements for the year ended December 31, 2013, which Investment Management provided to SSVF's investors, materially overstated the value of the fund's assets by approximately $1.69 million. Because Investment Management was entitled to receive SSVF's net fund profits as its compensation for advising SSVF, the overstatement allowed Investment Management to withdraw significantly more money from SSVF than was authorized under the terms of the fund's private placement memorandum ("PPM").

3. Respondents caused Peterson Sullivan to issue an audit report containing an opinion that SSVF's financial statements for the period ended December 31, 2013, which included the valuations of the fund's assets and Investment Management's draws from the fund, were presented fairly, in all material respects, in conformity with general accepted accounting principles ("GAAP"). Peterson Sullivan's audit report also stated that the audit was conducted in accordance with auditing standards generally accepted in the United States. However, Respondents' audit failed to comply with numerous American Institute of Certified Public Accountants ("AICPA") auditing standards, the applicable professional standards for the audit of SSVF. These included failing to obtain sufficient appropriate audit evidence about the existence of certain fund assets, failing to exercise appropriate professional judgment and professional skepticism, and failing to properly supervise the financial statement audit. Respondent Holmdahl also authorized the issuance of a report with an

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

inaccurate audit opinion. Peterson Sullivan voluntarily withdrew its audit report for SSVF's 2013 financial statements based on the material overstatement of SSVF's valuation and ownership interest in certain of its assets. Respondents' conduct, as described below, constituted improper professional conduct pursuant to Rule 102(e)(1)(iv)(B)(1) and (2).

B. RESPONDENTS

4. **Raymon Holmdahl, CPA**, 57, resides in Lake Forest Park, Washington. Holmdahl is currently a partner at Peterson Sullivan, an accounting firm registered with the Public Company Accounting Oversight Board ("PCAOB"), and has worked for Peterson Sullivan since 1980. Holmdahl served as the engagement partner for Peterson Sullivan's FY2013 audit of SSVF and related audit work, and served as an engagement partner for audits of public companies. Holmdahl is a certified public accountant licensed in Washington State.

5. **Kanako Matsumoto, CPA**, 50, resides in Seattle, Washington. Matsumoto is currently a senior manager at Peterson Sullivan, and initially joined the firm in 1999. Matsumoto served as the manager for Peterson Sullivan's FY2013 audit of SSVF and related audit work, and has worked on audits of several broker-dealers. Matsumoto is a certified public accountant licensed in Washington State.

C. OTHER RELEVANT ENTITIES

6. **Summit Asset Strategies Investment Management, LLC ("Investment Management")** is a Washington limited liability company based in Bellevue, Washington and served as the investment adviser to three private investment funds, including SSVF. During the relevant timeframe, Investment Management, through its principal/CEO, made investment decisions on behalf of SSVF and was entitled to receive SSVF's net fund profits as its compensation.

7. **Summit Stable Value Fund, LLC ("SSVF")** is a Washington limited liability company based in Bellevue, Washington. SSVF is a private pooled investment vehicle formed by Investment Management's principal in 2010 and was at all times advised by Investment Management.

D. FACTS

Investment Management Materially Overstated the Value of SSVF's Assets

8. According to SSVF's PPM, Investment Management was entitled to receive SSVF's net fund profits as compensation for its work in advising SSVF. The PPM permitted Investment Management to withdraw estimated "net fund profits" (defined as the profit less principal, interest payments, and fund expenses) from the fund on a monthly basis, but also required Investment Management to "true up" any distributions to match net fund profits as "determined in the Fund's annual audit." Accordingly, it was important for Investment Management to properly value SSVF's assets, as its compensation was specifically tied to the unrealized gains and losses in those assets each year.

9. Investment Management caused SSVF to materially overstate its asset values in its FY2013 financial statements. Specifically, Investment Management falsely claimed that SSVF had purchased 500,000 shares of an entity called Prime Pacific Bank in December 2012. Because the Prime Pacific Bank security was purportedly illiquid, Investment Management developed a financial model to value this asset. For FY2013, this model showed that SSVF's interest in Prime Pacific Bank had more than tripled in value from the shares' purported purchase price of $1.00 per share to $3.22 per share by the end of the fiscal year. As such, SSVF's FY2013 financial statements presented the value of the claimed Prime Pacific Bank security as approximately $1.6 million. The putative increase in Prime Pacific Bank's value enabled Investment Management to withdraw significantly more money as net fund profits from SSVF than it would otherwise have been entitled to under the terms of SSVF's PPM.

10. In reality, SSVF did not own any shares of Prime Pacific Bank. Instead, SSVF held 250,000 shares in a different entity, Prime Pacific Financial Services, Inc. ("PPFS"), which had a quoted trading price ranging between $0.27 per share to $0.70 per share in 2012 and 2013. Accordingly, SSVF's interest in PPFS had a value worth less than $175,000 at fiscal year-end 2013. As a result of these irregularities, SSVF's financial statements for FY2013 were materially overstated.

Respondents' Deficient FY2013 Audit

11. Peterson Sullivan's audit report for SSVF's FY2013 financial statements states that the audit was conducted in accordance with "auditing standards generally accepted in the United States." These standards are codified by AICPA professional auditing standards.[4] Holmdahl, as engagement partner, was responsible for supervising the audit team and reviewing audit work for compliance with these professional standards. Holmdahl was also responsible for considering whether the audit team adequately documented in the working papers their findings, analysis, and information upon which they relied, and that the working papers provided a reasonable basis to render an audit opinion. Matsumoto, as audit manager, was principally responsible for performing the audit procedures, supervising junior staff, and assisting Holmdahl in his role as engagement partner.

12. During the FY2013 audit, Holmdahl approved the audit program and reviewed the working papers with Matsumoto. At the outset, Holmdahl and Matsumoto each recognized that the presentation of SSVF's asset values posed "significant" risk, and could result in a material misstatement of the fund's financial statements. In addition, Respondents were aware that the fund's predecessor auditor had disagreed with Investment Management's valuation of the purported Prime Pacific Bank security and subsequently resigned due to its inability to "gather adequate audit evidence to support audit opinions" regarding, among other things, the existence and valuation of assets, during the FY2013 audit. In response to these heightened risks,

[4] GAAS and the professional standards applicable to the preparation and issuance of audit reports are embodied in Statements on Auditing Standards, as issued by the Auditing Standards Board of the AICPA and codified in the *U.S. Auditing Standards-AICPA (clarified).* Relevant auditing standards will be referenced as "AU-C" herein.

Respondents specifically planned in their audit procedures to rely on third-party confirmation of all investment account balances and investment income.

13. Despite knowledge of these risks, Respondents failed to perform the fund's FY2013 audit in accordance with AICPA standards, particularly with respect to the fund's investments. Among the deficiencies, Respondents failed: (i) to obtain sufficient appropriate audit evidence about the existence of certain fund assets; (ii) to exercise appropriate professional judgment and professional skepticism; and (iii) to properly supervise the financial statement audit. Respondent Holmdahl, as engagement partner, also authorized the issuance of a report with an inaccurate audit opinion. As a result of these deficiencies, Respondents caused Peterson Sullivan to issue an unmodified opinion with respect to the fund's materially overstated financial statements.

Respondents Failed to Obtain Sufficient Appropriate Audit Evidence Regarding the Fund's Purported Investment in Prime Pacific Bank

14. AICPA Auditing Standards ("AU-C") require the auditor to "obtain sufficient appropriate audit evidence … on which to base the auditor's opinion…" (AU-C § 500.04) and to "…design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence." (AU-C § 500.06).

15. Professional standards also require the auditor (1) to "perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure" (AU-C § 330.18); (2) to "design and implement overall responses to address the assessed risks of material misstatement at the financial statement level" (AU-C 330.05); (3) to "design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level" (AU-C 330.06); and (4) to "consider whether external confirmation procedures are to be performed as substantive audit procedures" (AU-C 330.19).

16. Respondents planned to obtain audit evidence of SSVF's investments through third party confirmation, but ultimately failed to send third party confirmation letters for the fund's purported investment in Prime Pacific Bank. Despite repeatedly recognizing in their workpapers the need for heightened scrutiny, Respondents did not confirm the fund's investment in PPFS with the bank or any third party for purposes of auditing the investment balance. In failing to follow their own audit plan, Respondents did not learn that the fund's purported Prime Pacific Bank investment did not exist. Had they executed on their plan to confirm the existence of investments, Respondents would have likely learned that SSVF's claimed investment in Prime Pacific Bank was nonexistent, and that it should not have been included in the fund's FY2013 financial statements.

17. In the absence of performing the planned third party confirmations, Respondents did not perform alternative or additional procedures to test the existence of SSVF's purported investment in Prime Pacific Bank. Indeed, the working papers do not reflect any audit procedures taken by Respondents to obtain sufficient appropriate audit evidence relevant to the existence of the Prime Pacific Bank security.

Respondents Committed Similar Failures With Respect to Other Assets Included in SSVF's Financial Statements

18. Respondents similarly failed to obtain sufficient appropriate audit evidence for two other assets reported in the fund's FY2013 financial statements: (1) SSVF's claimed investment in a Korean entity called Summit Asset Strategies Korea Co. Ltd. ("SASK"), which purportedly was a management consulting services company; and (2) SSVF's claimed $3.6 million receivable from SASK. For instance, Respondents planned to test the existence of SSVF's investment in SASK through third party confirmations, but ultimately failed to do so. The workpapers otherwise reflect that Respondents did not perform other audit procedures to test the existence of these supposed assets or perform any alternative procedures to obtain sufficient appropriate audit evidence regarding the existence of these assets. These assets were significant to SSVF's FY2013 financial statements and comprised 63% of the fund's reported assets as of fiscal year-end 2013.

Respondents Failed to Exercise Appropriate Professional Judgment and Professional Skepticism

19. Under GAAS, auditors must exercise appropriate professional judgment and professional skepticism. (AU-C §200.08.) Professional skepticism includes demonstrating a questioning mind and a critical assessment of audit evidence. (AU-C § 200.14). In addition, AU-C §200.17 requires auditors to "plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated."

20. Respondents did not exercise the appropriate professional judgment when conducting the audit and issuing an opinion on SSVF's financial statements for FY2013. Respondents' assessment of the risks posed by SSVF's asset values should have caused them to place greater emphasis on obtaining sufficient appropriate audit evidence regarding the existence of the fund's investments. They did not. The working papers do not document any audit procedures taken by Respondents to address these risks.

Respondents Failed to Properly Supervise the Financial Statement Audit

21. GAAS requires the engagement partner to "take 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).

22. Holmdahl failed to adequately supervise the FY2013 audit. Although Holmdahl appreciated the significant risks posed by the fund's valuations – as demonstrated by his approval of the audit plan – he did not adequately review the audit documentation to satisfy

himself that sufficient appropriate audit evidence was obtained about the existence of the fund's purported investments in Prime Pacific Bank and SASK.

23. GAAS provides that the engagement partner may use the assistance of other members of the engagement team and delegate certain procedures. (AU-C § 220.6 and (AU-C § 220.10). Matsumoto did not adequately supervise and review the audit team's response to the risk of material misstatement for SSVF's assets. Matsumoto knew that SSVF's asset values posed risks during the audit and planned to perform third party confirmations for SSVF's purported Prime Pacific Bank investment. Notwithstanding the plan, Matsumoto did not adequately review the work of junior staff members to consider whether: (i) the nature, timing, and extent of the work performed is appropriate and without need for revision; (ii) the work performed supports the conclusions reached and is appropriately documented; (iii) the evidence obtained is sufficient and appropriate to support the auditor's report; and (iv) the objectives of the engagement procedures have been achieved.

Holmdahl Was Responsible For Authorizing the Issuance of a Report with an Inaccurate Audit Opinion

24. GAAS requires an unmodified opinion to state that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework, which, in the case of SSVF, is US-GAAP. (AU-C §700.35). An auditor should modify its opinion when it concludes that the financial statements as a whole are materially misstated or is unable to obtain sufficient appropriate audit evidence to conclude that they are free from material misstatement. (AU-C §705.07).

25. As audit partner with ultimate responsibility for SSVF's financial statement audit for FY2013, Holmdahl approved the issuance of an audit report containing an unmodified opinion. However, the fund's financial statements materially overstated its assets and "net fund profits," and as such, Peterson Sullivan should not have issued an audit report containing an unmodified opinion. Peterson Sullivan has since withdrawn its report and opinion based on the material overstatement of SSVF's valuation and ownership interest in its assets.

E. VIOLATIONS

26. 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) of the Commission's Rules of Practice provide that, with respect to persons licensed to practice as accountants, negligent improper professional conduct includes either (1) "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted," or (2) "[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."

27. As a result of the conduct described above, Respondents engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule

102(e)(1)(iv)(B)(1)&(2) of the Commission's Rules of Practice. Respondents engaged in a single instance of highly unreasonable conduct where heightened scrutiny was warranted, or alternatively, repeated instances of unreasonable conduct indicating a lack of competence to practice before the Commission.

IV.

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

Accordingly, pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Holmdahl is denied the privilege of appearing or practicing before the Commission as an accountant.

B. Matsumoto is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After three years from the date of this order, either Respondent may request that the Commission consider his or her 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 or she 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 or she is associated, has been inspected by the PCAOB and that inspection did not identify any criticisms of or potential defects in the quality control system relating to the work of Respondent that will indicate that Respondent will not receive appropriate supervision;

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

(d) Respondent acknowledges his or her responsibility, as long as he or she appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, 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 or her CPA license is current and he or she 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.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75844 / September 4, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3682 / September 4, 2015

Admin. Proc. File No. 3-15659

In the Matter of

THOMAS D. MELVIN, CPA

OPINION OF THE COMMISSION

RULE 102(e)(3) PROCEEDING

Grounds for Remedial Action

Civil Injunction

Certified public accountant was permanently enjoined from violating antifraud provisions of the federal securities laws. *Held*, it is in the public interest to permanently disqualify respondent from appearing or practicing before the Commission.

APPEARANCES:

C. Brian Jarrard, C. Brian Jarrard, LLC, for Thomas D. Melvin.

Joshua A. Mayes, for the Division of Enforcement.

Appeal filed: October 14, 2014
Last brief received: March 3, 2015

Thomas D. Melvin, a certified public accountant and a principal in the accounting firm of Melvin, Rooks, and Howell in Griffith, Georgia, appeals from an initial decision permanently disqualifying him from practicing before the Commission, based on his having been enjoined from violating antifraud provisions of the federal securities laws and rules thereunder.[1] We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

I. BACKGROUND

A. Melvin consented to the entry of an injunction in federal district court.

On April 10, 2013, Melvin settled civil proceedings by consenting to the entry of a final judgment (the "Injunctive Order") that permanently enjoined him from violating Exchange Act Sections 10(b) and 14(e) and Exchange Act Rules 10b-5 and 14e-3.[2] As part of that settlement, he agreed that, "in any disciplinary proceeding before the Commission based on the entry of the injunction in this action, Melvin understands that he shall not be permitted to contest the factual allegations of the complaint in this action."

The complaint in the civil proceeding (the "Complaint") alleged that, in December 2009, Melvin learned about a pending tender offer involving the stock of Chattem, Inc., a Tennessee-based distributor of over-the-counter pharmaceutical products. Melvin learned of the tender offer from a longtime accounting client, who was a Chattem director and who consulted Melvin to "mitigat[e] the personal tax liability that would accompany [the] tender offer and forced exchange of" Chattem stock options the director held. But, according to the Complaint, the client "made clear," and Melvin understood, that the tender offer information was confidential and disclosed "solely for the purpose of obtaining tax advice." Nonetheless, within an hour of discussing the tender offer with this client, Melvin called a longstanding client of his accounting practice and told him of the pending offer, including the information that Chattem was to be acquired in the near future and that the purchase price for Chattem would be approximately $90 per share. Over the next few days, Melvin made similar disclosures to two other long-time accounting clients and a partner in his accounting practice.[3] Each of the four tippees who learned of the tender offer from Melvin traded in Chattem stock, the price of which rose

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1 *Thomas D. Melvin, CPA*, Initial Decision Release No. 673, 2014 WL 4678751 (Sept. 22, 2014).

2 15 U.S.C. §§ 78j(b), 78n(e); 17 C.F.R. §§ 240.10b-5, 240.14e-3. Melvin also agreed to disgorge approximately $61,328 in profits and $6,995 in prejudgment interest (for which he was jointly and severally liable with other persons involved in the misconduct), and to pay a civil penalty of $108,930.05.

Melvin signed a second consent on June 28, 2013. There is no material difference between the two consents with respect to the issues on appeal.

3 Two of the accounting clients were also close friends of Melvin.

substantially on the day the tender offer was announced.[4] Moreover, Melvin's four tippees told five other people about the Chattem tender offer; these five tippees also traded in the stock, and one of them tipped two additional people, who also traded. Eventually, according to the Complaint, at least ten individuals (not including Melvin) traded the stock based on inside information obtained directly or indirectly from Melvin, profiting by more than $550,000.[5]

The Georgia Board of Accountancy Code of Professional Conduct (the "Code") expressly provided that a Georgia-licensed CPA, such as Melvin, could not, without the consent of his client, disclose any confidential information pertaining to the client that the CPA obtained in the course of performing professional services. The Complaint alleged that Melvin "[d]isregard[ed] the duty of confidentiality owed to his client and imposed on him by the [Code,] misappropriated the material non-public information . . . and disclosed" that information to others. His misappropriation and disclosures were alleged to have provided him a benefit in the form of furthering his professional and personal relationships.

B. An administrative law judge permanently disqualified Melvin from practicing before the Commission.

On December 20, 2013, we issued an Order Instituting Proceedings ("OIP"), based on the Injunctive Order and pursuant to Rule of Practice 102(e)(3)(i),[6] and temporarily suspended Melvin from appearing or practicing before the Commission.[7] In doing so, we found that suspending Melvin was "appropriate and in the public interest."[8] Melvin filed a timely petition to lift the temporary suspension,[9] which we denied.[10] We also directed that a hearing be held before a law judge to "determine[] what, if any, action may be appropriate to protect the

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4 The acquisition price represented a roughly 33% premium over the closing price for Chattem stock on the day preceding announcement of the merger.

5 The Complaint alleges that Melvin's four tippees "and six others" traded in the securities of Chattem based on the material non-public information that Melvin disclosed, but it enumerates a total of eleven traders: Melvin's four tippees, their five tippees, and two more remote tippees. Our determination that Melvin's permanent disqualification from appearing or practicing before the Commission is an appropriate sanction would be the same whether there were ten or eleven tippees.

6 17 C.F.R. § 201.102(e)(3)(i).

7 *Thomas D. Melvin, CPA*, Exchange Act Release No. 71161, 2013 WL 6705182 (Dec. 20, 2013).

8 *Id.* at *1.

9 *See* Rule of Practice 102(e)(3)(ii), 17 C.F.R. § 201.102(e)(3)(ii) (providing that a temporary suspension imposed under Rule 102(e)(3)(i) will become permanent unless a petition to lift it is filed within thirty days after service of the order imposing the temporary suspension).

10 *Thomas D. Melvin, CPA*, Exchange Act Release No. 71761, 2014 WL 1091679, at *2 (Mar. 20, 2014).

Commission's processes" in light of the Injunctive Order.[11] On September 22, 2014, the law judge issued an initial decision permanently disqualifying Melvin from practicing before the Commission.[12] This appeal followed.[13]

II. Analysis

A. Burden of Proof and Standard of Review

The Division introduced evidence, and it is undisputed, that Melvin was permanently enjoined from violating "provision[s] of the Federal securities laws."[14] As a result, under our rules, "the burden" passed to Melvin "to show cause" why he should not be censured or disqualified from appearing and practicing before us. In determining whether that burden has been met and assessing an appropriate sanction, we are guided by the strong and clear public interest in ensuring the integrity of our processes.[15] That assessment is, in turn, informed by our consideration of public interest factors we traditionally consider in other types of administrative proceedings, including the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood of future violations.[16] Our application of these factors is flexible

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[11] *Id.* at *2. *See* Rule 102(e)(3)(iii), 17 C.F.R. § 201.102(e)(3)(iii) (providing for Commission action in response to petition filed pursuant to Rule 102(e)(3)(ii)).

[12] *Thomas D. Melvin, CPA*, 2014 WL 4678751, at *9.

[13] The Initial Decision allowed twenty-one days after service of the Initial Decision for filing petitions of review, citing Rule of Practice 360, 17 C.F.R. § 201.360. But Rule of Practice 540, 17 C.F.R. § 201.540, requires that a petition for review of an initial decision as to whether a temporary sanction shall be made permanent must be filed within ten days after service of the initial decision. The Initial Decision was served on Melvin on September 22, 2014, and Melvin filed his petition for review of October 14, 2014. Although the petition was not timely filed in accordance with Rule 540, we have determined, in an exercise of our discretion, to grant review in this instance given the longer period specified in the Initial Decision.

[14] Rules 102(e)(3)(i)(A), 102(e)(3)(iv); 17 C.F.R. §§ 201.102(e)(3)(i)(A), 102(e)(3)(iv).

[15] *See, e.g.*, *Michael C. Pattison, CPA*, Exchange Act Release No. 67900, 2012 WL 4320146, at *5 (Sept. 20, 2012) ("Rule of Practice 102(e) has been the primary tool available to the Commission to preserve the integrity of its processes . . . .") (citing additional authority).

[16] *See, e.g.*, *id.* at *8 (102(e)(3) proceeding; citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)); *Chris G. Gunderson, Esq.*, Exchange Act Release No. 61234, 2009 WL 4981617, at *5 (Dec. 23, 2009) (same).

and no single factor is dispositive.[17] We also consider the extent to which a sanction may have a deterrent effect.[18]

Applying these factors, and based on our consideration of all the circumstances surrounding Melvin's misconduct, we find that he represents such a significant threat to the integrity of our processes that he must be permanently disqualified from appearing or practicing before us. Beginning almost immediately after receiving what he understood to be confidential information, Melvin, acting with scienter,[19] directly tipped three clients and his partner in separate conversations, abusing his position of trust to enhance professional relationships that could yield him pecuniary gain. By misappropriating the information and disclosing it for personal benefit, Melvin defrauded the client whose information he misused, "feigning fidelity to the source of [the misappropriated] information" and thus engaging in "fraud akin to embezzlement."[20] Melvin's four tippees continued to pass along the misappropriated information, such that Melvin's misconduct ultimately led to trading by at least ten individuals. Moreover, Melvin's disclosures were particularly serious because the non-public information related to a tender offer,[21] and the specific details he passed along about the imminence of the tender offer and the anticipated share price enhanced the tippees' ability to profit from the misappropriated information. We have stated that conduct that violates the antifraud provisions of the federal securities laws, including insider trading, is "especially serious"[22] and warrants "'the severest of sanctions.'"[23] And we have held that "'[f]idelity to the public interest' requires a severe sanction when a respondent's misconduct involves fraud because the 'securities business is

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17 *Pattison*, 2012 WL 4320146, at *8 (citing *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *4 (Dec. 21, 2007), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009)).

18 *Id.* (citing additional authority).

19 "Scienter is a mental state consisting of an intent to deceive, manipulate, or defraud, and includes recklessness, commonly defined as 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it." *Toby G. Scammell*, Investment Advisers Act Release No. 3961, 2014 WL 5493265, at *6 n.41 (Oct. 29, 2014) (quoting *Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076, at *10 n.67) (July 12, 2013)).

20 *See United States v. O'Hagan*, 521 U.S. 642, 654-55 (1997) (finding such deception "essential to the misappropriation theory" of insider trading).

21 *See Tender Offers*, Exchange Act Release No. 17120, 1980 WL 20869, at *4-5 (Sept. 4, 1980) ("The abuses which result from trading in securities by persons in possession of material, nonpublic information are particularly troublesome in the context of tender offers. . . . This practice results in unfair disparities in market information and market disruption.").

22 *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 *5 (Apr. 20, 2012)), *petition denied*, 773 F.3d 89 (D.C. Cir. 2014).

23 *Toby G. Scammell*, 2014 WL 5493265, at *5 (quoting *Gunderson*, 2009 WL 4981617, at *5).

one in which opportunities for dishonesty recur constantly.'"[24] Further, we have recognized the applicability in disciplinary proceedings under Rule 102(e) of the general rule that "an antifraud injunction 'ordinarily' warrants barring participation in the securities industry."[25]

Melvin violated explicit professional conduct standards and betrayed the trust placed in him by a longtime client seeking tax accounting advice. As we previously stated in the analogous context of an investment banker who disclosed a client's confidential information in order to favor his own interest in establishing a collegial relationship,

> [t]he ability to credibly assure a client that [obviously confidential] information will be used solely to advance the client's own interests is central to any securities professional's ability to provide informed advice to clients. Disclosure of such information jeopardizes the foundation of trust and confidence crucial to any professional advising relationship.[26]

Melvin's unethical and illegal actions were, in our view, clearly egregious. The betrayal of trust, the rapidity with which he shared the confidential information, the details he passed on about the tender offer, and the tipping of multiple business associates all contribute to our assessment of the gravity of his misconduct. Although Melvin's violation involved one misappropriation of client information, it was not an 'isolated' infraction, as he passed the information along to four people at four different times. Thus, Melvin chose to breach his client's trust on four different occasions, each giving him a chance to reflect on his actions. We see little recognition by Melvin of the wrongfulness of his actions and find that, given those actions, he constitutes an unacceptable threat to our processes. We further find that Melvin's permanent disqualification serves important deterrent objectives, both for him and other securities industry professionals.[27]

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[24] *Id.* (quoting *Gunderson*, 2009 WL 4981617, at *5).

[25] *Gunderson*, 2009 WL 4981617, at *5 (quoting *Justin F. Ficken*, Investment Advisers Act Release No. 2803, 2008 WL 4610345, at *3 (Oct. 17, 2008)).

[26] *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 WL 56755, at *10 (Jan. 9, 2009), *petition denied*, 586 F.3d 122 (2d Cir. 2009).

[27] *Cf. Steadman*, 603 F.2d at 1140 (stating that a compelling reason supporting a bar would be that "the nature of the conduct mandates permanent debarment as a deterrent to others in the industry").

Melvin does not dispute the allegations that form the basis for the Injunctive Order,[28] but argues that they do not justify his permanent disqualification. In support, he asserts that he did not personally trade on the information or benefit financially from his actions. According to Melvin, the misappropriation was an "isolated event in an otherwise law-abiding and productive life." He further claims that he has recognized his misconduct by agreeing to settle the matter and timely pay the amounts agreed to in the settlement. Rather than permanent disqualification, Melvin argues that "[i]t is appropriate to impose a three year bar" which is consistent, he asserts, with settlement discussions he had with Division counsel.[29] Although he acknowledges that the Commission is not bound by such discussions, he asserts that it should nevertheless consider what "the SEC employee most familiar with" the case believes would be "appropriate given all that [the employee] knew of the case."

We are unpersuaded by Melvin's effort to minimize the seriousness of his misconduct. His argument that his conduct was not so bad because he was "only a tipper" fails to acknowledge how destructive that conduct was. Melvin's misconduct created substantial losses, or the risk of substantial losses, to other persons: he defrauded Chattem of the exclusive use of the tender offer information, conduct that the Supreme Court has likened to embezzlement,[30] and he undermined the integrity of the negotiating process for the tender offer, thus creating the risk of substantial losses to both the target company and the potential acquirer.[31] Moreover, the

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28 As noted, Melvin agreed that he would not challenge allegations supporting the Injunctive Order in a related Commission disciplinary proceeding. *See* Rule of Practice 101(a)(3), 17 C.F.R. § 201.101(a)(3) (defining "disciplinary proceeding" to mean "an action pursuant to Rule 102(e)"). Melvin is therefore precluded from contesting the Complaint's allegations here, and we may consider them in determining an appropriate sanction. *See, e.g.*, *Siris v. SEC*, 773 F.3d 89, 96 (D.C. Cir. 2014) (holding that the Commission "was entitled to rely on the allegations of the complaint" in deciding whether to impose a permanent bar in a follow-on proceeding based on a consent judgment, where the terms of the consent judgment "unambiguously barred Siris from making any future challenge to the allegations in the complaint") (citations omitted); *Toby G. Scammell*, 2014 WL 5493265, at *3, 7 (refusing to consider "claims that impermissibly contradict the allegations of the complaint" in determining sanctions in follow-on proceeding based on injunction entered by consent, where Scammell had "specifically agreed [in the consent agreement] that he would not contest the factual allegations of the complaint in any administrative proceeding before the Commission").

29 Melvin asserts in his pleadings that he and Division staff agreed, in connection with discussions regarding settlement of the civil proceedings, that he also would "not be banned from practicing before the Commission . . . in excess of three years." He further asserts that he first learned that the Commission was "not honoring the agreement" several months later, after the OIP was issued. Nevertheless, Melvin concedes in his brief that "the Commission itself is not bound by the commitments of its [D]ivision counsel."

30 *See O'Hagan*, 521 U.S. at 652-54.

31 *See Litton Indus., Inc. v. Lehman Bros. Kuhn Loeb Inc.*, 967 F.2d 742, 747-51 (2d Cir. 1992) (finding that insider trading in advance of a tender offer can artificially inflate the price the acquirer must pay for the acquisition, resulting in overpayment by the acquirer and its

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substantial gains by all of the tippees who benefited from the confidential information passed along by Melvin are attributable to Melvin, even if Melvin did not personally trade.[32] Melvin's tipping his clients and partner in the expectation that they would trade is equivalent to Melvin's trading himself and then giving the trading profits to those individuals.[33] Had Melvin not misappropriated the confidential client information and passed it along, the ensuing improper trading, which resulted in illegal profits of more than half a million dollars, would not have happened, making Melvin's conduct in some respects more "directly culpable" than that of the tippees who personally traded.[34] And, as discussed above, Melvin is not permitted to contest the fact that he personally benefitted from his unlawful disclosures by furthering personal and professional relationships.[35] Despite Melvin's attempt to minimize the benefits he received, they apparently were sufficient to motivate the multiple instances of misconduct at issue here, providing reason to believe that they could do so again. His actions reveal a highly troubling willingness to ignore a fundamental professional obligation to respect and protect client confidence along with a willingness to instigate and facilitate fraudulent stock trading activity.[36] As we have held,

> [t]he prohibitions against insider trading [in our securities laws] play an essential role in maintaining the fairness, health, and integrity of our markets. We have long recognized that the fundamental unfairness of insider trading harms not only

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shareholders); *SEC v. Gaspar*, No. 83 Civ. 3037, 1985 WL 521, at *15-17 (S.D.N.Y. Apr. 16, 1985) (escalation in share price resulting from insider trading decreased attractiveness of premium offered, contributing to collapse of tender offer).

32 *See, e.g.*, *SEC v. Warde*, 151 F.3d 42, 49-50 (2d Cir. 1998) ("A tippee's gains are attributable to the tipper, regardless [of] whether benefit accrues to the tipper.").

33 *See Dirks v. SEC*, 463 U.S. 646, 659, 663-64 (1983) (citing Exchange Act Section 20(b), 15 U.S.C. § 78t(b), which "mak[es] it unlawful to do indirectly 'by means of any other person' any act made unlawful by the federal securities laws," and finding that when a person "makes a gift of confidential information to a trading relative or friend," that is equivalent to "trading by the [person] himself followed by a gift of the proceeds to the recipient").

34 *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 312-13 & n.23 (1985).

35 *See Dirks*, 463 U.S. at 663-64 (recognizing that a breach of fiduciary duty and exploitation of nonpublic information for insider trading purposes may be shown when a tipper receives a "direct or indirect personal benefit from the disclosure," such as when the tipper "makes a gift of confidential information to a trading relative or friend").

36 *See, e.g.*, *Thomas W. Heath, III*, 2009 WL 56755, at *4 (finding that investment banker who disclosed confidential client information "violated one of the most fundamental ethical standards in the securities industry").

> individual investors, but also the very foundations of our markets, by undermining investor confidence in the integrity of our markets.[37]

Our view that conduct like Melvin's merits significant sanctions is evident from a similar case in which we found that a bar was an appropriate sanction for insider trading even though the tipper was not charged with trading and received no direct economic benefit for the tip he provided.[38]

Nor do we consider it significant that, as Melvin claims, he discussed a possible settlement with our staff that would have resulted in his disqualification for a number of years

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37 *Toby G. Scammell*, 2014 WL 5493265, at *6 (quoting *Selective Disclosure & Insider Trading*, Exchange Act Release No. 42259, 1999 WL 1217849, at *17 (Dec. 20, 1999), and citing H.R. Rep. No. 98-355, at 2 (1984), *reprinted in* 1984 U.S.C.C.A.N. 2274, 2275, 1983 WL 25397, at *2 (finding that insider trading destroys the integrity of the marketplace "by undermining the public's expectations of honest and fair securities markets where all participants play by the same rules")).

38 *See Robert Bruce Lohmann*, Exchange Act Release No. 48092, 2003 WL 21468604, at *4-5 (June 26, 2003). *Cf. SEC v. Gupta*, No. 11 Civ. 7566, 2013 WL 3784138, at *4 (S.D.N.Y. July 17, 2013) (permanently enjoining Gupta from further violations of the securities laws and imposing officer-director and associational bars "notwithstanding the fact that Gupta's long-term pecuniary gain from the insider trading conspiracy was speculative").

Melvin does not raise any argument challenging the factual premises that underlie his liability as a tipper under Exchange Act Section 10(b) or 14(e) and Exchange Act Rules 10b-5 and 14e-3. Nor can he, because as part of settling the civil proceeding he agreed not to contest the factual allegations of the Complaint in this disciplinary proceeding. Accordingly, we understand Melvin's argument that he did not personally trade as an attempt to establish a mitigating factor regarding relief, not as a challenge to his underlying liability. In any event, there would be no merit to such a challenge to his liability. The Complaint alleged that Melvin's misappropriation and disclosures were alleged to have provided him a benefit in the form of furthering both his personal and professional relationships. *See Dirks*, 463 U.S. at 663-64 ("reputational benefit that will translate into future earnings" is sufficient); *SEC v. Yun*, 327 F.3d 1263, 1280 (11th Cir. 2003) (sufficient personal benefit where tipper and tippee worked closely together and were frequently partners in real estate deals); *SEC v. Sergeant*, 229 F.3d 68, 77 (1st Cir. 2000) (tipping "to maintain a useful networking contact" is sufficient personal benefit); *United States v. Newman*, 773 F.3d 438, 452-53 (2d Cir. 2014) (tipping that "could yield future pecuniary gain," including a "referr[al]" or monetary "commission," is sufficient). The allegation that Melvin had a close personal relationship with his tippees independently supports the sufficiency of his personal benefit. *See Dirks*, 463 U.S. at 663-64; *Lohmann*, 2003 WL 21468604, at *4; *Yun*, 327 F.3d at 1275; *Sargent*, 229 F.3d at 77; *SEC v. Obus*, 693 F.3d 276, 285 (2d Cir. 2012). Finally, a breach of fiduciary duty for personal benefit is not an element of liability under Exchange Act Section 14(e) and Rule 14e-3. *See O'Hagan*, 521 U.S. at 676; *Tender Offers*, 1980 WL 20869, at *5-13 (Sept. 4, 1980).

rather than permanently. As he acknowledges, we are not bound by such discussions,[39] and we have repeatedly held that sanctions imposed in connection with settlements are frequently less severe than those that result from litigation.[40] There is no suggestion that Melvin was in any way prevented from identifying the circumstances that, according to him, led a member of our staff to conclude (or that otherwise support his position) that disqualification for a term of years is sufficient.[41] We have carefully considered the evidence he has presented and his arguments in mitigation, but conclude that they do not justify any leniency.

Although Melvin asserts that he "has recognized the wrongful nature of what transpired," his arguments on appeal support a contrary conclusion. His contention that although his conduct was bad, the conduct of his partner, who also engaged in fraudulent misconduct related to the Chattem tender offer, was worse, indicates that he does not appreciate the seriousness of his misconduct.[42]

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39 *See, e.g.*, *CFTC v. Field*, 249 F.3d 592, 594 (7th Cir. 2001) ("[A] settlement on behalf of the United States may be enforced only if the person who entered into the settlement had actual authority to settle the litigation."). *See also* SEC Division of Enforcement, Enforcement Manual, available at http://www.sec.gov/divisions/enforce/enforcementmanual.pdf, Section 2.5.1 (noting that "most settlements of previously authorized enforcement actions . . . require Commission authorization" and describing procedure for obtaining such authorization); *Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *19 & n.67 (Feb. 27, 2012) ("[O]ur rules are clear on this point: an offer to settle is binding only if formally submitted to, and approved by, the Commission . . . ." (citing Rule of Practice 240, 17 C.F.R. § 201.240 ("Final acceptance of any offer of settlement will occur only upon the issuance of findings and an order by the Commission.")), *aff'd on other grounds sub nom.*, *Collins v. SEC*, 736 F.3d 521 (D.C. Cir. 2013).

40 *See, e.g.*, *Pattison*, 2012 WL 4320146, at *11 ("[R]espondents who offer to settle may properly receive lesser sanctions than they otherwise might have," because in settling cases "'we take into account pragmatic considerations such as the avoidance of time-and-manpower-consuming adversary proceedings.'") (quoting *Nassar & Co.*, 47 S.E.C. 20, 26 & n.3 (1978), *aff'd*, 600 F.2d 280 (D.C. Cir. 1979)).

41 *Cf.*, *e.g.*, *Jose P. Zollino*, Exchange Act Release No. 55107, 2007 WL 98919, at *4 (Jan. 16, 2007) (although respondent in a follow-on proceeding may not challenge the allegations that provide the basis for the underlying injunctive order, he or she is "free to introduce evidence regarding the 'circumstances surrounding those allegations as a means of addressing 'whether sanctions should be imposed in the public interest'") (quoting *Schield Mgmt. Co.*, Exchange Act Release No. 53201, 2006 WL 231642, at *6 (Jan. 31, 2006)).

42 Melvin asserts that his partner "admitted to misappropriating" confidential information about the Chattem tender offer, but cites nothing to support this assertion. We are unaware of any allegations that the partner misappropriated confidential information, as opposed to trading on the basis of confidential information that Melvin disclosed to him. Based on the premise that the partner's conduct was worse than his, Melvin argues that any sanction imposed on him should be less serious than the permanent suspension from appearing or practicing as an accountant imposed on his partner.

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C. The proceeding was timely instituted.

Melvin also challenges his disqualification on procedural grounds, arguing that "these proceedings were untimely under clearly established federal law," because the order of temporary suspension (which was included in the OIP) was not issued until December 20, 2013, more than 90 days after entry of the Injunctive Order. Under Rule of Practice 102(e)(3), the temporary suspension order had to be issued no "more than 90 days after the date on which the final judgment has become effective, whether upon completion of review or appeal procedures or because further review or appeal procedures are no longer available."[43] Melvin does not dispute that, under the Federal Rules of Appellate Procedure, he had 60 days to file a notice of appeal of the Injunctive Order, but he contends that because he waived his right to appeal the Injunctive Order, "appeal procedures [were] no longer available" within the terms of Rule 102(e)(3) from the time the Injunctive Order was entered, and that Rule 102(e)(3)'s 90-day limit therefore expired on November 12, 2013. The Division responds that, though "he was almost certain to fail, Melvin was free to file a notice of appeal and challenge the judgment" and that, therefore, the temporary suspension order was timely because it was issued within 90 days of when Melvin's period for filing an appeal expired on October 13, 2013.

The parties cite to no authority interpreting this aspect of the Rule. The relevant statutory language does not address the issue, nor do the related proposing or adopting releases.[44] Thus, we must interpret the language without any such guidance.

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We reject this argument. Both the partner and Melvin were enjoined from antifraud violations, which, as we noted above, ordinarily warrants permanent exclusion from participation in the securities industry. Their misconduct was serious for many of the same reasons, and the fact that some particulars differed—Melvin misappropriated but didn't trade, his partner traded but didn't misappropriate, Melvin tipped four people, his partner tipped one person—does not mean that the public interest would mandate that they receive different sanctions.

We further find that Melvin deserves no special credit for making the payments he agreed to. *Cf.*, *e.g.*, *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *7 (Feb. 24, 2012) (for those who agreed to abide by FINRA's rules, compliance with obligations under those rules is not a mitigating factor in determining sanctions); *Kevin M. Glodek*, Exchange Act Release No. 80937, 2009 WL 3652429, at *8 (Nov. 4, 2009) (same), *petition denied*, 416 F. App'x 95 (2d Cir. 2011).

43 17 C.F.R. § 201.102(e)(3).

44 When the Commission adopted the amendment to then-Rule 2(e) that made "a permanent injunction against securities-laws violations or a finding of securities-laws violations . . . a basis upon which the Commission may initiate proceedings to censure or temporarily or permanently disqualify an attorney, accountant, engineer, or other professional or expert from appearing and practicing before the Commission," the amendment contained the language currently found in Rule 102(e)(3) that looks to whether "further review or appeal procedures are no longer available," among other factors, in determining whether the Commission's entry of an order of temporary suspension was timely. *Suspension or Disbarment*

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For purposes of Rule 102(e)(3), we interpret the phrase "further review or appeal procedures are no longer available" to mean that the party is foreclosed from pursuing further review or appeal of his or her case because the time for appeal has expired. We recognize that the application of the language of the rule may be ambiguous where, as here, a party has waived the right to an appeal. Review is arguably "no longer available" in light of a waiver. But we believe the phrase "appeal procedures are no longer available" is better interpreted to refer to the procedural availability of the means for bringing an appeal under the federal rules, rather than to the viability of any substantive claim that is brought.

We do not believe it is correct to say that "appeal procedures are no longer available" simply because a person has waived the right to appeal in a consent agreement. Even where such a waiver is enforced and an appellate court dismisses the appeal because of the waiver, "appeal *procedures*" are still "available" in the sense that a person is entitled to file the appeal within the time provided by the federal rules and to obtain a ruling of some kind from the appellate court. Moreover, there are some very limited instances in which an appellate court may decide to reject a waiver and hear an appeal on the merits.[45] For these reasons, we construe the phrase "appeal procedures are no longer available" to mean that the period allotted by rule for filing a notice of appeal has expired, without regard to whether the right to appeal has been waived in a particular case or to the validity of any such waiver. Applying this interpretation, we find that Federal Rule of Appellate Procedure 4(a)(1)(B) allows 60 days for filing an appeal from a district court's final judgment in which the United States or an agency is a party, and therefore, for purposes of Rule 102(e)(3), appeal procedures were "available" to Melvin with respect to the Injunctive Order within the terms of the rule until that period ended.[46]

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from Appearance or Practice Before the Commission, Securities Act Release No. 5147, 1971 WL 126066, at *2, 4 (May 10, 1971). There is no discussion of the phrase, "no longer available," and subsequent amendments to Rule 102(e) have not clarified the meaning of that language.

45 Appeal waivers will generally be enforced, absent exceptional circumstances such as the lack of actual consent, fraud in obtaining consent, or mistake. *See, e.g.*, *Van v. Barnhart*, 483 F.3d 600, 609 & n.5 (9th Cir. 2007) (noting general rule and citing cases that recognize exceptions); *Mock v. T.G. & Y. Stores Co.*, 971 F.2d 522, 526-27 (10th Cir. 1992) (affirming judgments of district court in favor of defendants where plaintiffs consented to judgment and did not reserve the right to appeal). Where a party has consented to a valid settlement, as Melvin did here, courts do not hesitate to enforce provisions expressly waiving the right to appeal. *E.g.*, *SEC v. Adair*, 549 F. App'x 699 (9th Cir. 2013) (dismissing appeal where litigant had expressly, voluntarily, and knowingly waived the right to appeal the district court's order); *cf. Throne v. Citicorp Inv. Servs., Inc.*, 378 F. App'x 629, 631-32 (9th Cir. 2010) (affirming district court awarding attorneys' fees and costs for appeal where appeal was filed in contravention of express waiver).

46 While this interpretation works to Melvin's detriment in that it allows the proceeding against him to continue, Melvin cannot credibly argue that his conduct would have been any different if he had known when he consented to the settlement of the civil proceeding that we

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Melvin argues that the majority of federal courts do not generally consider the merits of appeals from consent judgments, and that no applicable exception to this general rule applies in this case. We agree with both of those assertions.[47] But, as explained above, this does not mean that "appeal procedures [were] no longer available" to Melvin; it simply means that the use of those procedures would very likely have proved unsuccessful.

Our interpretation of Rule 102(e)(3) is also supported by policy considerations. We find it preferable for reasons of efficiency, clarity, and ease of administration, to adopt a bright-line rule that bases the timeliness of temporary suspension orders in Rule 102(e)(3) disciplinary proceedings on the time for filing a notice of appeal. Federal Rule of Appellate Procedure 4(a)(1)(B) clearly sets forth such a deadline, making it easy to determine when a disciplinary proceeding must be brought. By contrast, Melvin's proposed interpretation of the phrase "no longer available" would require a case-by-case analysis as to whether a particular appeal or review proceeding would be futile or unsuccessful for reasons other than lack of timeliness. That approach would create uncertainty over the application of our deadlines in particular cases. The time for filing an appeal is a more certain and uniform starting point to gauge the running of our 90-day period.

Our approach is also supported by the approach taken by the United States Court of Appeals for the District of Columbia Circuit in *Adams v. SEC*.[48] The court there adopted a similar bright-line rule that a final disposition of an administrative proceeding became "unappealable" for the purpose of determining the timeliness of fee applications under the Equal Access to Justice Act only when the statutory period allowed for appeals from such dispositions had expired. The court rejected a rule like the one advanced by Melvin here that would have

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would apply Rule 102(e)(3) in this way. The consent Melvin signed specifically alluded to the possibility of a "disciplinary proceeding before the Commission based on the entry" of the Injunctive Order. Moreover, his argument that Division counsel had discussed the possibility of a three-year suspension from practice with him demonstrates that he understood that a 102(e) proceeding could follow. Thus, this is not a situation where a respondent was deprived of fair notice of our interpretation of a rule governing the respondent's conduct in a way that impacts the fairness of a proceeding. *See, e.g.*, *Marrie v. SEC*, 374 F.3d 1196, 1208 (D.C. Cir. 2004) (finding that Commission impermissibly applied interpretation to Rule 102(e) retroactively, in part because accountants "did not have fair notice [when they engaged in conduct at issue] that they could be sanctioned for improper professional conduct even if they had been acting in good faith); *KPMG, LLC v. SEC*, 289 F.3d 109, 116, 126 (D.C. Cir. 2002) (reversing finding that "success" fee/royalty arrangement violated AICPA Rule 302 because KPMG "lacked fair notice" that the Commission would interpret the rule so as to deem that arrangement to be a prohibited contingent fee). To the contrary, adopting the interpretation Melvin urges would effectively give him a windfall, by relieving him of the need to participate in a proceeding that he knew to be a likely outcome of his actions.

[47] *See supra* note 45.

[48] 287 F.3d 183, 184, 191 (D.C. Cir. 2002).

analyzed whether a particular disposition was specifically appealable based on the standing or lack of standing of the litigant. The court recognized that adopting this bright-line rule, which was "discernible by looking at the category of order in question," "eliminate[d] the high potential for confusion" that would have resulted from determining appealability on a case-by-case basis.[49]

Melvin also argues that most federal courts hold that a consent judgment is "effective" immediately upon entry, and that we should interpret Rule 102(e)(3) the same way.[50] We understand him to be using "effective" here to mean something like "binding on the party subject to the judgment." Indeed, "effective" is used that way elsewhere in Rule 102(e)(3), when the rule states that "[a]n order of temporary suspension shall become effective upon service on the respondent."[51] In the case before us, though, the question is not whether Melvin was bound by the injunction as soon as it was entered, but rather when the time for entering an order of temporary suspension started to run. The Rule 102(e)(3) language we must interpret measures the time for entering an order of temporary suspension from "the date on which the final judgment or order entered in a judicial or administrative proceeding described in paragraph (e)(3)(i)(A) or (e)(3)(i)(B) of this section has become effective, whether upon completion of review or appeal procedures or because further review or appeal procedures are no longer available." In this context, "effective" means that review or appeal procedures have been completed or that further review or appeal procedures are no longer available.[52]

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49 *Id.* Several other federal courts of appeals have also adopted a bright-line rule in similar circumstances. *See, e.g.*, *Impresa v. Construzioni Geom. Domenica Garufi v. United States*, 531 F.3d 1367, 1372 (Fed. Cir. 2008) (adopting a uniform rule for EAJA petitions in the Court of Federal Claims in holding that the period for filing an EAJA application started on expiration of the period for filing a petition for certiorari from the final judgment of the Federal Circuit because "a clear rule better serves the interests of litigants and the court"); *Van*, 483 F.3d at 612 (adopting bright-line rule whereby "EAJA's 30-day filing period does not begin to run until after the 60-day appeal period in Rule 4(a) has expired," even when a claimant has obtained a judgment as to which the Commissioner of the Social Security Administration has consented, in part because the possibility that consent judgments can be appealed otherwise could create uncertainty and confusion).

50 Melvin cites no authority to support this contention.

51 17 C.F.R. § 201.102(e)(3).

52 This does not mean, however, that an order or judgment is not effective or binding until all appeals have been resolved or the period for filing appeals has run. As we have repeatedly held, for example, the pendency of an appeal of a civil or criminal proceeding does not justify any delay in related "follow-on" administrative proceedings. *See, e.g.*, *Ran H. Furman*, Exchange Act Release No. 65680, 2011 WL 5231425, at *2 (Nov. 3, 2011) ("Although Furman is entitled to appeal the underlying case against him, the possibility of an appeal to the court of appeals 'does not alter the effect' of the jury's finding of securities law violations or the court's imposition of an injunction here.") (quoting *Daniel S. Lezak*, Exchange Act Release No. 50729, 2004 WL 2721400, at *2 & n.16 (Nov. 23, 2004)); *Gunderson*, 2009 WL 4981617, at *4 ("'[I]t is well established that the existence of an appeal of the district court's decision does not affect the [permanent] injunction's status as a basis for administrative action.'") (quoting *Conrad P.*

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Melvin engaged in serious misconduct. He betrayed a longtime client by misappropriating sensitive and valuable information that he knew was confidential and sharing it with business associates. Although he did not personally trade on the information, his disclosures furthered his professional and personal relationships and led to fraudulent and profitable insider trading by at least ten individuals. Moreover, Melvin does not appear fully to appreciate the wrongfulness of his actions, which heightens our concerns about the possibility of future misconduct. In sum, Melvin's actions demonstrate that he poses a threat to the integrity of our processes and amply justify his permanent disqualification from appearing or practicing before us.

An appropriate order will issue.[53]

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

Brent J. Fields
Secretary

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

(...continued)
Seghers, Investment Advisers Act Release No. 2656, 2007 WL 2790633, at *3 & n.12 (Sept. 26, 2007), and citing additional authority).

53 We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75844/September 4, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 3682/September 4, 2015

Admin. Proc. File No. 3-15659

In the Matter of THOMAS D. MELVIN, CPA

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Thomas D. Melvin, CPA, is hereby permanently disqualified from appearing or practicing before the Commission.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-75845; File No. S7-15-15]

RIN 3235-AL74

Access to Data Obtained by Security-Based Swap Data Repositories and Exemption from Indemnification Requirement

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: Pursuant to section 763(i) of Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protcction Act of 2010 ("Dodd-Frank Act"), the Securities and Exchange Commission ("Commission") is proposing amendments to rule 13n-4 under the Securities Exchange Act of 1934 ("Exchange Act") related to regulatory access to security-based swap data held by security-based swap data repositories. The proposed rule amendments would implement the conditional Exchange Act requirement that security-based swap data repositories make data available to certain regulators and other authorities, and would set forth a conditional exemption from the statutory indemnification requirement associated with that regulatory access provision.

DATES: Submit comments on or before [insert date 45 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 S7-15-15 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 S7-15-15. 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, or Joshua Kans, Senior Special Counsel, 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 to add paragraphs (b)(9) and (b)(10) to Exchange Act rule 13n-4 to implement the statutory requirement that security-based swap data repositories conditionally provide data to certain regulators and other authorities. The Commission also is proposing to add paragraph (d) to rule 13n-4 to provide a conditional exemption from the associated statutory indemnification requirement.

I. Background

A. Statutory Requirements for Access to Security-Based Swap Data Repository Information

Title VII of the Dodd-Frank Act amended the Exchange Act to provide a comprehensive regulatory framework for security-based swaps, including the regulation of security-based swap data repositories.[1]

Those amendments, among other things, require that security-based swap data repositories make data available to certain regulators and other entities. In particular, the amendments conditionally require that security-based swap data repositories "on a confidential basis pursuant to section 24, upon request, and after notifying the Commission of the request, make available all data obtained by the security-based swap data repository, including individual

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[1] Pub. L. No. 111-203, section 761(a) (adding Exchange Act section 3(a)(75) (defining "security-based swap data repository")) and section 763(i) (adding Exchange Act section 13(n) (establishing a regulatory regime for security-based swap data repositories)).

References in this release to the terms "data repository," "trade repository," "repository" or "SDR" generally address security-based swap data repositories unless stated otherwise.

counterparty trade and position data."[2] The repositories must make that data available to: "each appropriate prudential regulator"[3]; the Financial Stability Oversight Council ("FSOC"); the Commodity Futures Trading Commission ("CFTC"); the Department of Justice; and "any other person that the Commission determines to be appropriate," including foreign financial supervisors (including foreign futures authorities), foreign central banks and foreign ministries.[4]

This access to data is conditional, however. In part, before a repository shares such data, the repository "shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 24 relating to the information on security-based swap transactions that is provided."[5] Moreover, before such data is shared, "each entity shall agree to indemnify the security-based swap data repository and the Commission for any expenses arising from litigation relating to the information provided under section 24."[6]

B. Prior Proposals and Comments Received

1. 2010 proposal

In 2010, the Commission proposed several rules to implement statutory provisions related to the registration process, duties and core principles applicable to security-based swap data

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[2] Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G). The confidentiality requirements addressed by Exchange Act section 24, 15 U.S.C. 78x, are addressed below. See note 84, infra.

[3] As discussed below, the term "prudential regulator" encompasses the Board of Governors of the Federal Reserve System and certain other regulators, with regard to certain categories of regulated entities. See note 44, infra.

[4] Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G).

[5] Exchange Act section 13(n)(5)(H)(i), 15 U.S.C. 78m(n)(5)(H)(i).

[6] Exchange Act section 13(n)(5)(H)(ii), 15 U.S.C. 78m(n)(5)(H)(ii).

repositories.[7] That proposal, among other things, encompassed rules that incorporated the statutory language that set forth the data access provisions.[8]

In proposing those rules, the Commission recognized that "regulators may be legally prohibited or otherwise restricted from agreeing to indemnify third parties, including SDRs as well as the Commission," and that the "indemnification provision could chill requests for access to data obtained by SDRs, thereby hindering the ability of others to fulfill their regulatory mandates and responsibilities."[9] The Commission added that it expected that a repository "would not go beyond the minimum requirements of the statute so as not to preclude [recipient entities described by the statute] from obtaining the data maintained by an SDR."[10] The Commission further noted that the Commission itself had the authority to share nonpublic information with, among others, certain domestic and foreign regulatory authorities.[11]

In response, four commenters addressed the data access provisions.[12] Those commenters generally supported providing relevant authorities with access to security-based swap data maintained by repositories when the access is within the scope of those authorities' mandates, but expressed particular concerns relating to the indemnification requirement and to the scope of

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7 See Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306 (Dec. 10, 2010), corrected at 75 FR 79320 (Dec. 20, 2010) and 76 FR 2287 (Jan. 13, 2011) ("SDR Proposing Release").

8 See SDR Proposing Release, 75 FR at 77368 (paragraphs (b)(9) and (b)(10) of proposed Exchange Act rule 13n-4 incorporated relevant language of Exchange Act sections 13(n)(5)(G) and (H).

9 75 FR at 77318-19.

10 75 FR at 77319.

11 Id.

12 Cleary Gottlieb comment (Sept. 20, 2011) at 31-32 (comment was provided in response to a joint SEC-CFTC roundtable regarding the cross-border application of Title VII, and can be found at http://www.sec.gov/comments/4-636/4-636.shtml), DTCC comment (Nov. 15, 2010) at 3, ESMA comment (Jan. 17, 2011) at 2 and Managed Funds Association comment (Jan. 24, 2011) at 3.

authorities' access to data. Two commenters concurred that relevant authorities likely would be unable to agree to indemnify data repositories or the Commission.[13] One commenter expressed the concern that the statutory requirement is vague and could result in a data repository providing

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[13] Prior to the proposed rules, one of those commenters described the indemnification requirement as contravening the purpose of data repositories and jeopardizing market stability by diminishing regulators' ability to carry out oversight functions. See DTCC comment (Nov. 15, 2010) at 3. This comment and other comments that addressed data repository issues in response to a general request for comments regarding the implementation of Title VII are located on the Commission's website at http://www.sec.gov/comments/df-title-vii/swap-data-repositories/swap-data-repositories.shtml.

Subsequently, in response to the proposed rules, that commenter further: (1) stated that the indemnification requirement should not apply where relevant authorities carry out their regulatory responsibilities in accordance with international agreements and while maintaining the confidentiality of data provided to them; (2) suggested that the Commission provide model indemnification language; and (3) urged that "any indemnity should be limited in scope to minimize the potential reduction in value of registered SDRs to the regulatory community." See DTCC comment (Jan. 24, 2011) at 12. These and other comments addressing the proposed implementation of the data access provisions (as well as other aspects of the Commission's 2010 proposal regarding security-based swap data repository registration, duties and core principles) are located on the Commission's website at http://www.sec.gov/comments/s7-35-10/s73510.shtml.

Another commenter stated that because indemnification would not be feasible, "it would be problematic for [the Commission and the CFTC] to require non-U.S. SDRs to register with the Commissions," and that the indemnification requirement could impede effective regulatory coordination. See Cleary Gottlieb comment (Sept. 20, 2011) at 31-32.

That commenter further stated that when a non-U.S. data repository registers with the Commission "but is also subject to regulatory oversight by an appropriate non-U.S. regulator," the SEC should adopt the CFTC's interpretation "that the non-U.S. regulator is not as a result subject to Dodd-Frank's notice and indemnification provisions." See id. The Commission since then has issued final rules and interpretations regarding the cross-border application of the registration requirement for security-based swap data repositories, which exempts certain non-U.S. data repositories subject to regulation abroad from having to comply with requirements otherwise applicable to repositories. See Exchange Act Release No. 74246 (Feb. 11, 2015), 80 FR 14438, 14450-51, 14516-17, 14556 (Mar. 19, 2015) ("SDR Adopting Release") (generally stating that a non-U.S. person that performs the functions of a security-based swap data repository within the United States is required to register with the Commission absent an exemption, and adopting Exchange Act rule 13n-12 to provide an exemption from data repository requirements for certain non-U.S. persons when regulators with supervisory authority over those non-U.S. persons have entered into a memorandum of understanding ("MOU") or other arrangement with the Commission regarding the confidentiality of data collected and maintained by such non-U.S. person, access by the Commission to such data, and any other matters determined by the Commission). Also, under the preliminary interpretation discussed below, the conditions to the Exchange Act data access requirements would not restrict access when a repository registered with the Commission also is registered or licensed with a foreign authority that obtains the data pursuant to foreign law. See part IV.A, infra.

access to persons without proper authority.[14] Another commenter recommended that the Commission adopt rules to help streamline the indemnification requirement for an "efficient exchange of information."[15]

2. 2013 cross-border proposal

a. Proposed exemption to indemnification requirement

In 2013, the Commission proposed a number of rules related to the cross-border application of the Title VII security-based swap requirements. At that time, recognizing the significance of commenter concerns and understanding that certain authorities may be unable to agree to indemnify a data repository and the Commission, the Commission preliminarily concluded that the indemnification requirement could frustrate the purposes of the statutory requirement that repositories make available data to relevant authorities. The Commission further took the view that the indemnification requirement should not be applied rigidly so as to frustrate the statutory purposes of data repositories, and hinder relevant authorities' ability to fulfill their regulatory mandates and legal responsibilities.[16]

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14 That commenter particularly expressed concern regarding the possibility of "unfettered access" to security-based swap information by regulators, including foreign financial supervisors, foreign central banks and foreign ministries, "beyond their regulatory authority and mandate." See Managed Funds Association comment (Jan. 24, 2011) at 3. That comment further recommended that the Commission take an approach similar to that taken by rules proposed by the CFTC, requiring any regulator requesting access to such data to certify the statutory authority for the request and detail the basis for the request. See id. at 3-4. The CFTC subsequently adopted that certification requirement as a final rule, but did not adopt the proposed requirement that the regulator also detail the basis for the request. See note 31, infra, and accompanying text.

15 That commenter also reiterated the notion that relevant authorities must ensure the confidentiality of security-based swap data provided to them, and that the indemnification requirement "undermines the key principle of trust according to which exchange of information [among relevant authorities] should occur." See ESMA comment (Jan. 17, 2011) at 2.

16 See Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968, 31048-49 (May 23, 2013) ("Cross-Border Proposing Release").

To address these concerns, the Commission proposed an exemption to provide that a data repository "is not required" to comply with the indemnification requirement, conditioned on: (1) an entity requesting the information "to fulfill a regulatory mandate and/or legal responsibility"; (2) the request pertaining "to a person or financial product subject to the jurisdiction, supervision or oversight of the entity"; and (3) the entity having entered into a supervisory and enforcement memorandum of understanding ("MOU") or other arrangement addressing the confidentiality of the information provided and any other matter as determined by the Commission.[17] The Commission took the preliminary view that the proposed exemption was consistent with commenters' views, including one commenter's suggestion that the indemnification requirement not apply when relevant authorities carry out their responsibilities in accordance with international agreements and while maintaining the confidentiality of data provided to them.[18]

The Commission further stated that the exemption's proposed condition that the request be for the purpose of fulfilling a relevant authority's regulatory mandate or legal responsibility was aligned with statutory requirements to protect the security-based swap information maintained by a repository, including proprietary and highly sensitive data, from unauthorized disclosure, misappropriation or misuse.[19] The Commission also expressed the preliminary view that the proposed condition that the Commission enter into an MOU or other arrangement with a relevant authority represented an effective way to streamline the indemnification requirement for

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17 See id. at 31209 (paragraph (d) of proposed Exchange Act rule 13n-4).

18 See id. at 31049 (addressing DTCC comment from Jan. 24, 2011). The Commission also stated that the proposal was consistent with commenter suggestions that the exemption be "location agnostic" (by treating relevant domestic and foreign authorities similarly), and that the exemption was intended to help preserve the "spirit of cooperation and coordination" between regulators around the world. See id.

19 See id. at 31049-50.

an "efficient exchange of information" to help protect the confidentiality of information and further the purposes of the Dodd-Frank Act.[20]

b. Additional guidance

In the Cross-Border Proposing Release, the Commission also addressed the application of the statutory requirement that repositories notify the Commission regarding data requests. The Commission stated its preliminarily belief that repositories could satisfy that requirement by providing the Commission with notice of an initial request by a relevant authority, and maintaining records of the initial request and all subsequent requests.[21] The Commission further expressed preliminary views regarding the process for determining which additional authorities may obtain information from data repositories pursuant to these data access provisions.[22]

c. Comments

In response to this proposal, the Commission received one comment that addressed the data access provisions, including the indemnification requirement. That commenter stated that the proposal "did not erase the need for a legislative solution to clarify the scope and

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20 See id. at 31050. The Commission moreover expressed the preliminary view that, in determining whether to enter into such an MOU or other arrangement, the Commission would consider, among other things, whether: (1) "the relevant authority needs security-based swap information from an SDR to fulfill its regulatory mandate or legal responsibilities; (2) the relevant authority agrees to protect the confidentiality of the security-based swap information provided to it; (3) the relevant authority agrees to provide the Commission with reciprocal assistance in securities matters within the Commission's jurisdiction; and (4) a supervisory and enforcement MOU or other arrangement would be in the public interest." See id. at 31049-50.

21 See id. at 31046-47.

22 See id. at 31047-48 (indicating that the Commission would make such determinations by order, and that the Commission would consider a variety of factors, including whether there is a supervisory and enforcement MOU between the Commission and the relevant authority, and whether the relevant authority has a legitimate need for the information).

applicability" of the indemnification requirement.[23] The commenter further recommended that the Commission incorporate, as part of the exemption, a "safe harbor provision from liability for information shared pursuant to global information sharing agreements."[24]

The commenter also objected to the prospect that repositories would be required to notify the Commission of an initial information request, stating that such a requirement could lead authorities to hesitate to make requests if that would trigger notice, "particularly if such request is pursuant to an investigation." The commenter instead recommended that the Commission consider the notification requirement to be satisfied if the request is made "pursuant to an established information sharing agreement."[25]

3. Final rules reserving action on the data access provisions

In February 2015, the Commission adopted a number of final rules governing the registration process, duties and core principles applicable to security-based swap data repositories.[26] Those final rules, however, neither addressed the statutory data access requirements applicable to data repositories, nor provided an exception to the indemnification requirement. The Commission instead stated that final resolution of the issue would benefit from further consideration and public comment.[27]

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23 See DTCC cross-border comment (Aug. 21, 2013) at 6-7 (expressing concern that the indemnification provision would continue to limit data sharing across jurisdictions, leading foreign regulators to seek to establish "national" repositories that would fragment data among jurisdictions). That comment and other comments responding to the cross-border proposal are located on the Commission's website at: http://www.sec.gov/comments/s7-02-13/s70213.shtml.

24 See DTCC cross-border comment at 8.

25 See id. at 7.

26 See SDR Adopting Release.

27 See id., 80 FR at 14487-88 (further noting that repositories will have to comply with all statutory requirements, including the indemnification requirement, when the current exemptive relief from requirements applicable to repositories expires). As a result, in adopting those final rules the Commission

C. Treatment of These Issues in the Swaps Context

The Dodd-Frank Act also revised the Commodity Exchange Act ("CEA") to impose comparable data access requirements – including confidentiality and indemnification conditions – upon swap data repositories that are subject to CFTC jurisdiction.[28]

1. Certification of scope of jurisdiction

To implement those requirements, the CFTC adopted rules that in part identify the domestic[29] and foreign regulators[30] to which a swap data repository must make swap data available. The rules provide that when those regulators seek access to data maintained by a swap data repository, they must file a request with the swap data repository and certify that they are acting within the scope of their jurisdiction.[31]

2. Scope of confidentiality and indemnification requirements

The CFTC implementing rules generally require domestic and foreign regulators to execute confidentiality and indemnification agreements with the swap data repository prior to

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reserved paragraphs (b)(9) and (b)(10) of Exchange Act rule 13n-4 (which as proposed would have addressed the data access obligations of registered security-based swap data repositories), and did not adopt the indemnification exemption proposed as paragraph (d) of rule 13n-4.

[28] See CEA sections 21(c)(7), (d), 7 U.S.C. 24a(c)(7), (d).

[29] The CFTC has defined "Appropriate Domestic Regulator" to mean: (i) the SEC; (ii) each prudential regulator "with respect to requests related to any of such regulator's statutory authorities, without limitation to the activities listed for each regulator" in the statutory definition; (iii) the Financial Stability Oversight Council; (iv) the Department of Justice; (v) any Federal Reserve Bank; (vi) the Office of Financial Research; and (vii) any other person the CFTC deems appropriate. See 17 CFR 49.17(b)(1).

[30] The CFTC has defined "Appropriate Foreign Regulator" to mean foreign regulators "with an existing memorandum of understanding or other similar type of information sharing arrangement" executed with the CFTC, and/or foreign regulators "without an MOU as determined on a case-by-case basis" by the CFTC. See 17 C.F.R. 49.17(b)(2).

[31] See 17 CFR 49.17(d)(1). In this regard, the CFTC did not adopt proposed requirements to require regulators to set forth the basis for their requests in sufficient detail, and to require a swap data repository to provide access only if it is satisfied that the regulator is acting within the scope of its authority. See 76 FR 54538, 54553 (Sept. 1, 2011).

receipt of any requested swap data.[32] The CFTC, however, also recognized that it might be difficult for certain regulators to implement those confidentiality and indemnification requirements.[33] Accordingly, the CFTC provided that a domestic regulator with regulatory jurisdiction over a swap data repository registered with it pursuant to separate statutory authority may access such data without the need to enter into confidentiality or indemnification agreements if: (i) the domestic regulator executes an MOU or similar information sharing arrangement with the CFTC; and (ii) the CFTC designates the domestic regulator to receive direct electronic access.[34]

The CFTC implementing rules further provided that a foreign regulator with supervisory responsibility over a swap data repository registered with the foreign regulator pursuant to foreign law and/or regulation would not need to enter into such confidentiality or indemnification agreements.[35] In addition, the CFTC noted that the confidentiality and

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32 See 17 CFR 49.17(d)(6), 49.18(b).

33 See 76 FR at 54554.

34 See 17 CFR 49.17(d)(2), 49.18(c); 76 FR at 54554 (also referencing a separate statutory provision, CEA section 21(c)(4)(A), 7 U.S.C. 24a(c)(4)(A), that requires swap data repositories to provide "direct electronic access" to the CFTC and its designees).

There are differences between the Commission's proposed approach, discussed below, and the approach the CFTC has taken in adopting rules to implement the data access requirement under the CEA. In part, while the CFTC rule requires that entities accessing swap data certify that they are acting within the scope of their jurisdiction, the Commission's proposal instead anticipates considering an entity's interest in the security-based swap information when determining whether to determine that entity may access security-based swap information. See part II.A.3.a, infra. Also, the Commission's proposed exemption from the indemnification requirement is conditioned in part on an entity requesting security-based swap information in connection with a regulatory mandate, or legal responsibility or authority. See part III.B.1.a, infra.

35 See 17 CFR 49.17(d)(3), 49.18(c); 76 FR at 54555 n.166 (adding that the CFTC does not interpret the notification and indemnification provisions to apply "in circumstances in which an Appropriate Foreign Regulator possesses independent sovereign legal authority to obtain access to the information and data held and maintained by an SDR").

indemnification requirements would not apply when the CFTC itself shares information in its possession with foreign authorities.[36]

The CFTC subsequently issued an interpretative statement that the indemnification and confidentiality provisions under the CEA generally apply only to such data reported pursuant to the CEA and CFTC regulations, and that those confidentiality and indemnification provisions "should not operate to inhibit or prevent foreign regulatory authorities from accessing data in which they have an independent regulatory interest (even if that data also has been reported pursuant to the CEA and [CFTC] regulations)."[37] The CFTC further stated that a registered swap data repository would not be subject to the indemnification and confidentiality provisions under the CEA if the swap data repository is "registered, recognized or otherwise authorized in a foreign jurisdiction's regulatory regime," when the data sought to be accessed by the foreign regulatory authority has been reported to the swap data repository "pursuant to the foreign jurisdiction's regulatory regime."[38]

D. The Current Proposal

The Commission today is proposing rules related to the data access obligation applicable to security-based swap data repositories, including rules to provide a conditional exemption from the indemnification requirement. This new proposal builds upon the earlier proposals, but with certain changes.

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36 See 76 FR at 54554.

37 See Swap Data Repositories: Interpretative Statement Regarding the Confidentiality and Indemnification Provisions of the Commodity Exchange Act, 77 FR 65177, 65180-81 (Oct. 25, 2012).

38 See id. The CFTC added that this principle applies even if the applicable data also is reported pursuant to CFTC rules, and that foreign and domestic regulatory authorities also may receive data from the CFTC (rather than the swap data repository) without execution of a confidentiality and indemnification agreement. See id. at 65181.

Among other aspects, as discussed below, the proposal would provide for the statutory confidentiality agreement requirement to be satisfied via the use of MOUs or other agreements between the Commission and the entity accessing data from a security-based swap data repository. The proposal also encompasses an indemnification exemption that would be effective when the relevant conditions are met, in contrast to the earlier proposed approach of conditionally allowing a data repository to elect whether to waive the indemnification requirement.

Taken as a whole, the proposal would provide that when the conditions to the data access provisions are satisfied – including as applicable the conditions to the indemnification exemption – a repository would be required to provide security-based swap data to relevant authorities.

II. Proposed Data Access Rules

The Commission is proposing rules, to implement the data access provisions of Exchange Act sections 13(n)(5)(G) and (H),[39] that address commenter concerns and reflect the Commission's further consideration of the issues. Under the proposal:

- Security-based swap data repositories generally would be required, on a confidential basis after notifying the Commission, to make available security-based swap data, including individual counterparty trade and position data, to certain entities that are identified in the proposed rules and any other persons that are determined by the Commission to be appropriate.[40]
- The data access requirement would be subject to a confidentiality provision that conditions the data access requirement on there being an agreement between the

[39] 15 U.S.C. 78m(n)(5)(G) and (H).

[40] See proposed Exchange Act rule 13n-4(b)(9).

Commission and the entity (in the form of an MOU or otherwise) that addresses the confidentiality of the information received.[41]

- In addition, as discussed below, there would be a conditional exemption to the statutory provision that conditions the data access on the recipient of the data agreeing to indemnify the repository and the Commission for expenses arising from litigation related to the information provided.[42]

A. Data Access Requirement

1. Application to prudential regulators and Federal Reserve Banks

The Exchange Act specifically states that a repository is conditionally obligated to make information available to, among others, "each appropriate prudential regulator."[43] The proposed rules would specifically identify, as being eligible to access data, each of the entities encompassed within the statutory "prudential regulator" definition: the Board of Governors of the Federal Reserve System ("Board"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation ("FDIC"), the Farm Credit Administration, and the Federal Housing Finance Agency.[44]

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41 See proposed Exchange Act rule 13n-4(b)(10).

42 See proposed Exchange Act rule 13n-4(b)(ii).

43 See Exchange Act section 13(n)(5)(G)(i), 15 U.S.C. 78m(n)(5)(G)(i).

44 See proposed Exchange Act rule 13n-4(b)(9)(i)-(v).

Exchange Act section 3(a)(74), 15 U.S.C. 78c(a)(74), defines "prudential regulator" by reference to the CEA. The CEA, in turn, defines "prudential regulator" to encompass: (a) the Board, (b) the Office of the Comptroller of the Currency, (c) the FDIC, (d) the Farm Credit Administration or (e) the Federal Housing Finance Agency – in each case with respect to swap dealers, major swap participants, security-based swap dealers or major security-based swap participants (cumulatively, "dealers" or "major participants") that fall within the regulator's authority. See CEA section 1a(39); 7 U.S.C. 1a(39).

For example, the definition provides that the Board is a prudential regulator with regard to, among others, certain dealers and major participants that are: state-chartered banks and agencies, foreign banks that do not operate insured branches, or members of bank holding companies. Also, for example, Under this approach of specifically identifying each of those regulators, rather than generally referring to "appropriate prudential regulators," the ability of those regulators to access security-based swap data would not vary depending on whether entities regulated by the regulators are acting as security-based swap dealers, as major security-based swap participants, or in some other capacity.[45] For similar reasons, under this approach those regulators' access also would not vary depending on whether the regulator acts in a "prudential" capacity in connection with the information.[46]

The proposed rules also would include "any Federal Reserve Bank" among the entities conditionally eligible to access security-based swap data from repositories,[47] in accordance with the Exchange Act provision that extends data access to "any other person that the Commission determines to be appropriate."[48] Consistent with the standards the Commission expects to

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the definition provides that the Office of the Comptroller of the Currency is a prudential regulator with regard to, among others, certain dealers or major participants that are national banks, federally chartered branches or agencies of foreign banks or federal saving associations.

45 This approach particularly addresses the fact that the statutory "prudential regulator" definition noted above specifically refers to those regulators in connection with dealers and major participants that fall within their authority. In the Commission's preliminary view the application of the data access provision should not vary depending on whether an entity regulated by the regulator is acting as a dealer or major participant, or in some other capacity. Such a reading would not further the purposes of Title VII, and the Dodd-Frank Act more generally, including facilitating regulator access to security-based swap information to help address the risks associated with those instruments. Accordingly, the proposed rule does not limit those regulators' access to security-based swap information based on the capacity in which a regulated entity is acting.

46 Those regulators' ability to access security-based swap data accordingly would not be limited to situations in which they act in the capacity of a prudential supervisor. Thus, for example, the FDIC would conditionally be authorized to access security-based swap data from a repository in connection with all of its statutory capacities, including its prudential supervisory capacity as well as other capacities such as the FDIC's resolution authority pursuant to the Federal Deposit Insurance Act and the Orderly Liquidation Authority provisions of Title II of the Dodd-Frank Act.

47 See proposed Exchange Act rule 13n-4(b)(9)(i).

48 See Exchange Act section 13(n)(5)(G)(v), 15 U.S.C. 78m(n)(5)(G)(v). The CFTC has identified the Federal Reserve Banks as being "appropriate domestic regulators" that may access swap data from swap data repositories. See note 29 supra.

consider in connection with determining other entities to be authorized to access such data – including consideration of a relevant authority's interest in accessing security-based swap data based on its regulatory mandate, or legal responsibility or authority[49] – the Commission preliminarily believes that it is appropriate for the Federal Reserve Banks to be able to access such data. The Commission particularly understands that the Federal Reserve Banks occupy important oversight roles under delegated authority from the Board, including supervision of banks that are under the Board's authority, and gathering and analyzing information to inform the Federal Open Market Committee regarding financial conditions.[50] We further understand that the Federal Reserve Banks, as well as the Board, would use data from security-based swap data repositories to fulfill statutory responsibilities related to prudential supervision and financial stability.[51] The Commission accordingly believes preliminarily that the Federal Reserve Banks'

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49 See part II.A.3, infra.

50 Section 11(k) of the Federal Reserve Act grants the Board authority "to delegate, by published order or rule…any of its functions, other than those relating to rulemaking or pertaining to monetary and credit policies to…members or employees of the Board, or Federal Reserve banks." 12 U.S.C. 248(k). The Federal Reserve Banks carry out the Board's activities including the supervision, examination and regulation of financial institutions as directed by the Board and under its supervision. See the Board's Rules of Organization, sec. 3(j) FRRS 8-008 (providing that the Director of the Board's Division of Banking Supervision and Regulation "coordinates the System's supervision of banks and bank holding companies and oversees and evaluates the Reserve Banks' examination procedures"). The Board further has delegated extensive authority to the Reserve Banks with respect to numerous supervisory matters. See 12 CFR 265.11 (functions delegated by the Board to the Federal Reserve Banks).

51 We understand that the Board and the Federal Reserve Banks jointly would use the data in support of the prudential supervision of institutions under the Board's jurisdiction, such as state member banks, bank holding companies, and Edge Act corporations. See, e.g., section 9 of the Federal Reserve Act, 12 U.S.C. §§ 321-338a (supervision of state member banks); the Bank Holding Company Act, 12 U.S.C. §§ 1841-1852 (supervision of bank holding companies); the Edge Act, 12 U.S.C. §§ 610 et seq. (supervision of Edge Act corporations). We also understand that the Board and the Federal Reserve Banks would use the data in support of the implementation of monetary policy, such as through market surveillance and research. See, e.g., section 12A of the Federal Reserve Act, 12 U.S.C. § 263 (establishing the Federal Open Market Committee); and section 2A of the Federal Reserve Act, 12 U.S.C. § 225a (setting monetary policy objectives). In addition, we understand that the Board and the Federal Reserve Banks would use the data in fulfilling the Board's responsibilities with respect to assessing, monitoring and mitigating systemic risk, such as supervision of systemically important institutions. See,

access to security-based swap data held by repositories would appropriately fall within their regulatory mandate and legal responsibility or authority, and that the Federal Reserve Banks should conditionally have access to the security-based swap data.[52]

A Federal Reserve Bank's ability to access such data would be subject to conditions related to confidentiality and indemnification (as would the ability of any other entity that is identified by statute or determined by the Commission to access such data).[53]

2. FSOC, CFTC, Department of Justice and Office of Financial Research

The Exchange Act also states that FSOC, CFTC, and the Department of Justice may access security-based swap data.[54] The proposed rules accordingly would identify those entities as being conditionally authorized to access such data.[55]

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e.g., section 113 of the Dodd-Frank Act, 12 U.S.C. § 5323 (SIFIs); and section 807 of the Dodd-Frank Act, 12 U.S.C. § 5466 (designated FMUs).

52 The Federal Reserve Banks' access to this information, like the access of the entities directly identified by the statute, would be subject to conditions related to confidentiality and indemnification as discussed below, including conditions to limit an authority's access to data by linking the scope of the exemption from the indemnification requirement to information that is related to persons or activities within an entity's regulatory mandate or its legal responsibility or authority, as specified in an MOU between the Commission and the entity. See parts II.C and III.C, infra.

In proposing to permit the Federal Reserve Banks to access security-based swap information pursuant to the data access provisions, the Commission preliminarily believes that the Federal Reserve Banks' access should not be limited to information regarding security-based swap transactions entered into by banks supervised by the Board, but should be available more generally with regard to security-based swap transaction data. This is consistent with the fact that Title VII does not limit the Board's access to data in such a way. This view also reflects the breadth of the Federal Reserve Banks' responsibilities regarding prudential supervision and financial stability, as addressed above.

53 In this regard, the Commission notes that personnel of the Board and the Reserve Banks already are subject to a number of confidentiality requirements. See 18 U.S.C. 1905 (imposing criminal sanctions on U.S. government personnel who disclose non-public information except as provided by law), 18 U.S.C. 641 (imposing criminal sanctions on the unauthorized transfer of records), 5 CFR 2635.703 (Office of Government Ethics regulations prohibiting unauthorized disclosure of nonpublic information); see also Federal Reserve Bank Code of Conduct section 3.2 (requiring Reserve Bank employees to maintain the confidentiality of nonpublic information).

54 See Exchange Act sections 13(n)(5)(G)(ii)-(iv), 15 U.S.C. 78m(n)(5)(G)(ii)-(iv).

55 See proposed Exchange Act rule 13n-4(b)(9)(vi)-(viii).

The proposed rules further would make the Office of Financial Research ("OFR") conditionally eligible to access such data,[56] in accordance with the Exchange Act provision that that extends data access to "any other person that the Commission determines to be appropriate."

The Commission preliminarily believes that such access by the OFR is appropriate in light of the OFR's regulatory mandate and legal responsibility and authority.[57] The OFR was established by Title I of the Dodd-Frank Act to support FSOC and FSOC's member agencies by identifying, monitoring and assessing potential threats to financial stability thorough the collection and analysis of financial data gathered from across the public and private sectors.[58] In connection with this statutory mandate to monitor and assess potential threats to financial stability, the OFR's access to security-based swap transaction data may be expected to help assist it in examining the manner in which derivatives exposures and counterparty risks flow through

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56 See proposed Exchange Act rule 13n-4(b)(9)(ix), (x).

57 See proposed Exchange Act rule 13n-4(b)(9)(ix). We note that the CFTC has identified the OFR as being an "appropriate domestic regulator" that may access swap data from swap data repositories. See note 29, supra.

58 See Dodd-Frank Act section 153(a) (identifying the purpose of the OFR as: (1) collecting data on behalf of FSOC and providing such data to FSOC and its member agencies; (2) standardizing the types and formats of data reported and collected; (3) performing applied research and essential long-term research; (4) developing tools for risk measurement and monitoring; (5) performing other related services; (6) making the results of the activities of the Office available to financial regulatory agencies; and (7) assisting those member agencies in determining the types and formats of data authorized by the Dodd-Frank Act to be collected by the member agencies); Dodd-Frank Act section 154(c) (requiring that OFR's Research and Analysis Center, on behalf of FSOC, develop and maintain independent analytical capabilities and computing resources to: (A) develop and maintain metrics and reporting systems for risks to U.S. financial stability; (B) monitor, investigate, and report on changes in systemwide risk levels and patterns to FSOC and Congress; (C) conduct, coordinate, and sponsor research to support and improve regulation of financial entities and markets; (D) evaluate and report on stress tests or other stability-related evaluations of financial entities overseen by FSOC member agencies; (E) maintain expertise in such areas as may be necessary to support specific requests for advice and assistance from financial regulators; (F) investigate disruptions and failures in the financial markets, report findings and make recommendations to FSOC based on those findings; (G) conduct studies and provide advice on the impact of policies related to systemic risk; and (H) promote best practices for financial risk management).

The OFR is also required to report annually to Congress its analysis of any threats to the financial stability of the United States. See Dodd-Frank Act section 154(d).

the financial system, and in otherwise assessing those risks. The Commission accordingly believes preliminarily that the OFR's access to security-based swap data held by repositories would appropriately fall within its regulatory mandate and legal responsibility and authority, and that the OFR should conditionally have access to the security-based swap data.[59]

As with the other entities that may access data pursuant to the data access provision, the OFR's ability to access such data would be subject to conditions related to confidentiality and indemnification.[60]

3. Future Commission determination of additional entities

The proposal also would require that repositories provide data to any other person that the Commission determines to be appropriate. The Commission anticipates that entities that may seek such access would likely include foreign financial supervisors (including foreign futures authorities), foreign central banks and foreign ministries.[61] One or more self-regulatory organizations also potentially may seek such access. The proposal further would provide that the Commission will make such determinations through the issuance of Commission orders, and that

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59 As discussed below, the conditions to the proposed indemnification exemption would limit an entity's access to data by linking the scope of the exemption to information that related to persons or activities within an entity's regulatory mandate or legal responsibility or authority, as specified in an MOU between the Commission and the entity. See part III.C, infra

60 As U.S. government personnel, OFR personnel are subject to the same general confidentiality requirements that are addressed above in the context of the Board and the Federal Reserve Banks. See note 53, supra. In addition, the OFR is required to keep data collected and maintained by the OFR data center secure and protected against unauthorized disclosure. See Dodd-Frank Act section 154(b)(3); see also 12 CFR 1600.1 (ethical conduct standards applicable to OFR employees, including post-employment restrictions linked to access to confidential information); 31 CFR 0.206 (Treasury Department prohibition on employees disclosing official information without proper authority).

61 See proposed Exchange Act rule 13n-4(b)(9)(x).

such determinations may be conditional or unconditional.[62] A relevant authority would be able to request that the Commission make such a determination.

a. Determination factors and conditions

The Commission continues to expect that it would consider a variety of factors in connection with making such a determination, and that it may impose associated conditions in connection with the determination. The Commission expects to consider the factors discussed below, as well as any other factors the Commission determines to be relevant.[63]

In part, the Commission expects to consider whether there is an MOU or other arrangement[64] between the Commission and the relevant authority that is designed to protect the confidentiality of the security-based swap data provided to the authority.[65] The Commission also

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[62] See id. In those respects, the proposed rule would implement the corresponding statutory language, which provides the Commission with the authority to allow data access to "any other person that the Commission determines to be appropriate." See Exchange Act section 13(n)(5)(G)(v), 15 U.S.C. 78m(n)(5)(G)(v).

[63] The factors discussed below that may be expected to be relevant to a Commission's determination that a person is eligible to access security-based swap information pursuant the statutory data access provisions – including factors related to the presence of a confidentiality MOU and related to a person's regulatory mandate, or legal responsibility or authority – parallel certain of the conditions to the exemption from the indemnification requirement. See parts III.B, C, infra.

[64] The Cross-Border Proposing Release specifically referred to a "supervisory and enforcement MOU or other arrangement" in this context. See Cross-Border Proposing Release, 78 FR at 31047. The Commission is revising its proposed guidance to refer to MOUs and other arrangements generally – rather than "supervisory and enforcement" MOUs and arrangements – to allow the parties more flexibility in arriving at such confidentiality arrangements.

[65] Such an MOU or other arrangement may also satisfy the statutory requirement that a security-based swap data repository obtain a confidentiality agreement from the authority. See part II.B.1, infra (proposed Exchange Act rule 13n-4(b)(10)(i) would permit an agreement between the Commission and a relevant authority to satisfy the statutory condition that the repository obtain a confidentiality agreement from the authority).

Moreover, this MOU or other arrangement further may satisfy the proposed indemnification exemption's condition that there be an arrangement between the Commission and an entity regarding the confidentiality of the information provided. See part III.C, infra. To the extent that a relevant authority's needs access to additional information, the relevant authority may request that the Commission consider revising its determination order, and MOU or other arrangement, as applicable.

expects to consider whether information accessed by the applicable authority would be subject to robust confidentiality safeguards. The Commission believes that these factors are important given the proprietary and highly sensitive nature of the data maintained by the repository.[66]

In making a determination the Commission also may consider the relevant authority's interest in access to security-based swap data based on the relevant authority's regulatory mandate, or legal responsibility or authority. Limiting the amount of information accessed by an authority in this manner may help minimize the risk of unauthorized disclosure, misappropriation, or misuse of security-based swap data because each relevant authority will only have access to information within its regulatory mandate, or legal responsibility or authority.

Consistent with this factor, the Commission preliminarily expects that such determination orders typically would incorporate conditions that specify the scope of a relevant authority's access to data, and that limit this access in a manner that reflects the relevant authority's regulatory mandates or legal responsibility or authority.[67] Depending on the nature of the relevant authority's interest in the data, such conditions potentially could address factors such as the domicile of the counterparties to the security-based swap, and the domicile of the underlying

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66 See Exchange Act section 13(n)(5)(H)(i).

67 To appropriately limit a relevant authority's access to only security-based swap data that is consistent with the MOU between the Commission and the relevant authority, a repository may, for example, need to customize permissioning parameters to reflect each relevant authority's electronic access to security-based swap data. See generally note 103, infra (discussing access criteria currently used by DTCC in connection with current voluntary disclosure practices).

reference entity.[68] Focusing access to data in this way should help address one commenter's concerns regarding "unfettered access" to such proprietary data.[69]

The Commission further anticipates taking into account any other factors that are appropriate to the determination, including whether such a determination would be in the public interest. This consideration likely would include whether the relevant authority agrees to provide the Commission and other U.S. authorities with reciprocal assistance in matters within their jurisdiction.

b. Additional matters related to the determinations

The Commission contemplates taking various approaches in deciding whether to impose additional conditions in connection with its consideration of requests for determination orders. For example, the Commission may issue a determination order that is for a limited time. The Commission further may revoke a determination at any time. For example, the Commission may revoke a determination or request additional information from a relevant authority to support the continuation of the determination if for example a relevant authority fails to comply with the MOU, such as by failing to keep confidential security-based swap data provided to it by a repository. Even absent such a revocation, moreover, an authority's access to data pursuant to

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[68] See note 105, infra, and accompanying text (discussing application of those factors in the context of the indemnification exemption).

[69] See note 14, supra (comment voicing concerns about "unfettered access" to security-based swap information by regulators, including foreign financial supervisors, foreign central banks and foreign ministries, beyond their regulatory authority and mandate).

As discussed below, moreover, the availability of the proposed indemnification exemption would similarly be conditioned to reflect the recipient's regulatory mandates or legal responsibility or authority. See part III.C, infra. Accordingly, based on the expectation that persons who seek access pursuant to these provisions would rely on the indemnification exemption, there would be comparable limitations to access applicable to persons directly identified by Exchange Act sections 15(n)(5)(i) through (iv) (the "prudential regulators," FSOC, CFTC and Department of Justice) or added by the proposed rules (the Federal Reserve Banks and the OFR).

these provisions also would cease upon the termination of the MOU or other arrangement used to satisfy the confidentiality condition, or, as applicable, the indemnification exemption.[70]

The Commission preliminarily believes that the determination process described above represents a reasonable approach toward providing appropriate access to relevant authorities. Moreover, the Commission preliminarily believes that this process – particularly the link between access and the authority's interest in the information – appropriately builds upon existing voluntary frameworks, in accordance with one commenter's suggestion that the applicable framework incorporate other cooperative efforts with regard to access to information.[71]

The Commission expects that repositories will provide relevant authorities with access to security-based swap data in accordance with the determination orders, and the Commission generally does not expect to be involved in reviewing, signing-off on or otherwise approving relevant authorities' requests for security-based swap data from repositories that are made in

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70 See parts II.B and III.B, C, supra.

71 See DTCC comment (June 3, 2011) at 6-7 ("It is critical that the United States, the European Union and the other major global markets align their regulatory regimes to limit opportunities for market distorting arbitrage. The creation of a global credit default swap repository would not have occurred without the global regulatory cooperation achieved through the OTC Derivatives Regulators' Forum ('ODRF') and the OTC Derivatives Regulators Supervisors Group ('ODSG'). It is important that the global SDR framework incorporate their efforts, particularly the ODRF's guidelines on regulatory access to information stored in trade repositories for over-the-counter derivatives."); DTCC comment (Jan. 24, 2011) at 3 ("DTCC relies upon the direction provided by the OTC Derivatives Regulators' Forum ('ODRF'), whose membership includes the SEC and the Commodity Futures Trading Commission ('CFTC'). DTCC's Trade Information Warehouse (the 'Warehouse' or 'TIW') has followed the ODRF's guidance, recognizing that broad agreement among global regulators is difficult to achieve. DTCC is committed to complying with the policies adopted by the regulators and working with the Commission in this regard.").

In this regard, DTCC further has stated that it routinely provides U.S. regulators with credit default swap data related to overseas transactions entered into by non-U.S. persons on U.S. reference entities, and that it provides European regulators with data related to transactions in the U.S. by U.S. persons on European reference entities. See DTCC comment (Jan. 24, 2011) at 12; see also DTCC comment (June 3, 2011) at 7-8.

accordance with a determination order. Moreover, the Commission continues preliminarily to believe that it is not necessary to prescribe by rule specific processes to govern a repository's treatment of requests for access.[72]

Finally, the Commission notes that it may elect to apply these determination factors and consider applying protections similar to those in the data access provisions of Exchange Act sections 13(n)(5)(G) and (H) when designating authorities to receive direct access under section 13(n)(5)(D). Section 13(n)(5)(D) states that a repository must provide direct electronic access to the Commission "or any designee of the Commission, including another registered entity."[73] In practice, the Commission expects that security-based swap data repositories may satisfy their obligation to make available data pursuant to sections 13(n)(5)(G) and (H) by providing electronic access to appropriate authorities. To the extent a repository were to satisfy those requirements by some method other than electronic access, however, the Commission separately may consider whether to also designate particular authorities as being eligible for electronic access to the repository pursuant to section 13(n)(5)(D). In making such assessments under section 13(n)(5)(D), the Commission preliminarily believes that it may consider factors similar to the above determination factors, including the presence of confidentiality safeguards, and the authority's interest in the information based on its regulatory mandate or legal responsibility or authority.

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72 See Cross-Border Proposing Release, 78 FR 31047-48. One commenter suggested that the Commission adopt an approach proposed by the CFTC, whereby a regulator requesting access to data first file a request for access and certify the statutory authority for the request and detail the basis for the request. See Managed Funds Association comment (Jan. 24, 2011) at 3-4. In contrast to that proposal, however, the final CFTC rules do not require relevant authorities to detail the basis for their requests, and do not require a swap data repository to provide access only if it is satisfied that the regulator is acting within the scope of its authority. See note 31, supra.

73 15 U.S.C. 78m(n)(5)(D).

4. Notification requirement

The proposal would implement the statutory notification requirement – which states that a repository must notify the Commission when an entity requests that the repository make available security-based swap data[74] – by requiring the repository to inform the Commission upon its receipt of the first request for data from a particular entity (which may include any request that the entity be provided ongoing online or electronic access to the data).[75] A repository must keep such notifications and any related requests confidential.[76]

The repository further would have to maintain records of all information related to the initial and all subsequent requests for data access requests from that entity, including records of all instances of online or electronic access, and records of all data provided in connection with such requests or access.[77] For these purposes, we believe that "all information related to" such

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[74] See Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G). As discussed below, see part IV, infra, the notification requirement does not apply to circumstances in which disclosures are made outside of the requirements of Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G), particularly when a dually regulated data repository makes disclosure pursuant to foreign law, or when the Commission provides security-based swap data to an entity.

[75] See proposed Exchange Act rule 13n-4(e). The rule does not require the repository to proactively inform the Commission of subsequent requests.

[76] Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G), and proposed rule 13n-4(b)(9) both require that a repository must make data available "on a confidential basis." Failure by a repository to treat such notifications and requests as confidential could have adverse effects on the underlying basis for the requests. If, for example, a regulatory use of the data is improperly disclosed, such disclosure could signal a pending investigation or enforcement action, which could have detrimental effects.

[77] See proposed Exchange Act rule 13n-4(e).

We note that Exchange Act rule 13n-7(b)(1) requires security-based swap data repositories to maintain copies of "all documents and policies and procedures required by the Act and the rules and regulations thereunder, correspondence, memoranda, papers, books, notices, accounts and other such records as shall be made or received by it in the course of its business as such." See also SDR Adopting Release, 80 FR at 14501 ("This rule includes all electronic documents and correspondence, such as data dictionaries, e-mails and instant messages, which should be furnished in their original electronic format."). Proposed Exchange Act rule 13n-4(e) identifies specific types of records that must be maintained in the specific context of access request to repositories.

requests would likely include, among other things: the identity of the requestor or person accessing the data; the date, time and substance of the request or access; and copies of all data reports or other aggregations of data provided in connection with the request or access.

In the Commission's preliminary view, the proposed notification requirement is designed to account for the way in which we believe entities are likely to access such data from repositories, by distinguishing steps that an entity takes to arrange access from subsequent electronic instructions and other means by which the recipient obtains data. By making relevant data available to the Commission in this manner, the proposed approach would place the Commission on notice that a recipient has the ability to access security-based swap data, and place the Commission in a position to examine such access as appropriate, while avoiding the inefficiencies that would accompany an approach whereby a repository must direct to the Commission information regarding each instance of access by each recipient. Moreover, the proposed approach would be consistent with the manner in which the Commission examines the records of regulated entities under the Commission's authority.

The Commission recognizes that one commenter opposed any requirement that the Commission receive notice of a recipient's initial request, on the grounds that such notice may cause other authorities to hesitate to make such requests.[78] While the Commission appreciates the commenter's concerns, the Commission preliminarily believes that it is necessary for the Commission to be informed of the initial request from a particular entity so that the Commission

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[78] See DTCC comment (Aug. 13, 2013) ("DTCC discourages the Commission from requiring a notification requirement upon initial request as suggested by the Cross-Border Proposal. Authorities will likely be hesitant to make such request to an SDR if it triggers a notice to another authority, particularly if such request is pursuant to an investigation. DTCC proposes that the Commission consider notification to be deemed satisfied if the request is made by an entity to the SDR pursuant to an established information sharing arrangement[.]").

may assess whether the initial conditions to data access (i.e., MOUs or other arrangements as needed to satisfy the confidentiality condition and the indemnification exemption[79]) have been met at the time the repository first is requested to provide the entity with information pursuant to the data access provisions, and, more generally, to facilitate the Commission's ongoing assessment of the repository's compliance with the data access provisions. The Commission also believes that commenter concerns that other regulators may be reluctant to place the Commission on notice of such initial requests are mitigated by the Commission's long history of cooperation with other authorities in supervisory and enforcement matters.[80]

5. Limitation to "security-based swap data"

Repositories that obtain security-based swap data may also obtain data regarding other types of financial instruments, such as swaps under the CFTC's jurisdiction. We do not read the data access provisions of Exchange Act sections 13(n)(5)(G) and (H) – which were added by Subtitle B of Title VII (which focused on the regulatory treatment of security-based swaps)[81] to the Exchange Act (which generally addresses the regulation of securities such as security-based swaps) – to require a repository to make available data that does not involve security-based swaps. The statutory confidentiality condition to the data access requirement further suggests

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79 See parts II.B and III.B, infra.

80 The Commission also recognizes that the same commenter stated that "regulators want direct electronic access to data in SDRs where that data is needed to fulfill regulatory responsibilities" rather than access "by request, with notice to another regulatory authority." See DTCC comment (Jan. 24, 2011) at 11-12. Data repositories in fact can provide direct electronic access to relevant authorities under the proposed interpretation. The proposed requirement that the repository inform the Commission when the relevant authority first requests access to security-based swap data maintained by the repository, and to retain records of subsequent access, is designed to facilitate such direct access.

81 See Dodd-Frank Act section 763(i) (addressing "public reporting and repositories for security-based swaps," including the addition of section 13(n), 15 U.S.C. 78m(n), to the Exchange Act to address security-based swap data repositories); see generally Subtitle B to Title VII of the Dodd-Frank Act, section 761 et seq. (addressing "Regulation of Security-Based Swap Markets").

that the data access provisions are intended to apply only to security-based swap data.[82] Accordingly, the proposed rules specifically address access to "security-based swap data" obtained by a security-based swap data repository.[83]

B. Confidentiality Condition

The Exchange Act provides that, prior to providing data, a repository "shall receive a written agreement from each entity stating that the entity shall abide by the confidentiality requirements described in section 24 relating to the information on security-based swap transactions that is provided."[84]

The proposed rule implementing this condition would require that, before a repository provides information pursuant to the data access provisions, "there shall be in effect an arrangement between the Commission and the entity (in the form of a memorandum of understanding or otherwise) to address the confidentiality of the security-based swap information

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82 In particular, the confidentiality condition to the data access provisions specifically requires that the recipient entity abide by confidentiality requirements for "the information on security-based swap transactions that is provided," suggesting that the Exchange Act data access provisions are intended solely to address security-based swap data. See Exchange Act section 13(n)(5)(H)(i), 15 U.S.C. 78m(n)(5)(H)(i).

Moreover, this approach is consistent with the CFTC's comparable rules, which apply only to swap data. See 17 CFR 49.17(d) and 49.18 (discussing regulators' access to swap data under the CEA).

83 See proposed Exchange Act rule 13n-4(b)(9).

84 See Exchange Act section 13(n)(5)(H)(i), 15 U.S.C. 78m(n)(5)(H)(i).

Exchange Act section 24, 15 U.S.C. 78x, generally addresses disclosures of information by the Commission and its personnel. In relevant part it provides that the Commission may, "in its discretion and upon a showing that such information is needed," provide all records and other information "to such persons, both domestic and foreign, as the Commission by rule deems appropriate if the person receiving such records or information provides such assurances of confidentiality as the Commission deems appropriate." See Exchange Act section 24(c), 15 U.S.C 78x(c); see also Exchange Act rule 24c-1(b) (providing that the Commission may, upon "such assurances of confidentiality as the Commission deems appropriate," provide non-public information to persons such as domestic and foreign governments or their political subdivisions, authorities, agencies or instrumentalities, self-regulatory organizations and foreign financial authorities).

made available to the entity."[85] The proposed rule further would provide that this arrangement would be deemed to satisfy the statutory requirement that the repository receive a written confidentiality agreement from the entity.[86]

This proposed approach to implementing the confidentiality condition, in other words, would use an arrangement between the Commission and a regulator or other recipient entity to satisfy the statutory confidentiality condition. The approach would not necessitate the use of confidentiality agreements entered into by repositories.[87]

In the Commission's preliminary view, this approach reflects an appropriate way to satisfy the interests associated with the confidentiality condition, while facilitating the statutory data access provision's goal of promoting the flow of information to authorities. The approach further would build upon the Commission's experience in negotiating MOUs with other regulators in connection with enforcement and supervision, particularly the Commission's experience in connection with the development of provisions related to maintaining the confidentiality of information.

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85 See proposed Exchange Act rule13n-4(b)(10).

86 See Exchange Act section 13(n)(5)(H)(1). As discussed below, see part IV, infra, the confidentiality condition does not apply to circumstances in which disclosures are made outside of the requirements of Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G), particularly when a dually regulated data repository makes disclosure pursuant to foreign law, or when the Commission provides security-based swap data to an entity.

87 In this regard, the Commission notes that the statute does not require that the security-based swap data repository "agree" with the entity, "enter into" an agreement, or otherwise be a party to the confidentiality agreement. The statute merely states that the repository "receive" such an agreement. See Exchange Act section 13(n)(5)(H)(i), 15 U.S.C. 78m(n)(5)(H)(i). Accordingly, we believe that, at a minimum, the statutory language is ambiguous as to whether the data repository must itself be a party to the confidentiality agreement. In light of this ambiguity, we have preliminarily determined to read the statute to permit the Commission to enter into confidentiality agreements with the entity, with the repository receiving the benefits of the agreement. Accordingly, the Commission believes that it is appropriate to view a security-based swap data repository as having received a confidentiality agreement when the entity enters into a confidentiality agreement with the Commission and that agreement runs to the benefit of the repository.

As a result, the approach would potentially obviate the need for each individual repository to negotiate and enter into dozens of confidentiality agreements. By building upon the Commission's experience and expertise in this area, moreover, the Commission expects that this approach also would help avoid the possibility of uneven and potentially inconsistent application of confidentiality protections across data repositories and recipient entities.

In proposing this approach, the Commission also is mindful that the statutory provision specifically references the "confidentiality requirements described in section 24" of the Exchange Act. In the Commission's preliminary view this statutory language articulates a standard which requires that there be adequate confidentiality assurances. Thus, the Commission preliminarily believes that the proposed provision, under which the Commission would negotiate and enter into agreements providing such confidentiality assurances, appropriately implements the statutory reference to section 24.

C. Request for Comment

The Commission requests comment regarding all aspects of these proposed rules regarding access to security-based swap data from repositories. Among other things, commenters particularly are invited to address the proposal that the confidentiality agreement requirement would be satisfied by an MOU or other agreement between the Commission and another entity. Commenters also are invited to address: the proposed limitation of the data access requirement to security-based swap data; the proposed provisions related to access by prudential regulators, the Federal Reserve Banks and the OFR; the criteria that the Commission should consider in evaluating whether to determine to permit additional entities to access data from repositories; whether the orders that make such determinations generally should encompass conditions that limit a relevant authority's access to information to reflect its regulatory mandate or legal responsibility or authority; whether the Commission should prescribe specific processes to govern requests for such access; and whether the Commission should prescribe a process to govern a repository's treatment of requests for access.

In addition, commenters are invited to address the proposed rules implementing the notification requirement, including the proposed provisions regarding the maintenance of information related to data requests. In this regard, is there an alternative to requiring repositories to maintain copies of all data they provide in connection with the data access provisions that would still permit the Commission to assess the repository's ongoing compliance with those provisions? For example, are alternative approaches available such that the Commission should not require repositories to maintain actual copies of all reports or other aggregations of data provided pursuant to the data access provisions, such as if the repository instead implements policies and procedures sufficient to demonstrate a process for creating records that reflect the data provided, and the repository produces promptly copies of such records upon request by a representative of the Commission?[88] Would such an alternative approach reduce the burdens on repositories while still permitting the Commission to assess ongoing compliance?

Commenters further are invited to address whether the Commission should determine that other domestic authorities, such as one or more self-regulatory organizations, should be

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[88] For example, in adopting Exchange Act rule 17a-4(b)(13) to provide that broker-dealers must preserve certain written policies and procedures in connection with creditworthiness assessments, the Commission stated that although the rule does not require that a broker-dealer maintain a record of each such creditworthiness determination, a broker-dealer would need to be able to support each such determination, and that the broker-dealer may do so by either maintaining documentation of those determinations or by being in a position to "replicate the original credit risk determination using the same process, information, and inputs employed to make the original determination." See Exchange Act Release No. 71194 (Dec. 27, 2013), 79 FR 1522, 1528-29, 1550 (Jan. 8, 2014).

eligible to access security-based swap data pursuant to these provisions. If so, should the access of such self-regulatory organizations be limited in any particular respects?

III. Proposed Exemption from the Indemnification Requirement

A. Proposed Exemption

The Exchange Act also conditions the data access requirement on each recipient entity agreeing "to indemnify the security-based swap data repository and the Commission for any expenses arising from litigation relating to information provided under section 24."[89]

Pursuant to the Commission's authority under Exchange Act section 36,[90] the Commission is proposing a conditional exemption from that statutory indemnification requirement. This proposed exemption would be effective whenever the applicable conditions are met, in contrast with the earlier proposal, which would have conditionally exempted regulators and other authorities from the indemnification requirement only at the election of the data repository.[91]

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89 Exchange Act section 13(n)(5)(H)(ii), 15 U.S.C. 78m(n)(5)(H)(ii). As discussed below, see part IV, infra, the statutory indemnification requirement would not always be triggered by the disclosure of security-based swap information.

In the event that the proposed exemption is unavailable, the Commission agrees with one commenter's view that "any indemnity should be limited in scope to minimize the potential reduction in value of registered SDRs to the regulatory community." See DTCC comment (Jan. 24, 2011) at 12. Consistent with that view, as stated in the Cross-Border Proposing Release, the Commission would not expect that an indemnification agreement would include a provision requiring a relevant authority to indemnify the repository from the repository's own wrongful or negligent acts. See Cross-Border Proposing Release, 78 FR at 31051 n.829.

90 15 U.S.C. 78mm (providing the Commission with general exemptive authority . . . "to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors").

91 To implement this approach, the Commission proposes in relevant part that the indemnification requirement conditionally "shall not be applicable" with regard to the repository's disclosure of security-based swap information. See proposed Exchange Act rule 13n-4(d)(1). The earlier proposal would have conditionally provided that a registered security-based swap data repository "is not required to comply"

This proposed exemption reflects the Commission's preliminary concern that requiring authorities to agree to provide indemnification could lead to negative consequences in practice. The Commission continues to understand that certain authorities may be legally prohibited or otherwise limited from agreeing to indemnify data repositories or the Commission for expenses arising in connection with the information received from a repository.[92]

As a result, application of the indemnification requirement may chill some requests by regulators or other authorities for access to security-based swap data, which would hinder those authorities' ability to address their own regulatory mandate or legal responsibility or authority.[93] The resulting lack of access also may impair coordination among regulators with regard to the

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with the indemnification requirement. See Cross-Border Proposing Release, 78 FR at 31209 (paragraph (d) of proposed rule 13n-4).

[92] As stated in the Cross-Border Proposing Release, the Commission recognizes that certain domestic authorities, including some of those expressly identified in Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G), as a matter of law cannot provide an open-ended indemnification agreement. See Cross-Border Proposing Release, 78 FR at 31048-49 (particularly noting that the Antideficiency Act prohibits certain U.S. federal agencies from obligating or expending federal funds in advance or in excess of an appropriation, apportionment, or certain administrative subdivisions of those funds, e.g., through an unlimited or unfunded indemnification).

[93] See DTCC cross-border comment (Aug. 21, 2013) at 6 ("The continued presence of the Indemnification Provision (even as modified by the exemption in the Cross-Border Proposal) may pose problems for Commission-regulated, U.S.-based SDRs and their ability to share information with third-party regulatory authorities. As a result, foreign regulators may seek to establish their own 'national' repositories to ensure access to the information they need, fragmenting the data among jurisdictions. Similarly, non-U.S. trade repositories may find themselves subject to similar reciprocal impediments to sharing information with the Commission or other U.S. regulatory agencies absent a confidentiality and indemnification agreement."); see also DTCC comment (Nov. 15, 2010) at 3 ("DTCC remains concerned that regulators are not likely to grant SDRs indemnification in exchange for access to the information and, accordingly, regulators may actually receive less aggregated market data. Such an outcome would result in a reduction of information accessible to regulators on a timely basis both domestically and internationally, which contravenes the purpose of SDRs and jeopardizes market stability."); Cleary Gottlieb comment (Sept. 20, 2011) at 31 ("[T]he indemnification requirement could be a significant impediment to effective regulatory coordination, since non-US regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions."); ESMA comment (Jan. 17, 2011) at 2 ("We believe that ensuring confidentiality is essential for exchanging information among regulators and such indemnification agreement undermines the key principle of trust according to which exchange of information should occur.").

oversight of market participants that engage in security-based swap transactions across national boundaries. For example, European Union ("EU") law provides that the ability of certain non-EU regulators to access data from EU repositories is conditioned on there being an international agreement that ensures that EU authorities have "immediate and continuous access to all of the information needed for the exercise of their duties."[94] As a result, application of the indemnification requirement without an exemption being available potentially could preclude EU authorities from accessing data from U.S. security-based swap data repositories. Under such circumstances, it is possible that EU authorities may be unwilling to permit the Commission and other U.S. regulators to access security-based swap data from EU repositories. The resulting concerns associated with a lack of regulatory access to security-based swap data are particularly significant given that data access allows relevant authorities to be in a better position to, among other things, monitor risk exposures of individual counterparties to swap and security-based swap transactions, monitor concentrations of risk exposures and evaluate risks to financial stability.[95]

Such a result associated with application of the indemnification requirement further may make substituted compliance unavailable in connection with security-based swap data reporting

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[94] See EU regulation 648/2012 ("EMIR"), art. 75(2).

[95] See Darrell Duffie, Ada Li, and Theo Lubke, Policy Perspectives of OTC Derivatives Market Infrastructure, Federal Reserve Bank of New York Staff Report No. 424, dated January 2010, as revised March 2010 (with data from repositories regulators can "explore the sizes and depths of the markets, as well as the nature of the products being traded. With this information, regulators are better able to identify and control risky market practices, and are better positioned to anticipate large market movements."); see also DTCC comment (June 3, 2011) at 5 (noting that a data repositories should be able to provide: (i) enforcement authorities with necessary trading information; (ii) regulatory agencies with counterparty-specific information about systemic risk based on trading activity; (iii) aggregate trade information on market-wide activity and aggregate gross and net open interest for publication; and (iv) real-time reporting from [security-based swap execution facilities] and bilateral counterparties and related dissemination).

requirements, given that under rules adopted by the Commission the availability of substituted compliance for those requirements is predicated in part on the Commission's ability to directly access data in foreign repositories.[96]

The Commission recognizes that indemnification may help support confidentiality safeguards by making a recipient liable for expenses that a repository or the Commission incurs in connection with breaches of confidentiality. Nonetheless, the countervailing considerations noted above indicate that indemnification – of either the repository or the Commission – should not be required so long as appropriate confidentiality protections are provided in other ways.

For these reasons the Commission preliminarily believes that it is necessary and appropriate in the public interest, and consistent with the protection of investors, that the indemnification requirement be subject to an exemption that applies whenever the applicable conditions are satisfied.[97]

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[96] See Regulation SBSR, rule 908(c) (2)(iii)(C), 17 CFR 242.908(c)(2)(iii)(C) (conditioning the availability of substituted compliance in part on the Commission having "direct electronic access to the security-based swap data held by a trade repository or foreign regulatory authority to which security-based swaps are reported pursuant to the rules of that foreign jurisdiction"); see also Exchange Act Release No. 74244 (Feb. 11, 2015), 80 FR 14564, 14661 (Mar.19, 2015) ("Regulation SBSR Adopting Release") ("granting substituted compliance without direct electronic access would not be consistent with the underlying premise of substituted compliance: That a comparable regulatory result is reached through compliance with foreign rules rather than with the corresponding U.S. rules.").

[97] The Commission is not incorporating a commenter's suggestion that there be "a safe harbor provision from liability for information shared pursuant to global information sharing agreements into the Indemnification Exemption for SDRs operating pursuant to information sharing arrangements, as defined in the Indemnification Exemption, or comparable to those published by the OTC Derivatives Regulators Forum ("ODRF") or CPSS-IOSCO." See DTCC cross-border comment (Aug. 21, 2013) at 7; see also DTCC comment (Jan. 24, 2011) at 3 (urging the Commission to aim for regulatory comity as reflected in ODRF and CPSS-IOSCO standards); DTCC comment (June 3, 2011) at 6-7 (urging that the global framework incorporate efforts of the ODRF and the OTC Derivatives Regulators Supervisors Group).

To the extent that the commenter suggests that there be a safe harbor from the indemnification requirement, the Commission preliminarily believes that this proposed exemption, which is more narrowly tailored than the commenter's suggestion, would sufficiently address a repository's need for certainty. The Commission further notes that a repository's statutory duty to maintain the privacy of the

B. Confidentiality Arrangement Condition

The proposal in part would condition the indemnification exemption upon there being in effect one or more arrangements (in the form of an MOU or otherwise) between the Commission and the entity that addresses the confidentiality of the security-based swap information provided and other matters as determined by the Commission.[98] The Commission preliminarily believes that such an MOU or other arrangement would address similar confidentiality interests that appear to be reflected by the statutory indemnification requirement, particularly given that the disclosure of confidential information inconsistent with such arrangements can lead to the termination of the arrangement and the loss of data access. Just as an indemnification agreement may be expected to incentivize the confidential treatment of information, such a confidentiality arrangement would help strengthen the authority's incentive to maintain the confidentiality of information.

The Commission anticipates that in determining whether to enter into such an MOU or other arrangement, it would consider, among other things, whether: (a) security-based swap information from a repository would help fulfill the relevant authority's regulatory mandate, or legal responsibility or authority; (b) the relevant authority provides such assurances of confidentiality as the Commission deems appropriate with respect to the security-based swap information provided to the authority; (c) the relevant authority is subject to statutory and/or regulatory confidentiality safeguards; (d) the relevant authority agrees to provide the

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information received is separate and distinct from its statutorily mandated duty to provide security-based swap data to relevant authorities when specific conditions are satisfied, and that the privacy of security-based swap data provided to relevant authorities was addressed by Congress through the confidentiality agreement requirement in Exchange Act section 13(n)(5)(H), 15 U.S.C. 78m(n)(5)(H).

98 See proposed Exchange Act rule 13n-4(d)(2)(ii).

Commission with reciprocal assistance in matters within the Commission's jurisdiction; and (e) an MOU or other arrangement would be in the public interest. These considerations are comparable to the criteria that the Commission anticipates considering as it determines whether an entity is eligible to access information pursuant to the data access provisions.[99] Accordingly, for regulators or other authorities whose access is subject to a determination order, the same confidentiality MOUs or other agreements that are needed to satisfy the indemnification exemption may also serve to satisfy those prerequisites to the determinations.[100]

C. Condition Regarding Regulatory Mandate or Legal Responsibility or Authority

The proposal further would condition the indemnification exemption on the requirement that the information relate to persons or activities within the recipient entity's regulatory mandate, or legal responsibility or authority.[101] This proposed condition should reduce the potential for disclosure of confidential information by limiting the quantity of information each recipient may access. This limitation on access also should help address commenter concerns regarding "unfettered access" to security-based swap data.[102] This approach of limiting the availability of data to reflect such considerations also has parallels to the approach that one commenter indicated that it follows on a voluntary basis for providing relevant authorities with access to certain credit default swap information.[103]

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99 See notes 64 through 69, supra, and accompanying text.

100 Those entities that are expressly identified in the statute or the implementing rules (and thus are not subject to the determination process) also would need to enter into a separate MOU or other agreement to satisfy the confidentiality agreement condition.

101 See proposed Exchange Act rule 13n-4(d)(1).

102 See note 14, supra.

103 See note 71, supra (DTCC statement that it routinely provides U.S. regulators with data related to overseas credit default swap transactions entered into by non-U.S. persons on U.S. reference entities, and

The proposal would implement this requirement by further conditioning the indemnification exemption by requiring that the MOU or other arrangement between the Commission and the entity accessing the data would specify the types of security-based swap information that would relate to the recipient entity's regulatory mandate, or legal responsibility or authority.[104] While the relevant factors for specifying which information is within an entity's regulatory mandate, or legal responsibility or authority for these purposes may vary depending on the relevant facts and circumstances, such factors potentially would include the location of a counterparty to the transaction and the location of the reference entity.[105] In this way, the MOU or other arrangement would help reduce uncertainty regarding how the associated condition to the indemnification exemption may apply to particular types of information requests, and would

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that it provides European regulators with data related to credit default swap transactions in the U.S. by U.S. persons on European reference entities).

[104] See proposed Exchange Act rule 13n-4(d)(2)(ii).

[105] As an example, in the event of a request for access by a foreign authority that is responsible for security-based swap market surveillance and enforcement – and subject to negotiation of such an MOU or other arrangement between the Commission and that authority – criteria indicative of data regarding a transaction being within the authority's regulatory mandate or legal responsibility or authority may include: (i) one or more of the counterparties to the transaction being domiciled or having a principal place of business in the foreign jurisdiction (including branches of entities that are domiciled or that have a principal place of business in that jurisdiction); (ii) one or more of the counterparties being a subsidiary of a person domiciled or having a principal place of business in the foreign jurisdiction; (iii) one or more of the counterparties being a fund or other collective investment vehicle with an adviser that is domiciled or that have a principal place of business in the foreign jurisdiction; (iv) one or more of the counterparties being registered with the authority as a dealer or in some other capacity; or (v) the reference entity for the security-based swap being domiciled or having a principal place of business in the foreign jurisdiction.

As another example, in the case of a foreign authority that is responsible for prudential regulation, criteria indicative of data regarding a transaction being within the entity's regulatory mandate or legal responsibility or authority may include one or more of the counterparties to the transaction being part of a consolidated organization that is supervised by the prudential authority, including all affiliates within that consolidated organization.

provide direction to repositories regarding which disclosures would be covered by the indemnification exemption.[106]

D. Request for Comment

The Commission requests comment on all aspects of the proposed exemption to the statutory indemnification requirement. Commenters particularly are invited to address whether the exemption's proposed scope would adequately address the concerns associated with implementing the indemnification requirement. Among other things, commenters are invited to address whether alternative approaches or other considerations more effectively reflect the access and confidentiality interests associated with the Dodd-Frank Act? Also, should additional conditions be incorporated into the exemption?

Commenters further are invited to address whether the proposal appropriately would make use of an MOU or other arrangement to provide sufficient guidance to a repository regarding an entity's regulatory mandate, or legal responsibility or authority in connection with a request for security-based swap data. In this respect, would the proposed approach provide a repository with an adequate degree of guidance regarding which disclosures of information may or may not be subject to protection? Are there particular criteria that would be useful for incorporating into the MOU or other arrangement to help delimit which information would fall within an entity's regulatory mandate, or legal responsibility or authority?

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106 The Commission anticipates that data repositories would be able to rely on the guidance provided by such arrangements when assessing whether particular information would be subject to the indemnification exemption, thus permitting an authority to access that information without an indemnification agreement.

IV. Applicability of Exchange Act Data Access and Indemnification Provisions

The Exchange Act provisions addressed above – sections 13(n)(5)(G) and (H)[107] – establish one means by which certain regulators and other authorities may access security-based swap data from repositories. It is important to recognize, however, that those provisions do not exclusively govern the means by which such regulators or other authorities might access security-based swap data.

In particular, in the circumstances discussed below, regulators and other authorities in certain circumstances may access security-based swap data via authority that is independent of the above provisions. In those circumstances, the Commission preliminarily believes that the conditions associated with those data access provisions – particularly the provisions regarding indemnification, notification and confidentiality agreements – should not govern access arising from such independent authority.

A. Data Access Authorized by Foreign Law

The Commission continues to believe preliminarily, as discussed in the Cross-Border Proposing Release, that "the Indemnification Requirement does not apply when an SDR is registered with the Commission and is also registered or licensed with a foreign authority and that authority is obtaining security-based swap information directly from the SDR pursuant to that foreign authority's regulatory regime."[108] In those circumstances, the dually registered data repository would be subject to a data access obligation that is independent of the Exchange Act data access obligation, and the notification, confidentiality and indemnification conditions to the Exchange Act data access provision would not apply.

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[107] 15 U.S.C. 78m(n)(5)(G) and (H).

[108] See Cross-Border Proposing Release, 78 FR at 31049 n.807.

B. Receipt of Information Directly from the Commission

The Exchange Act also provides that relevant authorities may obtain security-based swap data from the Commission, rather than directly from data repositories.[109]

First, Exchange Act section 21(a)(2)[110] states that, upon request of a foreign securities authority, the Commission may provide assistance in connection with an investigation the foreign securities authority is conducting to determine whether any person has violated, is violating or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces.[111] That section further provides that, as part of this assistance, the Commission in its discretion may conduct an investigation to collect information and evidence pertinent to the foreign securities authority's request for assistance.[112]

In addition, the Commission may share "nonpublic information in its possession" with, among others, any "federal, state, local, or foreign government, or any political subdivision, authority, agency or instrumentality of such government . . . [or] a foreign financial regulatory

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109 See Cross-Border Proposing Release, 78 FR at 31045.

110 15 U.S.C. 78u(a)(2).

111 Exchange Act section 3(a)(50), 15 U.S.C. 78c(a)(50), broadly defines "foreign securities authority" to include "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters."

112 Exchange Act section 21(a)(2), 15 U.S.C. 78u(a)(2), also states that the Commission may provide such assistance without regard to whether the facts stated in the request also would constitute a violation of U.S. law.

That section further states that when the Commission decides whether to provide such assistance to a foreign securities authority, the Commission shall consider whether the requesting authority has agreed to provide reciprocal assistance in securities matters to the United States, and whether compliance with the request would prejudice the public interest of the United States.

authority."[113] This authority is subject to the recipient providing "such assurances of confidentiality as the Commission deems appropriate."[114]

In the Commission's view, and consistent with Commission practice for many years, these sections provide the Commission with separate, additional authority to assist domestic and foreign authorities in certain circumstances, such as, for example, by providing security-based swap data directly to the authority. At those times, the authority would receive information not from the data repository, but instead from the Commission.

C. Request for Comment

The Commission requests comment on these preliminary interpretations regarding the scope of the data access requirement and conditions set forth in Exchange Act sections 13(n)(5)(G) and (H).

V. Paperwork Reduction Act

Certain provisions of the proposed rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[115] The SEC has submitted them to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title of the new collection of information is "Security-Based Swap Data Repository Data Access Requirements." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless

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113 See Exchange Act rule 24c-1(c) (implementing Exchange Act section 24(c), 15 U.S.C. 78x(c), which states that the Commission may, "in its discretion and upon a showing that such information is needed," provide records and other information "to such persons, both domestic and foreign, as the Commission by rule deems appropriate," subject to assurances of confidentiality).

114 See id.

115 44 U.S.C. 3501 et seq.

it displays a currently valid OMB control number. OMB has not yet assigned a control number to the new collection of information.

A. Summary of Collection of Information

The proposal would require security-based swap data repositories to make security-based swap data available to other parties, including certain government bodies. This data access obligation would be conditioned on confidentiality and indemnification requirements, and the indemnification requirement itself would be subject to a conditional exemption. The proposal further would require such repositories to create and maintain information regarding such data access.

B. Proposed Use of Information

The data access requirement and associated conditions would provide the regulators and other authorities that receive the relevant security-based swap data with tools to assist with the oversight of the security-based swap market and of dealers and other participants in the market, and to assist with the monitoring of risks associated with that market.

C. Respondents

The data access requirement will apply to every person required to be registered with the Commission as a security-based swap data repository – that is every U.S. person performing the functions of a security-based swap data repository, and to every non-U.S. person performing the functions of a security-based swap data repository within the United States absent an exemption.[116] Commission staff is aware of seven persons that have, to date, filed applications

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[116] As discussed above, see note 13, supra, the Commission has determined that a non-U.S. person that performs the functions of a security-based swap data repository within the United States is required to register with the Commission absent an exemption. The Commission also has adopted Exchange Act rule 13n-12 to provide an exemption from data repository requirements for certain non-U.S. persons.

for registration with the CFTC as swap data repositories, three of which have withdrawn their applications and four of which are provisionally registered with the CFTC. It is reasonable to estimate that a similar number of persons provisionally registered with the CFTC may seek to register with the Commission as security-based swap data repositories. Therefore, the Commission estimates, for PRA purposes, that ten persons might register with the Commission as security-based swap data repositories.[117]

The conditions to data access under these proposed rules further will affect all persons that may seek access to security-based swap data pursuant to these provisions. As discussed below, these may include up to 30 domestic entities.

D. Total Annual Reporting and Recordkeeping Burden

1. Data access generally

The data access provisions may implicate various types of PRA burdens and costs: (i) burdens and costs that regulators and other authorities incur in connection with negotiating MOUs or other arrangements with the Commission in connection with the data access provisions; (ii) burdens and costs that certain authorities that have not been determined by statute or Commission rule may incur in connection with requesting that the Commission grant them access to repository data;[118] (iii) burdens and costs associated with information technology systems that repositories develop in connection with providing data to regulators and other authorities; and (iv) burdens and costs associated with the requirement that repositories notify the

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117 The Commission used the same estimate when adopting final rules to implement statutory provisions related to the registration process, duties and core principles applicable to security-based swap data repositories. See SDR Adopting Release, 80 FR at 14521.

118 These include MOUs and other arrangements in connection with: the determination of additional entities that may access security-based swap data (see part II.A.3, supra), the confidentiality condition (see part II.B.1, supra) and the indemnification exemption (see parts III.B.2, 3, supra).

Commission of requests for access to security-based swap data, including associated recordkeeping requirements.

a. MOUs

As discussed above, entities that access security-based swap data pursuant to these data access provisions would be required to enter into MOUs or other arrangements with the Commission to address the confidentiality condition and the indemnification exemption. In some cases, those entities also would enter into MOUs or other arrangements in connection with the Commission's determination of the entity as authorized to access such data (to the extent that the entity's access is already determined by statute or by the proposed rules). For purposes of the PRA requirements, the Commission estimates that up to 30 domestic entities potentially might enter into such MOUs or other arrangements, reflecting the nine entities specifically identified by statute or the proposed rules, and up to 21 additional domestic governmental entities or self-regulatory organizations that may seek access to such data. Based on the Commission's experience in negotiating similar MOUs that address regulatory cooperation, including confidentiality issues associated with regulatory cooperation, the Commission preliminarily believes that each regulator on average would expend 500 hours in negotiating such MOUs.[119]

[119] It may be expected that the initial MOU or other arrangement that is entered into between the Commission and another regulator may take up to 1,000 hours for that regulator to negotiate. In practice, however, subsequent MOUs and other arrangements involving other recipient entities would be expected to require significantly less time on average, by making use of using the prior MOUs as a basis for negotiation. Based on these principles, the Commission preliminarily estimates that the average amount of time that domestic and foreign recipients of data would incur in connection with negotiating these arrangements would be 500 hours.

To the extent that each of those 30 domestic entities were to seek to access data pursuant to these provisions, and each of the applicable MOUs or other arrangements were to take 500 hours on average, the total burden would amount to 15,000 hours.

b. Requests for access

Separately, certain entities that are not identified by statute and/or the proposed rules may request that the Commission determine that they may access such security-based swap data. For those entities, in light of the relevant information that the Commission preliminarily would consider in connection with such determinations (apart from the MOU issues addressed above) – including information regarding how the entity would be expected to use the information, information regarding the entity's regulatory mandate or legal responsibility or authority, and information regarding reciprocal access – the Commission preliminarily estimates that each such entity would expend 40 hours in connection with such request. As noted above, the Commission estimates that 21 domestic entities not encompassed in the proposed rule may seek access to the data. Accordingly, to the extent that 21 domestic entities were to request access (apart from the nine entities identified by statute or the proposed rule), the Commission estimates a total burden of 840 hours for these entities to prepare and submit requests for access.

c. Systems costs

The Commission previously addressed the PRA costs associated with the Exchange Act's data access requirement in 2010, when the Commission initially proposed rules to implement those data access requirements in conjunction with other rules to implement the duties applicable to security-based swap data repositories. At that time, based on discussions with market participants, the Commission estimated that a series of proposed rules to implement duties applicable to security-based swap data repositories – including the proposed data access rules as well as other rules regarding repository duties (e.g., proposed rules requiring repositories to accept and maintain data received from third parties, to calculate and maintain position information, and to provide direct electronic access to the Commission and its designees) – together would result in an average one-time start-up burden per repository of 42,000 hours and

$10 million in information technology costs for establishing systems compliant with all of those requirements. The Commission further estimated the average per-repository ongoing annual costs of such systems to be 25,200 hours and $6 million.[120]

The Commission incorporated those same burden estimates earlier this year, when the Commission adopted final rules to implement the duties applicable to security-based swap data repositories, apart from the data access requirement.[121]

Subject to the connectivity issues addressed below, the Commission believes that the burden estimates associated with the 2010 proposed repository rules encompassed the costs and burdens associated with the proposed data access requirements in conjunction with other system-related requirements applicable to security-based swap dealers. To comply with those other system-related requirements – including in particular requirements that repositories provide direct electronic access to the Commission and its designees – we preliminarily believe that it is reasonable to expect that repositories may use the same systems as they would also use to comply with the data access requirements at issue here, particularly given that both types of access requirements would require repositories to provide security-based swap information to particular recipients subject to certain parameters.[122] As a result, subject to per-recipient

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120 See SDR Proposing Release, 75 FR at 77348-49. The Commission previously estimated, for PRA purposes, that ten persons may register with the Commission as security-based swap data repositories. See SDR Adopting Release, 80 FR at 14521, 14523. Based on the estimate of ten respondents, the Commission estimated total one-time costs of 420,000 hours and $10 million, and total annual ongoing systems costs of 252,000 and $60 million. See SDR Proposing Release, 75 FR at 77349.

121 See SDR Adopting Release, 80 FR at 14523. The Commission submitted the PRA burden associated with that release to OMB for approval, and the OMB has approved that collection of information.

122 The Commission also anticipates that repositories would use the same systems in connection with the Exchange Act data access requirements as they use in connection with the corresponding requirements under the CEA.

connectivity burdens addressed below, the Commission preliminarily believes that would be no additional burdens associated with information technology costs to implement the data access requirements of the proposed rule.

The Commission also recognizes, however, that once the relevant systems have been set up, repositories may be expected to incur addition incremental burdens and costs associated with setting up access to security-based swap data consistent with the recipient's regulatory mandate or legal responsibility or authority.[123] The Commission preliminarily believes that, for any particular recipient, security-based swap data repositories on average would incur a burden of 26 hours.[124] As discussed below, based on the estimate that approximately 300 relevant authorities may make requests for data from security-based swap data repositories,[125] the Commission preliminarily estimates that each repository would incur a one-time burden of 7,800 hours in connection with providing that connectivity.[126]

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[123] In addressing those burdens, the Commission expects that the MOUs or other arrangements that are used to satisfy the conditions of the indemnification exemption will set forth objective criteria that delimit the scope of a recipient's ability to access security-based swap data pursuant to the indemnification exemption. The Commission further expects that repositories would use those criteria to program their data systems to reflect the scope of the recipient's access to repository data. Absent such objective and programmable criteria, repositories would be expected to incur greater burdens to assess whether an authority's request satisfies the relevant conditions, particularly with regard to whether particular information relates to persons or activities within the entity's regulatory mandate or legal responsibility or authority.

[124] This estimate is based on the view that for each recipient requesting data, a repository would incur a 25 hour burden associated with programming or otherwise inputting the relevant parameters, encompassing 20 hours of programmer analyst time and five hours of senior programmer time. The estimate also encompasses one hour of attorney time in connection with each such recipient.

[125] See part VI.C.3.ii, infra.

[126] Across an estimated ten repositories, accordingly, the Commission estimates that repositories cumulatively would incur a one-time burden of 78,000 hours in connection with providing such connectivity.

d. Providing notification of requests, and associated records requirements

Under the proposed rules, repositories would be required to inform the Commission when they receive the first request for security-based swap data from a particular entity.[127] As discussed below, based on the estimate that approximately 300 relevant authorities may make requests for data from security-based swap data repositories, the Commission estimates that each repository would provide the Commission with actual notice approximately 300 times.[128] Moreover, based on the estimate that ten persons may register with the Commission as security-based swap data repository, the Commission estimates that repositories in the aggregate would provide the Commission with actual notice a total of 3,000 times. The Commission preliminarily estimates that each such notice would take no more than one-half hour to make on average, leading to a cumulative estimate of 1,500 hours associated with the notice requirement.

The proposed rule further requires that repositories must maintain records of all information related to the initial and all subsequent requests for data access, including records of all instances of online or electronic access, and records of all data provided in connection with such access.[129] The Commission estimates that there cumulatively may be 360,000 subsequent data requests or access per year across all security-based swap data repositories, for which repositories must maintain records as required by the proposed rule.[130] Based on its experience with recordkeeping costs associated with security-based swaps generally, the Commission preliminarily estimates that for each repository this requirement would create an initial burden of

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127 See proposed Exchange Act rule 13n-4(e) (further requiring the repository to maintain records of the initial and all subsequent requests).

128 See part VI.C.3.a.ii, infra.

129 See proposed Exchange Act rule 13n-4(e).

130 See part VI.C.3.a.ii, infra.

roughly 360 hours, and an annualized burden of roughly 280 hours and $40,000 in information technology costs.[131]

2. Confidentiality condition

The Commission preliminarily does not believe that the confidentiality provision of the proposal would be associated with collections of information that would result in a reporting or recordkeeping burden for security-based swap data repositories. This is because, under the proposal, the confidentiality condition would be satisfied by an MOU or other arrangement between the Commission and the recipient entity (i.e., another regulatory authority) addressing confidentiality. We preliminarily expect that in practice that the condition will be addressed by MOUs or other arrangements entered into by the Commission, and that repositories accordingly would not be involved in the drafting or negotiation of confidentiality agreements.

As discussed above, moreover, the confidentiality provision would be expected to impose burdens on authorities that seek to access data pursuant to these provisions, as a result of the need to negotiate confidentiality MOUs or other arrangements.[132]

E. Collection of Information is Mandatory

The conditional data access requirements of Exchange Act sections 13(n)(5)(G) and (H) and the underlying rules are mandatory for all security-based swap data repositories. The confidentiality condition is mandatory for all entities that seek access to data under those requirements. Also, the conditions to the indemnification exemption are mandatory to entities

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131 Across an estimated ten repositories, accordingly, the Commission preliminarily estimates that repositories cumulatively will incur an initial burden of roughly 3,600 hours in information technology costs, and an annualized burden of roughly 2,800 hours and $400,000 in information technology costs.

132 See part V.D.1.a, supra.

that seek to rely on the exemption, which the Commission believes will be all entities that seek data pursuant to these requirements.

F. Confidentiality

The Commission will make public requests for a determination that an authority is appropriate to conditionally access security-based swap data, as well as Commission determinations issued in response to such requests. The Commission preliminarily expects that it will make publicly available the MOUs or other arrangements with the Commission used to satisfy the confidentiality and indemnification conditions.

Initial notices of requests for access provided to the Commission by repositories will be kept confidential, subject to the provisions of applicable law. To the extent that the Commission obtains subsequent requests for access that would be required to be maintained by the repositories, the Commission also will keep those records confidential, subject to the provisions of applicable law.

G. Request for Comment

We request comment on our approach and the accuracy of the current estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the collection of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are required to respond, including through the use of automated collection techniques or other forms of information technology.

In this regard, the Commission particularly requests comment regarding the systems-related costs associated with these data access requirements. Among other things, commenters are invited to address the burdens associated with establishing and programming systems to provide regulators and other authorities with connectivity to repository data systems, including whether such costs would be incremental to the systems-related costs associated with the existing rule requiring that repositories provide direct electronic access to the Commission and its designees, and whether such systems-related costs would encompass capacity-related elements linked to the total number of regulators and other authorities that access repositories pursuant to these data access provisions. Commenters also are invited to address the estimated burdens associated with the requirement that repositories maintain records in connection with the notification requirement.

The Commission further requests comment regarding the burdens associated with the negotiation of MOUs or other arrangements between the Commission and other authorities, including the average time required for those regulators to negotiate such MOUs or other arrangements, and whether those other authorities may incur costs to retain outside counsel in connection with such negotiations.

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 send a copy to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-_____. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-_____, 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 concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VI. Economic Analysis

As discussed above, the Commission is proposing rules to implement data access requirements for relevant authorities other than the Commission that the Dodd-Frank Act imposes on security-based swap repositories, and to provide an exemption from the associated indemnification requirement. To carry out their regulatory mandate, or legal responsibility or authority, certain relevant entities other than the Commission may periodically need access to security-based swap data collected and maintained by SEC-registered security-based swap data repositories, and the proposed rules are intended to facilitate such access.

The Commission is sensitive to the economic effects of its rules, including the costs and benefits and the effects of its rules on efficiency, competition, and capital formation. Section 3(f)[133] of the Exchange Act requires the Commission, whenever it engages in rulemaking pursuant to the Exchange Act, to consider or determine whether an action is necessary or appropriate in the public interest, and to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. In addition, section 23(a)(2)[134] of the Exchange Act requires the Commission, when promulgating rules under the Exchange Act, to consider the impact such rules would have on competition. Exchange Act section 23(a)(2) also provides that the Commission shall not adopt any rule which

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[133] 15 U.S.C. 78c(f).

[134] 15 U.S.C. 78w(a)(2).

would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

A. Economic Considerations

1. Title VII Transparency Framework

The security-based swap market prior to the passage of the Dodd-Frank Act has been described as being opaque, in part because transaction-level data were not widely available to market participants or to regulators.[135] To increase the transparency of the over-the-counter derivatives market to both market participants and regulatory authorities, Title VII requires the Commission to undertake a number of rulemakings, including rules the Commission adopted earlier this year to address the registration process, duties and core principles applicable to security-based swap data repositories,[136] and to address regulatory reporting and public dissemination of security-based swap information.[137] Among other matters, those rules address market transparency by requiring security-based swap data repositories, absent an exemption, to collect and maintain accurate security-based swap transaction data, and address regulatory transparency by requiring security-based swap data repositories to provide the Commission with

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135 With respect to one type of security-based swap, credit default swaps ("CDSs"), the Government Accountability Office found that "comprehensive and consistent data on the overall market have not been readily available," "authoritative information about the actual size of the [CDS] market is generally not available" and regulators currently are unable "to monitor activities across the market." Government Accountability Office, GAO-09-397T, <u>Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps</u>, at 2, 5, 27, (2009) <u>available at</u>: http://www.gao.gov/new.items/d09397t.pdf; <u>see also</u> Robert E. Litan, <u>The Derivatives Dealers' Club and Derivatives Market Reform: A Guide for Policy Makers, Citizens and Other Interested Parties</u>, Brookings Institution (Apr. 7, 2010), http://www.brookings.edu/~/media/research/files/papers/2010/4/07%20derivatives%20litan/0407_derivatives_litan.pdf; Michael Mackenzie, <u>Era of an Opaque Swaps Market Ends</u>, Financial Times, June 25, 2010, <u>available at</u>: http://www.ft.com/intl/cms/s/0/f49f635c-8081-11df-be5a-00144feabdc0.html#axzz3HLUjYNI7.

136 <u>See</u> SDR Adopting Release, note 13, <u>supra</u>.

137 <u>See</u> Regulation SBSR Adopting Release.

direct electronic access to such data.[138]

Consistent with the goal of increasing transparency to regulators, the data access provisions at issue here set forth a framework for security-based swap data repositories to provide access to security-based swap data to relevant authorities other than the Commission. The proposed rules would implement that framework for repositories to provide data access to other relevant entities in order to fulfill their regulatory mandate, or legal responsibility or authority.

2. Transparency In the Market For Security-Based Swaps

The proposed data access rules and indemnification exemption, in conjunction with the transparency-related requirements generally applicable to security-based swap data repositories, are designed to, among other things, make available to the Commission and other relevant authorities data that will provide a broad view of the security-based swap market and help monitor for pockets of risk and potential market abuses that might not otherwise be observed by those authorities.[139] Unlike most other securities transactions, security-based swaps involve ongoing financial obligations between counterparties during the life of transactions that typically span several years. Counterparties to a security-based swap rely on each other's creditworthiness and bear this credit risk and market risk until the security-based swap terminates or expires. This can lead to market instability when a large market participant, such as a security-based swap

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[138] See Exchange Act rule 13n-5 (requiring repositories to comply with data collection and data maintenance standards related to transaction and position data); Exchange Act rule 13n-4(b)(5) (requiring repositories to provide direct electronic access to the Commission and its designees).

[139] See, e.g., Exchange Act section 13(n)(5)(D), 15 U.S.C. 78m(n)(5)(D), and rule 13n-4(b)(5) (requiring SDRs to provide direct electronic access to the Commission). See also 156 Cong. Rec. S5920 (daily ed. July 15, 2010) (statement of Sen. Lincoln) ("These new 'data repositories' will be required to register with the CFTC and the SEC and be subject to the statutory duties and core principles which will assist the CFTC and the SEC in their oversight and market regulation responsibilities.").

dealer, major security-based swap market participant, or central counterparty ("CCP") becomes financially distressed. The default of a large market participant could introduce the potential for sequential counterparty failure; the resulting uncertainty could reduce the willingness of market participants to extend credit, and substantially reduce liquidity and valuations for particular types of financial instruments.[140]

A broad view of the security-based swap market, including information regarding aggregate market exposures to particular reference entities (or securities), positions taken by individual entities or groups, and data elements necessary to determine the market value of the transaction, may be expected to provide the Commission and other relevant authorities with a better understanding of the actual and potential risks in the market and promote better risk monitoring efforts. The information provided by security-based swap data repositories also may be expected to help the Commission and other relevant authorities investigate market manipulation, fraud and other market abuses.

3. Global Nature of the Security-Based Swap Market

As highlighted in more detail in the Economic Baseline below, the security-based swap market is a global market. Based on market data in the Depository Trust and Clearing Corporation's Trade Information Warehouse ("DTCC-TIW"), the Commission estimates that only 12 percent of the global transaction volume that involves either a U.S.-domiciled counterparty or a U.S-domiciled reference entity (as measured by gross notional) between 2008 and 2014 was between two U.S.-domiciled counterparties, compared to 48 percent entered into

140 See, e.g., Markus K. Brunnermeier and Lasse Heje Pedersen, Market Liquidity and Funding Liquidity, 22 Review of Financial Studies 2201 (2009); Denis Gromb and Dimitri Vayanos, A Model of Financial Market Liquidity Based on Intermediary Capital, 8 Journal of the European Economic Association 456 (2010).

between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 40 percent entered into between two foreign-domiciled counterparties.[141]

In light of the security-based swap market's global nature there is the possibility that regulatory data may be fragmented across jurisdictions, particularly because a large fraction of transaction volume includes at least one counterparty that is not a U.S. person[142] and the applicable U.S. regulatory reporting rules depend on the U.S. person status of the counterparties.[143] As discussed further below, fragmentation of data can increase the difficulty in consolidating and interpreting security-based swap market data from repositories, potentially reducing the general economic benefits derived from transparency of the security-based swap market to regulators. Absent a framework for the cross-border sharing of data reported pursuant to regulatory requirements in various jurisdictions, the relevant authorities responsible for monitoring the security-based swap market may not be able to access data consistent with their regulatory mandate, or legal responsibility or authority.

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141 The data the Commission receives from the DTCC-TIW does not include transactions between two non-U.S. domiciled counterparties that reference a non-U.S. entity or security. This is approximately 19 percent of global transaction volume. See note 152, infra. Therefore, factoring in these transactions, approximately 10 percent of global transaction volume involves two U.S.-domiciled counterparties, 39 percent involve one U.S.-domiciled counterparty and one foreign counterparty, and 51 percent are between two foreign-domiciled counterparties.

142 This statement is based on staff analysis of voluntary CDS transaction data reported to the DTCC-TIW, which includes self-reported counterparty domicile. See note 161, infra. The Commission notes that the DTCC-TIW entity domicile may not be completely consistent with the Commission's definition of "U.S. person" in all cases but preliminarily believes that these two characteristics have a high correlation.

143 See Regulation SBSR rule 908(a) (generally requiring regulatory reporting and public dissemination when at least one direct or indirect counterparty is a U.S. person). Note that current voluntary reporting considers the self-reported domicile of the counterparty but the recently adopted SBSR rules consider the counterparty's status as a U.S. person.

4. Economic Purposes of the Rulemaking

The proposed data access requirements and indemnification exemption are designed to increase the quality and quantity of transaction and position information available to relevant authorities about the security-based swap market while helping to maintain the confidentiality of that information. The increased availability of security-based swap information may be expected to help relevant authorities act in accordance with their regulatory mandate, or legal responsibility or authority, and to respond to market developments.

Moreover, by facilitating access to security-based swap data for relevant authorities, including non-U.S. authorities designated by the Commission, the Commission anticipates an increased likelihood that the Commission itself will have commensurate access to security-based swap data stored in trade repositories located in foreign jurisdictions.[144] This may be particularly important in identifying transactions in which the Commission has a regulatory interest (e.g., transactions involving a U.S. reference entity or security) but may not have been reported to a registered security-based swap data repository due to the transactions occurring outside of the U.S. between two non-U.S. persons.[145] This should assist the Commission in fulfilling its

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[144] As discussed above, for example, EU law conditions the ability of non-EU authorities to access data from EU repositories on EU authorities having "immediate and continuous" access to the information they need. See note 94, supra, and accompanying text.

Also, as discussed above, the Commission anticipates considering whether or not the relevant authority requesting access agrees to provide the Commission and other U.S. authorities with reciprocal assistance in matters within their jurisdiction when making a determination as to whether the requesting authority shall be granted access to security-based swap data held in registered SDRs. See part II.A.3(a) supra.

[145] For example, it is possible to replicate the economic exposure of either a long or short position in a debt security that trades in U.S. markets by trading in U.S. treasury securities and credit default swaps that reference the debt security. Transactions between two non-U.S. persons on a U.S. reference entity supervised by the Commission or novations between two non-U.S. persons that reduce exposure to a U.S. registrant may provide information to the Commission about the market's views concerning the financial stability or creditworthiness of the registered entity.

regulatory mandate and legal responsibility and authority, including by facilitating the Commission's ability to detect and investigate market manipulation, fraud and other market abuses, by providing the Commission with greater access to security-based swap information than that provided under the current voluntary reporting regime.[146]

Such data access may be especially critical during times of market turmoil, by giving the Commission and other relevant authorities information to examine risk exposures incurred by individual entities or in connection with particular reference entities. Increasing the available data about the security-based swap market should further give the Commission and other relevant authorities better insight into how regulations are affecting or may affect the market, which may allow the Commission and other regulators to better craft regulations to achieve desired goals, and therefore increase regulatory effectiveness.

B. Baseline

To assess the economic impact of the proposed data access rules and indemnification exemption, the Commission is using as a baseline the security-based swap market as it exists today, including applicable rules that have already been adopted and excluding rules that have been proposed but not yet finalized. Thus we include in the baseline the rules that the Commission adopted earlier this year to govern the registration process, duties and core principles applicable to security-based swap data repositories, and to govern regulatory reporting and public dissemination of security-based swap transactions.

Because those rules were adopted only recently, there are not yet any registered swap data repositories, and the Commission does not yet have access to regulatory reporting data.

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146 See part VI.B, supra, for a description of the data the Commission receives from DTCC-TIW under the current voluntary reporting regime.

Hence, our characterization of the economic baseline, including the quantity and quality of security-based swap data available to the Commission and other relevant authorities and the extent to which data are fragmented, considers the anticipated effects of the final SDR rules and Regulation SBSR. The Commission acknowledges limitations in the degree to which it can quantitatively characterize the current state of the security-based swap market. As described in more detail below, because the available data on security-based swap transactions do not cover the entire market, the Commission has developed an understanding of market activity using a sample that includes only certain portions of the market.

1. Regulatory Transparency in the Security-Based Swap Market

There currently is no robust, widely accessible source of information about individual security-based swap transactions. In 2006, a group of major dealers expressed their commitment in support of DTCC's initiative to create a central trade industry warehouse for credit derivatives.[147] Moreover, in 2009, the leaders of the G20 – whose members include the United States, 18 other countries, and the European Union – called for global improvements in the functioning, transparency, and regulatory oversight of over-the-counter ("OTC") derivatives markets and agreed, among other things, that OTC derivatives contracts should be reported to trade repositories.[148] A single repository, the DTCC-TIW, makes the data reported to it under the voluntary reporting regime available to the Commission and other relevant authorities in accordance with the agreement between DTCC-TIW and the OTC Derivatives Regulatory

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[147] See Letter to Timothy Geithner, President, Federal Reserve Bank of New York, Mar. 10, 2006, available at: http://www.newyorkfed.org/newsevents/news/markets/2006/industryletter2.pdf.

[148] See G20 Leaders Statement from the 2009 Pittsburgh Summit, available at: http://www.g20.utoronto.ca/2009/2009communique0925.html.

Forum ("ODRF"), of which the Commission is a member.[149] Although many jurisdictions have implemented rules concerning reporting of security-based swaps to trade repositories,[150] the Commission understands that many market participants continue to report voluntarily to the DTCC-TIW.

The data that the Commission receives from DTCC-TIW do not encompass CDS transactions that both: (i) do not involve any U.S. counterparty, and (ii) are not based on a U.S. reference entity.[151] Based on a comparison of weekly transaction volume publicly disseminated by DTCC-TIW with data provided to the Commission under the voluntary arrangement, we estimate that the transaction data provided to the Commission covers approximately 77 percent of the global single-name credit default swap market.[152]

While DTCC-TIW generally provides detailed data on positions and transactions to regulators that are members of the ODRF, DTCC-TIW makes only summary information available to the public.[153]

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[149] See note 71, supra.

[150] See Eighth Progress Report on Implementation of OTC Derivatives Market Reforms (Nov. 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/r_141107.pdf.

[151] The Commission notes that the identification of entity domicile in the voluntary data reported to DTCC-TIW may not be consistent with the Commission's definition of "U.S. person" in all cases.

[152] In 2014, DTCC-TIW reported on its website new trades in single-name CDSs with gross notional of $15.4 trillion. During the same period, data provided to the Commission by DTCC-TIW, which include only transactions with a U.S. counterparty or transactions written on a U.S. reference entity or security, included new trades with gross notional equaling $12.4 trillion, or 81% of the total reported by DTCC-TIW.

[153] The DTCC-TIW publishes weekly transaction and position reports for single-name credit default swaps. In addition, ICE Clear Credit provides aggregated volumes of clearing activity, and large multilateral organizations periodically further report measures of market activity. For example, the Bank for International Settlements ("BIS") reports gross notional outstanding for single-name credit default swaps and equity forwards and swaps semiannually.

2. Current Security-Based Swap Market

The Commission's analysis of the current state of the security-based swap market is based on data obtained from DTCC-TIW, particularly data regarding the activity of market participants for single-name credit-default swaps from 2008 to 2014. While other repositories also may collect data on transactions in total return swaps on equity and debt, the Commission does not currently have access to such data for those products (or for other products that are security-based swaps). Although the definition of "security-based swap" is not limited to single-name credit-default swaps, the Commission believes that the single-name credit default swap data are sufficiently representative of the security-based swap market and therefore can directly inform the analysis of the state of the current security-based swap market.[154] The Commission believes that DTCC-TIW's data for single-name credit default swaps appear reasonably comprehensive because they include data on almost all single-name credit default swap transactions and market participants trading in single-name credit default swaps.[155]

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154 According to data published by BIS, the global notional amount outstanding in equity forwards and swaps as of December 2014 was $2.50 trillion. The notional amount outstanding was approximately $9.04 trillion for single-name CDSs, approximately $6.75 trillion for multi-name index CDSs, and approximately $0.61 trillion for multi-name, non-index CDSs. See Bank of International Settlement, BIS Quarterly Review, Statistical Annex, Table 19 (June 2015), available at: http://www.bis.org/publ/qtrpdf/r_qt1506.htm. For purposes of this analysis, the Commission assumes that multi-name index CDSs are not narrow-based security index CDSs, and therefore do not fall within the definition of security-based swap. See Exchange Act section 3(a)(68)(A), 15 U.S.C. 78c(a)(68)(A); see also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48207 (Aug. 13, 2012). The Commission also assumes that instruments reported as equity forwards and swaps include instruments such as total return swaps on individual equities that fall with the definition of security-based swap. Based on these assumptions, single-name CDS appear to constitute roughly 80 percent of the security-based swap market. Although the BIS data reflects the global OTC derivatives market, and not only the U.S. market, the Commission is not aware of any reason to believe that these ratios differ significantly in the U.S. market.

155 See ISDA, CDS Marketplace, Exposures & Activity, available at: http://www.isdacdsmarketplace.com/exposures_and_activity ("DTCC Deriv/SERV's Trade Information Warehouse is the only comprehensive trade repository and post-trade processing infrastructure for OTC

Based on this information, our analysis below indicates that the current security-based swap market: (i) is global in scope, and (ii) is concentrated among a small number of dealing entities. Although under the voluntary reporting regime discussed above there was a single repository, as various jurisdictions have implemented mandatory reporting rules in their jurisdictions the number of trade repositories holding security-based swap data has grown.[156]

a. Security-Based Swap Market Participants

A key characteristic of security-based swap activity is that it is concentrated among a relatively small number of entities that engage in dealing activities.[157] Based on the Commission's analysis of DTCC-TIW data, there were 1,879 entities engaged directly in trading credit default swaps between November 2006 and December 2014.[158] Table 1 below highlights that of these entities, there were 17, or approximately 0.9 percent, that were ISDA-recognized dealers.[159] ISDA-recognized dealers executed the vast majority of transactions (82.6 percent)

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credit derivatives in the world. Its Deriv/SERV matching and confirmation service electronically matches and confirms more than 98% of credit default swaps transactions globally.").

156 See, for example, the list of trade repositories registered by ESMA, available at: http://www.esma.europa.eu/content/List-registered-Trade-Repositories. As of May 28, 2015, there were six repositories registered by ESMA, all of which are authorized to receive data on credit derivatives.

157 See Exchange Act Release No.72472 (Jun. 25, 2014), 79 FR 47278, 47293 (Aug. 12, 2014) ("Cross-Border Definitions Adopting Release"). All data in this section cites updated data from that release and its accompanying discussion.

158 These 1,879transacting agents represent over 10,000 accounts representing principal risk holders. See Cross-Border Definitions Adopting Release, 79 FR at 47293-94 (discussing the number of transacting agents and accounts of principal risk holders).

As noted above, the data provided to the Commission by the DTCC-TIW only includes transactions that either include at least one U.S.-domiciled counterparty or reference a U.S. entity or security. Therefore, any entity that is not domiciled in the U.S., never trades with a U.S.-domiciled entity and never buys or sells protection on a U.S. reference entity or security would not be included in this analysis.

159 For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as a recognized dealer in any year during the relevant period. Dealers are only included in the ISDA-recognized dealer category during the calendar year in which they are so identified. The complete list of

measured by the number of counterparties (each transaction has two counterparties or transaction sides). Many of these dealers are regulated by entities other than, or in addition to, the Commission. In addition, thousands of other market participants appear as counterparties to security-based swap transactions, including, but not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and non-financial companies.

Table 1. The number of transacting agents in the single-name CDS market by counterparty type and the fraction of total trading activity, from November 2006 through December 2014, represented by each counterparty type.

Transacting Agents	Number	Percent	Transaction share
Investment Advisers	1,419	75.5%	10.9%
- SEC registered	*572*	*30.4%*	*6.9%*
Banks	260	13.8%	5.0%
Pension Funds	29	1.5%	0.1%
Insurance Companies	38	2.0%	0.3%
ISDA-Recognized Dealers[160]	17	0.9%	82.6%
Other	116	6.2%	1.2%
Total	1,879	100%	100%

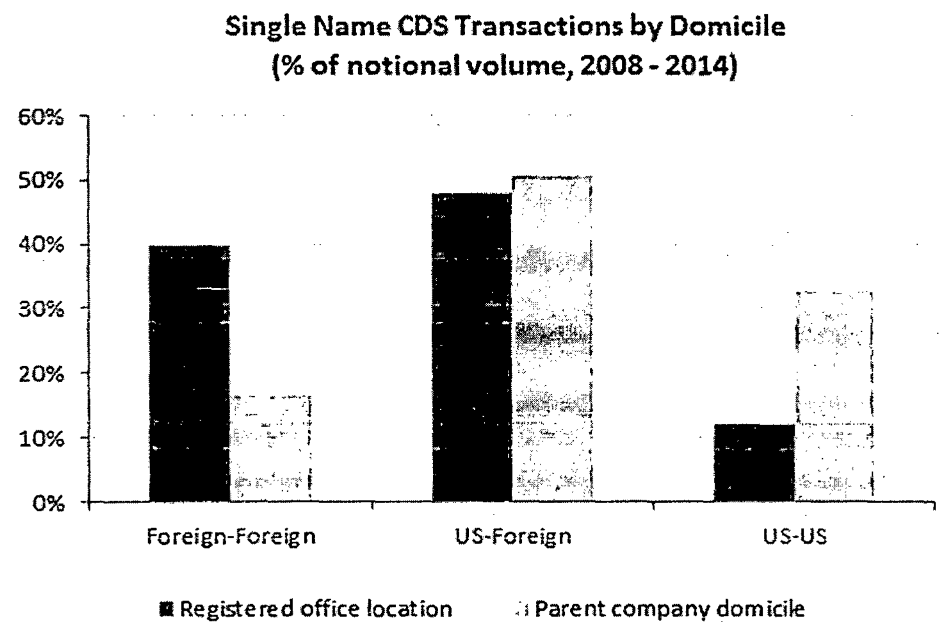
Although the security-based swap market is global in nature, approximately 60 percent of the transaction volume in the 2008-2014 period included at least one U.S.-domiciled entity (see

ISDA recognized dealers is: JP Morgan Chase NA (and Bear Stearns), Morgan Stanley, Bank of America NA (and Merrill Lynch), Goldman Sachs, Deutsche Bank AG, Barclays Capital, Citigroup, UBS, Credit Suisse AG, RBS Group, BNP Paribas, HSBC Bank, Lehman Brothers, Société Générale, Credit Agricole, Wells Fargo, and Nomura. See ISDA, Operations Benchmarking Surveys, available at: http://www2.isda.org/functional-areas/research/surveys/operations-benchmarking-surveys.

160 For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as belonging to the G14 or G16 dealer group during the period: JP Morgan Chase NA (and Bear Stearns), Morgan Stanley, Bank of America NA (and Merrill Lynch), Goldman Sachs, Deutsche Bank AG, Barclays Capital, Citigroup, UBS, Credit Suisse AG, RBS Group, BNP Paribas, HSBC Bank, Lehman Brothers, Société Générale, Credit Agricole, Wells Fargo and Nomura. See, e.g., http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf.

Figure 1). Moreover, 48 percent of the single-name CDS transactions reflected in DTCC-TIW data that include at least one U.S.-domiciled counterparty or a U.S. reference entity or security were between U.S.-domiciled entities and foreign-domiciled counterparties.

Figure 1: The fraction of notional volume in North American corporate single-name CDSs 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.



The fraction of new accounts with transaction activity that are domiciled in the U.S. fell through the 2008-2014 period. Figure 2 below is a chart of: (1) the percentage of new accounts with a domicile in the United States,[161] (2) the percentage of new accounts with a domicile

161 The domicile classifications in DTCC-TIW are based on the market participants' own reporting and have not been verified by Commission staff. Prior to enactment of the Dodd-Frank Act, account holders did not formally report their domicile to DTCC-TIW because there was no systematic requirement to do so. After enactment of the Dodd-Frank Act, the DTCC-TIW has collected the registered office location of the account. This information is self-reported on a voluntary basis. It is possible that some market participants may misclassify their domicile status because the databases in DTCC-TIW do not assign a unique legal entity identifier to each separate entity. It is also possible that

outside the United States, and (3) the percentage of new accounts that are domiciled outside the United States but managed by a U.S. entity, foreign accounts that include new accounts of a foreign branch of a U.S. bank, and new accounts of a foreign subsidiary of a U.S. entity. Over time, a greater share of accounts entering the DTCC-TIW data either have had a foreign domicile or have had 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, and the increase in foreign accounts managed by U.S. persons may reflect the flexibility with which market participants can restructure their market participation in response to regulatory intervention, competitive pressures and other factors. There are, however, alternative explanations for the shifts in new account domicile in Figure 2. Changes in the domicile of new accounts through time may reflect improvements in reporting by market participants to DTCC-TIW. Additionally, because the data include only accounts that are domiciled in the United States, transact with U.S.-domiciled counterparties or transact in single-name CDSs with U.S. reference entities or securities, changes in the domicile of new accounts may reflect increased transaction activity between U.S. and non-U.S. counterparties.

We note that cross-border rules related to regulatory reporting and public dissemination of security-based swap transactions depend on, among other things, the U.S. person status of the counterparties.[162] The analyses behind Figures 1 and 2 show that the security-based swap market is global, with an increasing share of the market characterized by cross-border trade.

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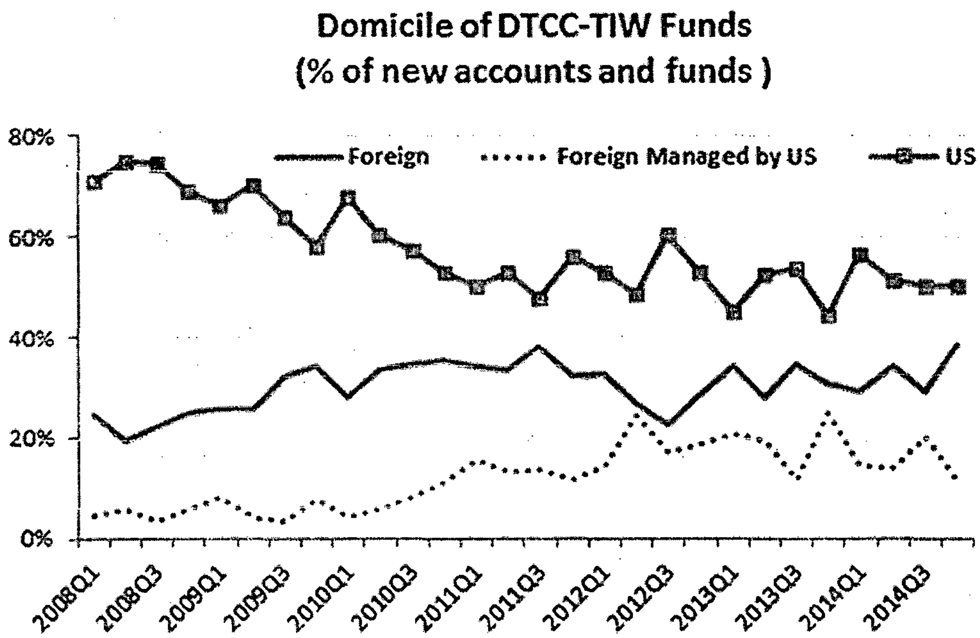
the domicile classifications may not correspond precisely to the definition of "U.S. person" under the rules defined in Exchange Act rule 3a71-3(a)(4), 17 CFR 240.3a71-3(a)(4). Notwithstanding these limitations, the Commission believes that the cross-border and foreign activity demonstrates the nature of the single-name CDS market.

162 See note 143, supra.

Figure 2: The percentage of (1) new accounts with a domicile in the United States (referred to below 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. entity, new accounts of a foreign branch of a U.S. bank, and new accounts of a foreign subsidiary of a U.S. entity (collectively referred to below as "Foreign Managed by US").[163] Unique, new accounts are aggregated each quarter and shares are computed on a quarterly basis, from January 2008 through December 2014.



b. Security-Based Swap Data Repositories

No security-based swap data repositories are currently registered with the Commission. The Commission is aware of one entity in the market (i.e., the DTCC-TIW) that has been

[163] 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.

accepting voluntary reports of single-name and index credit default swap transactions. In 2014, DTCC-TIW received approximately 4 million records of single-name credit default swap transactions, of which approximately 868,000 were price-forming transactions.[164]

The CFTC has provisionally registered four swap data repositories.[165] These swap data repositories are: BSDR LLC, Chicago Mercantile Exchange Inc., DTCC Data Repository LLC, and ICE Trade Vault, LLC. The Commission believes that these entities will likely register with the Commission as security-based swap data repositories and that other persons may seek to register with both the CFTC and the Commission as swap data repositories and security-based swap data repositories, respectively.[166]

Efforts to regulate the swap and security-based swap markets are underway not only in the United States, but also abroad. Consistent with the call of the G20 leaders for global improvements in the functioning, transparency and regulatory oversight of OTC derivatives markets,[167] substantial progress has been made in establishing the trade repository infrastructure to support the reporting of OTC derivatives transactions.[168] Currently, multiple trade repositories operate, or are undergoing approval processes to do so, in a number of different jurisdictions.[169]

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164 Price-forming credit default swap transactions include all new transactions, assignments, modifications to increase the notional amounts of previously executed transactions and terminations of previously executed transactions. Transactions terminated or 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.

165 CFTC rule 49.3(b) provides for provisional registration of a swap data repository. 17 CFR 49.3(b).

166 For the purpose of estimating PRA related costs, the number of swap data repositories is estimated to be as high as ten. See part V.C, supra.

167 See note 148, supra, and accompanying text.

168 See Eighth Progress Report on Implementation of OTC Derivatives Market Reforms (Nov. 2014), available at: http://www.financialstabilityboard.org/wp-content/uploads/r_141107.pdf.

169 Id.

Combined with the fact that the requirements for trade reporting differ across jurisdictions, the result is that security-based swap data is fragmented across many locations, stored in a variety of formats, and subject to many different rules for authorities' access. The data in these trade repositories accordingly will need to be aggregated in various ways if authorities are to obtain a comprehensive and accurate view of the global OTC derivatives markets.

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

As discussed above, the security-based swap market to date largely has developed as an opaque OTC market with limited dissemination of transaction-level price and volume information.[170] Accordingly, the Commission envisions that registered security-based swap data repositories, by storing the security-based swap transaction and position data required to be reported to them by market participants, will become an essential part of the infrastructure of the market in part by providing the data to relevant authorities in accordance with their regulatory mandate, or legal responsibility or authority.

In proposing these rules to implement the Exchange Act data access requirement and to provide a conditional exemption from the indemnification requirement, the Commission has attempted to balance different goals. On the one hand, the Commission preliminarily believes that the proposed rules will facilitate the sharing of information held by repositories with relevant authorities, which should assist those authorities in acting in accordance with their regulatory mandate, or legal responsibility or authority. At the same time, although regulatory access raises important issues regarding the confidentiality of the information, the Commission preliminarily

[170] See part VI.B.1, supra (addressing limited information currently available to market participants and regulators).

believes that the proposed rules should appropriately reduce the risk of breaching the confidentiality of the data by providing for a reasonable assurance that confidentiality will be maintained before access is granted.

Additionally, we note that the magnitude of the costs and benefits of the proposed rules depend in part on the type of access granted to relevant authorities. Ongoing, unrestricted direct electronic access by relevant authorities may be most beneficial in terms of facilitating efficient access to data necessary for those authorities to act in accordance with their regulatory mandate, or legal responsibility or authority, but at the cost of increasing the risk of improper disclosure of confidential information. Restricting each relevant authority's access to only that data consistent with that authority's regulatory mandate, or legal responsibility or authority reduces the quantity of data that could become subject to improper disclosure. On the other hand, restricting a relevant authority's access to data may make it more difficult for it to effectively act in accordance with its regulatory mandate or legal responsibility or authority.

The potential economic effects stemming from the proposed rules can be grouped into several categories. In this section, we first discuss the general costs and benefits of the proposed rules, including the benefits of reducing data fragmentation, data duplication and enhancing regulatory oversight, as well as the risks associated with potential breaches of data confidentiality. Next, we discuss the effects of the rules on efficiency, competition and capital formation. Finally, we discuss specific costs and benefits linked to the proposed rules.

1. General Costs and Benefits

As discussed above, the proposed rules would implement the statutory provisions that require a security-based swap data repository to disclose information to certain relevant authorities, conditional upon the authority agreeing to keep the information confidential and to indemnify the repository and the Commission for any expenses arising from litigation relating to the information provided. The proposal also would set forth a conditional exemption from the requirement that entities requesting data agree to provide indemnification. The exemption would be conditional on the requested information relating to a regulatory mandate and/or legal responsibility of the entity requesting the data, and on the entity entering into an MOU with the Commission addressing the confidentiality of the information provided and any other matters as determined by the Commission.

a. Anticipated benefits

The proposed rules should facilitate access to security-based swap transaction and position data by entities that require such information to fulfill their regulatory mandate or legal responsibility or authority. Market participants accordingly should benefit from relevant domestic authorities other than the Commission having access to the data necessary to fulfill their responsibilities. In particular, such access could help promote stability in the security-based swap market particularly during periods of market turmoil,[171] and thus could indirectly contribute to improved stability in related financial markets, including equity and bond markets.[172]

Moreover, as noted in part II.A(3)(a), the Commission anticipates, when making a determination concerning a relevant authority's access to security-based swap data, considering whether the relevant authority agrees to provide the Commission and other U.S. authorities with

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[171] SDR Adopting Release, 80 FR at 14531 ("Enhanced transparency could produce additional market-wide benefits by promoting stability in the [security-based swap] market, particularly during periods of market turmoil, and it should indirectly contribute to improved stability in related financial markets, including equity and bond markets.").

[172] See Darrell Duffie, Ada Li, and Theo Lubke, Policy Perspectives of OTC Derivatives Market Infrastructure, Federal Reserve Bank of New York Staff Report No. 424 (Jan. 2010, as revised Mar. 2010), note 95, supra ("Transparency can have a calming influence on trading patterns at the onset of a potential financial crisis, and thus act as a source of market stability to a wider range of markets, including those for equities and bonds.").

reciprocal assistance in matters within their jurisdiction. Allowing access to security-based swap data held by registered security-based swap data repositories by non-U.S. authorities may be expected to help facilitate the Commission's own ability to access data held by repositories outside the United States.[173] Accordingly, to the extent the Commission obtains access, the proposed rules further may be expected to assist the Commission in fulfilling its regulatory responsibilities, including by detecting market manipulation, fraud and other market abuses by providing the Commission with greater access to global security-based swap information.[174]

The ability of other relevant authorities to access data held in trade repositories registered with the Commission, as well as the ability of the Commission to access data held in repositories registered with other regulators, may be especially crucial during times of market turmoil. Increased data sharing should provide the Commission and other relevant authorities more-complete information to monitor risk exposures taken by individual entities and exposures connected to particular reference entities, and should promote global stability through enhanced regulatory transparency. Security-based swap data repositories registered with the Commission are required to retain complete records of security-based swap transactions and maintain the

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173 See note 94, supra, and accompanying text.

174 See SDR Adopting Release, 80 FR at 14450 ("Requiring U.S. persons that perform the functions of an SDR to be operated in a manner consistent with the Title VII regulatory framework and subject to the Commission's oversight, among other things, helps ensure that relevant authorities are able to monitor the build-up and concentration of risk exposure in the [security-based swap] market, reduce operational risk in that market, and increase operational efficiency."); id. at 14529 ("In conjunction with Regulation SBSR, the SDR Rules should assist the Commission in fulfilling its regulatory mandates and legal responsibilities such as detecting market manipulation, fraud, and other market abuses by providing it with greater access to [security-based swap] information than that provided under the voluntary reporting regime."); see also DTCC comment (Nov. 15, 2010) at 1 ("A registered SDR should be able to provide (i) enforcement agents with necessary information on trading activity; (ii) regulatory agencies with counterparty-specific information about systemic risk based on trading activity; (iii) aggregate trade information for publication on market-wide activity; and (iv) a framework for real-time reporting from swap execution facilities and derivatives clearinghouses.").

integrity of those records.[175] Based on discussions with other regulators, the Commission believes repositories registered with other authorities are likely to have comparable requirements. As a result, rules to facilitate regulatory access to those records in line with the recipient authorities' regulatory mandate, or legal responsibility or authority are designed to help position the Commission and other authorities to: detect market manipulation, fraud and other market abuses; monitor the financial responsibility and soundness of market participants; perform market surveillance and macroprudential supervision; resolve issues and positions after an institution fails; monitor compliance with relevant regulatory requirements; and respond to market turmoil.[176]

Additionally, improving the availability of data regarding the security-based swap market should give the Commission and other relevant authorities improved insight into how regulations are affecting, or may affect, the market. This may be expected to help increase regulatory

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[175] See SDR Adopting Release, 80 FR at 14531 ("The SDR Requirements [Exchange Act section 13(n) and the rules and regulations thereunder], including requirements that SDRs register with the Commission, retain complete records of [security-based swap] transactions, maintain the integrity and confidentiality of those records, and disseminate appropriate information to the public are intended to help ensure that the data held by SDRs is reliable and that the SDRs provide information that contributes to the transparency of the [security-based swap] market while protecting the confidentiality of information provided by market participants."); see also Exchange Act section 13(n)(5)(C), 15 U.S.C. 78m(n)(5)(c) (requiring SDRs to maintain security-based swap data)); Exchange Act rules 13n-5(b)(3) and (4) (requiring SDRs to establish, maintain, and enforce policies and procedures reasonably designed to ensure that transaction data and positions are accurate and to maintain the transaction data and positions for specified periods of time).

[176] See, e.g., SDR Proposing Release, 75 FR at 77307, 77356, corrected at 76 FR 79320 (stating that the "data maintained by an SDR may also assist regulators in (i) preventing market manipulation, fraud, and other market abuses; (ii) performing market surveillance, prudential supervision, and macroprudential (systemic risk) supervision; and (iii) resolving issues and positions after an institution fails," and further stating that "increased transparency on where exposure to risk reside in financial markets . . . will allow regulators to monitor and act before the risks become systemically relevant. Therefore, SDRs will help achieve systemic risk monitoring."); Cross-Border Proposing Release, 78 FR at 31186-31187 (discussing benefits of providing relevant foreign authorities with access to data maintained by SDRs).

effectiveness by allowing the Commission and other regulators to better craft regulation to achieve desired goals.

In addition, the Commission believes that providing relevant foreign authorities with access to data maintained by repositories may help reduce costs to market participants by reducing the potential for duplicative security-based swap transaction reporting requirements in multiple jurisdictions.[177] The Commission anticipates that relevant foreign authorities will likely impose their own reporting requirements on market participants within their jurisdictions.[178] Given the global nature of the security-based swap market and the large number of cross-border transactions, the Commission recognizes that it is likely that such transactions may be subject to the reporting requirements of at least two jurisdictions.[179] However, the Commission preliminarily believes that if relevant authorities are able to access security-based swap data in trade repositories outside their jurisdiction, such as repositories registered with the Commission, as needed, then relevant authorities may be more inclined to permit market participants involved in such transactions to fulfill their reporting requirements by reporting the transactions to a single

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177 Cf. Cleary Gottlieb comment (Sept. 20, 2011) at 31 (the indemnification requirement "could be a significant impediment to effective regulatory coordination, since non-U.S. regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions.").

178 For example, EU law requires that counterparties to derivatives contracts report the details of the contract to a trade repository, registered or recognized in accordance with EU law, no later than the working day following the conclusion, modification or termination of the contract. See EMIR art. 9; see also EC Delegated Regulation no. 148/2013 (regulatory technical standards implementing the reporting requirement).

179 For example, as noted above, market data regarding single-name CDS transactions involving U.S.-domiciled counterparties and/or U.S.-domiciled reference entities indicates that 13 percent of such transactions involve two U.S.-domiciled counterparties, while 48 percent involve a U.S.-domiciled counterparty and a foreign-domiciled counterparty. See note 141, supra, and accompanying text.

trade repository.[180] If market participants can report a transaction to a single trade repository rather than to separate trade repositories in each applicable jurisdiction, their compliance costs may be reduced. Similarly, to the extent that security-based swap data repositories provide additional ancillary services,[181] if market participants choose to make use of such services, they would likely find such services that make use of all of their data held in a single trade repository more useful than services that are applied only to a portion of that market participant's transactions. Ancillary services applied to only a portion of a participant's transactions could result if data were divided across multiple repositories as a result of regulations requiring participants to report data to separate trade repositories in each applicable jurisdiction.

b. Anticipated costs

The Commission believes that although there are benefits to security-based swap data repositories providing access to relevant authorities to data maintained by the repositories, such access will likely involve certain costs and potential risks. For example, the Commission expects that repositories will maintain data that are proprietary and highly sensitive[182] and that are

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180 For example, EU law anticipates the possibility that market participants may be able to satisfy their EU reporting obligations by reporting to a trade repository established in a third country, so long as that repository has been recognized by the European Securities and Markets Authority. See EMIR art. 77; see also Regulation SBSR, rule 908(c) (providing that to the extent that the Commission has issued a substituted compliance order/determination, compliance with Title VII regulatory reporting and public dissemination requirements may be satisfied by compliance with the comparable rules of a foreign jurisdiction).

181 According to one commenter, ancillary services "may include: asset servicing, confirmation, verification and affirmation facilities, collateral management, settlement, trade compression and netting services, valuation, pricing and reconciliation functionalities, position limits management, dispute resolution, counterparty identity verification and others." See MarkitSERV comment (Jan. 24, 2011) at 4 (comment in response to SDR Proposing Release).

182 As the Commission noted in the SDR Proposing Release, such data could include information about a market participant's trades or its trading strategy; it may also include non-public personal information. SDR Proposing Release, 75 FR at 77339.

subject to strict privacy requirements.[183] Extending access to such data to anyone, including relevant authorities, increases the risk that the confidentiality of the data maintained by repositories may not be preserved.[184] A relevant authority's inability to protect the confidentiality of data maintained by repositories could erode market participants' confidence in the integrity of the security-based swap market and increase the overall risks associated with trading.[185] As we discuss below, this may ultimately lead to reduced trading activity and liquidity in the market, hindering price discovery and impeding the capital formation process.[186]

To help mitigate these risks and potential costs to market participants, the Exchange Act and the proposed rules impose certain conditions on relevant authorities' access to data maintained by repositories.[187] In part, the Exchange Act and the proposed rules limit the authorities that may access data maintained by a security-based swap data repository to a specific list of domestic authorities and other persons, including foreign authorities, determined by the

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183 See Exchange Act section 13(n)(5)(F), 15 U.S.C. 78m(n)(5)(F) (requiring an SDR to maintain the privacy of security-based swap transaction information); Exchange Act rules 13n-4(b)(8) and 13n-9 (implementing Exchange Act section 13(n)(5)(F)).

184 See, e.g., ESMA comment (Jam. 17, 2011) at 2 (noting that relevant authorities must ensure the confidentiality of security-based swap data provided to them).

185 For example, should it become generally known by market participants that a particular dealer had taken a large position in order to facilitate a trade by a customer and was likely to take offsetting positions to reduce its exposure, other market participants may take positions in advance of the dealer attempting to take its offsetting positions. This "front running" of the dealer's trades would likely raise its trading costs. Should the dealer believe that its market exposure may become public before it has the opportunity to hedge, the price quote offered to its customer to establish the original position would reflect the increased hedging cost.

186 See SDR Proposing Release, 75 FR at 77307 ("Failure to maintain privacy of [SDR data] could lead to market abuse and subsequent loss of liquidity.").

187 Exchange Act section 13(n)(5)(G) and (H), 15 U.S.C. 78m(n)(5)(G) and (H); see also Exchange Act rules 13n-4(b)(9) (implementing Exchange Act sections 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G)) and (b)(10) (implementing Exchange Act section 13(n)(5)(H), 15 U.S.C. 78m(n)(5)(H)).

Commission to be appropriate,[188] and further require that a repository notify the Commission when the repository receives an authority's initial request for data maintained by the repository.[189] Restricting access to security-based swap data available to relevant authorities should reduce the risk of unauthorized disclosure, misappropriation or misuse of security-based swap data because each relevant authority will only have access to information within its regulatory mandate, or legal responsibility or authority.

The proposed rules further require that, before a repository shares security-based swap information with a relevant authority, there must be an arrangement (in the form of a MOU or otherwise) between the Commission and the relevant authority that addresses the confidentiality of the security-based swap information provided, and under which the relevant authority agrees to indemnify the Commission and the repository for any expenses arising from litigation relating to the information provided.[190] While the proposal also conditionally exempts the relevant authority requesting data from the indemnification requirement, it does so only if the requested information relates to a regulatory mandate or legal responsibility or authority of the entity requesting the data, and there is in effect an arrangement between the Commission and such relevant authority that addresses the confidentiality of the information provided.[191] The arrangement should further reduce the likelihood of confidential trade or position data being inadvertently made public.

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188 As discussed above in part II.A.3(a), the Commission anticipates that such determinations may be conditioned, in part, by specifying the scope of a relevant authority's access to data, and may limit this access to reflect the relevant authority's regulatory mandate, or legal responsibility or authority.

189 See Exchange Act section 13(n)(5)(G), 15 U.S.C. 78m(n)(5)(G); proposed Exchange Act rule 13n-4(b)(9).

190 See Exchange Act section 13(n)(5)(H), 15 U.S.C. 78m(n)(5)(H); proposed Exchange Act rule 13n-4(b)(10).

191 See proposed Exchange Act rule 13n-4(d).

Although the statutory indemnification requirement could provide a strong incentive for relevant authorities to take appropriate care in safeguarding data they might receive from a registered SDR, the Commission recognizes the significance of commenter concerns regarding the impact of requiring indemnification,[192] and understands that certain authorities may be unable to agree to indemnify a data repository and the Commission. Therefore, the Commission preliminarily believes that the indemnification requirement could frustrate the purposes of the statutory requirement that repositories make available data to relevant authorities. The Commission preliminarily believes that the proposed approach appropriately balances confidentiality concerns associated with regulatory access with the benefits accruing to security-based swap market participants from increased regulatory transparency.

2. Effects on Efficiency, Competition and Capital Formation

The rules described in this proposal are intended to facilitate access for relevant authorities to data stored in SEC-registered repositories and therefore affect such repositories, but do not directly affect security-based swap market participants. As discussed below, access by relevant authorities to security-based swap data could indirectly affect market participants through the benefits that accrue from the relevant authorities' improved ability to fulfill their regulatory mandate or legal responsibility or authority as well as the potential impact of disclosure of confidential data. However, because the Commission preliminarily believes that its rules will condition access to security-based swap data on the agreement of the relevant authorities to protect the confidentiality of the data, the Commission expects these rules to have little effect on the structure or operations of the security-based swap market. Therefore, the

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[192] See note 13, supra.

Commission preliminarily believes that effects of the proposed rules on efficiency, competition and capital formation will be small.[193] Nevertheless, there are some potential effects, particularly with respect to efficiency and capital formation, which flow from efficient collection and aggregation of security-based swap data. We describe these effects below.

In part VI.B of this release, the Commission describes the baseline used to evaluate the economic impact of the proposed rules, including the impact on efficiency, competition and capital formation. In particular, the Commission noted that the security-based swap data currently available from the DTCC-TIW is the result of a voluntary reporting system and access to that data is made consistent with guidelines published by the ODRF.

Under the voluntary reporting regime, CDS transaction data involving counterparties and reference entities from most jurisdictions is reported to a single entity, the DTCC-TIW. The DTCC-TIW, using the ODRF guidelines, then allows relevant authorities, including the Commission, to obtain data necessary to carry out their respective authorities and responsibilities with respect to OTC derivatives and the regulated entities that use derivatives.[194] As various regulators implement reporting rules within their jurisdictions, counterparties within those jurisdictions may or may not continue to report to the DTCC-TIW. As a result, the ability of the Commission and other relevant authorities to obtain the data required consistent with their regulatory mandate, or legal responsibility or authority, may require the ability to access data held in a trade repository outside of their own jurisdictions. That is, because the market is global and interconnected, effective regulatory monitoring of the security-based swap market may

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[193] See part VI.C.1b above for a discussion of the potential impact on capital formation of inadequate data confidentiality protections. The Commission preliminarily believes that the proposed approach balances the need for data confidentiality and the need for regulatory transparency.

[194] See note 149, supra.

require regulators to have access to information on the global market, particularly during times of market turmoil. The proposed data access rule amendments and indemnification exemption should facilitate access of relevant authorities other than the Commission to security-based swap data held in repositories, and may indirectly facilitate Commission access to data held by trade repositories registered with regulators other than the Commission. To the extent that the proposed data access rules and indemnification exemption facilitate the ability of repositories to collect security-based swap information involving counterparties across multiple jurisdictions, there may be benefits in terms of efficient collection and aggregation of security-based swap data.

To the extent that the proposed data access provisions and the indemnification exemption increase the quantity of transaction and position information available to regulatory authorities about the security-based swap market, the ability of the Commission and other relevant authorities to respond in an appropriate and timely manner to market developments could enhance investor protection through improved detection, and facilitating the investigation of fraud and other market abuses. Moreover, as noted above, we do not anticipate that the proposed rules would directly affect market participants, such enhancements in investor protections may decrease the risks and indirect costs of trading and could therefore encourage greater participation in the security-based swap market for a wider range of entities seeking to engage in a broad range of hedging and trading activities.[195] While we believe that increased participation is a possible outcome of the Commission's transparency initiatives, including these proposed

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[195] Indirect trading costs refer to costs other than direct transaction costs. Front running costs described above provide an example of indirect trading costs. In the context of investor protection, the risk of fraud represents a cost of trading in a market with few investor protections or safeguards.

rules, relative to the level of participation in this market if these initiatives were not undertaken, we preliminarily believe that the benefits that flow from improved detection, facilitating the investigation of fraud and other market abuses, and more-efficient data aggregation are the more direct benefits of the rules.

In addition, the improvement in the quantity of data available to regulatory authorities, including the Commission, should improve their ability to monitor concentrations of risk exposures and evaluate risks to financial stability and could promote the overall stability in the capital markets.[196]

Aside from the effects that the proposed data access rules may have on regulatory oversight and market participation, we expect the proposed rules potentially to affect how SDRs are structured. In particular, the proposed data access rules and indemnification exemption could reduce the potential for SDRs to be established along purely jurisdictional lines, with multiple repositories established in different countries or jurisdictions. That is, effective data sharing may reduce the need for repositories to be established along jurisdictional lines, reducing the likelihood that a single security-based swap transaction must be reported to multiple swap-data repositories. As noted previously by the Commission, due to high fixed costs and increasing economies of scale, the total cost of providing trade repository services to the market for security-based swaps may be lower if the total number of repositories is not increased due to a regulatory environment that results in trade repositories being established along jurisdictional lines.[197] To the extent that the proposed rules result in fewer repositories that potentially

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196 See note 95, supra.

197 See SDR Adopting Release, 80 FR at 14533 (discussion of high fixed costs and increasing economies of scale in the provision of security-based swap data repository services); see also SDR

compete across jurisdictional lines, cost savings realized by fewer repositories operating on a larger scale could result in reduced fees, with the subsequent cost to market participants to comply with reporting requirements being lower.[198]

Furthermore, multiple security-based swap data repositories with duplication of reporting requirements for cross-border transactions increase data fragmentation and data duplication, both of which increase the potential for difficulties in data aggregation. To the extent that the proposed data access rule amendments and indemnification exemption facilitate the establishment of SDRs that accept transactions from multiple jurisdictions, there may be benefits in terms of efficient collection and aggregation of security-based swap data. As discussed above, to the extent that the indemnification exemption allows relevant authorities to have better access to the data necessary to form a more complete picture of the security-based swap market – including information regarding risk exposures and asset valuations – the exemption should help the Commission and other relevant authorities perform their oversight functions in a more effective manner.

However, while reducing the likelihood of having multiple SDRs established along jurisdictional lines would resolve many of the challenges involved in aggregating security-based swap data, there may be costs associated with having fewer repositories. In particular, the existence of multiple repositories may reduce operational risks, such as the risk that a

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Adopting Release, 80 FR at 14479 (discussion of rule 13n-4(c)(1)(i), which requires each SDR to ensure that any dues, fees or other charges that it imposes, and any discounts or rebates that it offers, are fair and reasonable and not unreasonably discriminatory; particularly noting that "[o]ne factor that the Commission has taken into consideration to evaluate the fairness and reasonableness of fees, particularly those of a monopolistic provider of a service, is the cost incurred to provide the service")."

198 Alternatively, fewer repositories could result in those few repositories having the ability to take advantage of the reduced level of competition to charge higher prices.

catastrophic event or the failure of a repository leaves no registered repositories to which transactions can be reported, impeding the ability of the Commission and relevant authorities to obtain information about the security-based swap market.

Finally, as we noted above, a relevant authority's inability to protect the privacy of data maintained by repositories could erode market participants' confidence in the integrity of the security-based swap market. More specifically, confidentiality breaches, including the risk that trading strategies may no longer be anonymous due to a breach, may increase the overall risks associated with trading or decrease the profits realized by certain traders. Increased risks or decreased profits may reduce incentives to participate in the security-based swap markets, which may lead to reduced trading activity and liquidity in the market. Depending on the extent of confidentiality breaches, as well as the extent to which such breaches lead to market exits, disclosures of confidential information could hinder price discovery and impede the capital formation process.[199]

3. Additional Costs and Benefits of Specific Rules

Apart from the general costs and benefits associated with the structure of the Exchange Act data access provisions and proposed implementing rules, certain discrete aspects of the proposed rules and related interpretation raise additional issues related to economic costs and benefits.

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[199] See SDR Proposing Release, 75 FR at 77307 ("Failure to maintain privacy of [SDR data] could lead to market abuse and subsequent loss of liquidity.").

a. Benefits

i. Determination of recipient authorities

The Commission is proposing an approach to determining whether an authority, other than those expressly identified in the Exchange Act and the implementing rules,[200] should be provided access to data maintained by SDRs. The Commission believes that this proposed approach has the benefit of appropriately limiting relevant authorities' access to data maintained by repositories to protect the confidentiality of the data.[201] The Commission expects that relevant authorities from a number of jurisdictions may seek to obtain a determination by the Commission that they may appropriately have access to repository data. Each of these jurisdictions may have a distinct approach to supervision, regulation or oversight of its financial markets or market participants and to the protection of proprietary and other confidential information. The Commission believes that the proposed factors – which among other things would consider whether an authority has an interest in access to security-based swap data based on the relevant authority's regulatory mandate or legal responsibility or authority, whether there is an MOU or other arrangement between the Commission and the relevant authority that addresses the confidentiality of the security-based swap data provided to the authority, and whether information accessed by the applicable authority would be subject to robust confidentiality safeguards[202] – appropriately condition an authority's ability to access data on the confidentiality protections the authority will afford that data. This focus further would be strengthened by the Commission's ability to revoke its determination where necessary,

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200 See part II.A for a discussion of specific authorities included in the implementing rules.

201 See ESMA comment (Jan. 17, 2011) at 2 (noting that relevant authorities must ensure the confidentiality of security-based swap data provided to them).

202 See part II.A.3.a, supra.

including, for example, if a relevant authority fails to keep such data confidential.[203] This approach should increase market participants' confidence that their confidential trade data will be protected, reducing perceived risks of transacting in security-based swaps.

The Commission also believes that its proposed approach in determining the appropriate relevant authorities would reduce the potential for fragmentation and duplication of security-based swap data among trade repositories by facilitating mutual access to the data. Narrower approaches such as allowing regulatory access to security-based swap data only to those entities specifically identified in the Exchange Act[204] may increase fragmentation and duplication, and hence increase the difficulty in consolidating and interpreting security-based swap market data from repositories, potentially reducing the general economic benefits discussed above.

Furthermore, the Commission believes that its proposed approach in conditioning access to security-based swap data held in SDRs by requiring there to be in effect an arrangement between the Commission and the authority in the form of a MOU would promote the intended benefits of access by relevant authorities to data maintained by SDRs. Under the proposed approach, rather than requiring regulatory authorities to negotiate confidentiality agreements with multiple SDRs, a single MOU between the Commission and the relevant authority can serve as the confidentiality agreement that will satisfy the requirement for a written agreement stating that the relevant authority will abide by the confidentiality requirements described in section 24 of the Exchange Act relating to the security-based swap data. The Commission routinely negotiates MOUs or other arrangements with relevant authorities to secure mutual assistance or

203 See part II.A.4, supra.

204 See Exchange Act section 3(a)(74), 15 U.S.C. 78c(a)(74).

for other purposes, and the Commission preliminarily believes that the proposed approach is generally consistent with this practice.

The Commission further preliminarily believes that negotiating a single such agreement with the Commission will be less costly for the authority requesting data than negotiating directly with each registered SDR and eliminate the need for each SDR to negotiate as many as 200 confidentiality agreements with requesting authorities. This approach would also avoid the difficulties that may be expected to accompany an approach that requires SDRs to enter into confidentiality agreements – particularly questions regarding the parameters of an adequate confidentiality agreement, and the presence of uneven and potentially inconsistent confidentiality protections across SDRs and recipient entities.

ii. Notification requirement

The Commission is proposing an approach by which SDRs may satisfy the notification requirement by notifying the Commission upon the initial request for security-based swap data by a relevant authority and maintaining records of the initial request and all subsequent requests.[205] The Commission estimates that approximately 300 relevant authorities may make requests for data from security-based swap data repositories.[206] Based on the Commission's

205 See proposed Exchange Act rule 13n-4(e).

206 See proposed Exchange Act rule 13n-4(b)(9)(i)-(v) for a list of prudential regulators that may request data maintained by SDRs from SDRs. The Exchange Act also states that FSOC, the CFTC, and the Department of Justice may access security-based swap data. See parts II.A.1, 2, supra. The Commission also expects that certain self-regulatory organizations and registered futures associations may request security-based swap data from repositories. Therefore, the Commission estimates that up to approximately 30 relevant authorities in the United States may seek to access security-based swap data from repositories. The Commission preliminarily believes that most requests will come from authorities in G20 countries, and estimates that each of the G20 countries will also have no more and likely fewer than 30 relevant authorities that may request data from SDRs. Certain authorities from outside the G20 also may request data. Accounting for all of those entities, the Commission estimates that there will

experience in making requests for security-based swap data from trade repositories, the Commission estimates that each relevant authority will access security-based swap data held in SDRs using electronic access. Such access may be to satisfy a narrow request concerning a specific counterparty or reference entity or security, to create a summary statistic of trading activity or outstanding notional, or to satisfy a large request for detailed transaction and position data. Requests may occur as seldom as once per month if the relevant authority is downloading all data to which it has access in order to analyze it on its own systems, or may occur 100 or more times per month if multiple staff of the relevant authority are making specific electronic requests concerning particular counterparties or reference entities and associated positions or transactions. Therefore, under the Commission's proposed approach to notification requirement compliance, the Commission estimates based on staff experience that each repository would provide the Commission with actual notice as many as 300 times, and that repositories cumulatively would maintain records of as many as 360,000 subsequent data requests per year.[207] The proposed rule would be expected to permit repositories to respond to requests for data by relevant authorities more promptly and at lower cost than if notification was required for each request for data access, while helping to preserve the Commission's ability to monitor whether the repository provides data to each relevant entity consistent with the applicable conditions.

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likely be a total of no more than 300 relevant domestic and foreign authorities that may request security-based swap data from repositories.

[207] The annual estimate of 360,000 is calculated based on 300 recipient entities each making 100 requests per month cumulatively across all repositories. The estimate of 100 requests per authority is based on staff experience with similar data requests in other contexts.

The Commission's proposed rule would also simplify relevant authorities' direct access to security-based swap data needed in connection with their regulatory mandate or legal responsibility or authority, because repositories would not be required to provide the Commission with actual notice of every request prior to providing access to the requesting relevant authority.

iii. Use of confidentiality agreements between the Commission and recipient authorities

The proposed rules in part would condition regulatory access on there being an arrangement between the Commission and the recipient entity, in the form of an MOU or otherwise, addressing the confidentiality of the security-based swap information made available to the recipient. The proposed rules add that those arrangements shall be deemed to satisfy the statutory requirement for a written confidentiality agreement.[208]

As discussed above, the Commission preliminarily believes that this approach reflects an appropriate way to satisfy the interests associated with the confidentiality condition. The benefits associated with this approach include obviating the need for repositories to negotiate and enter into multiple confidentiality agreements, avoiding difficulties regarding the parameters of an adequate confidentiality agreement, and avoiding uneven and potentially inconsistent confidentiality protections. The proposed approach also would build upon the Commission's experience in negotiating such agreements.[209]

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208 See proposed Exchange Act rule 13n-4(10)(i).

209 See part II.B.1, supra.

iv. Indemnification exemption

The Commission also is proposing a conditional indemnification exemption, recognizing that application of the indemnification requirement could prevent some relevant domestic and foreign authorities from obtaining security-based swap information from repositories, because they cannot provide an indemnification agreement.[210] Effectively prohibiting some authorities other than the Commission from obtaining access to security-based swap data maintained by repositories potentially would greatly reduce the market transparency to regulators provided by Title VII.[211] Moreover, although relevant authorities could obtain security-based swap data from the Commission,[212] repositories are likely to have systems in place and expertise that allows them to provide such data to relevant authorities quickly, and economic incentives to minimize their own cost of providing data.

The Commission also preliminarily believes that the absence of an exemption to the indemnification requirement could increase the likelihood that foreign authorities would require duplicate reporting of cross-border transactions to repositories within the foreign jurisdiction. To the extent that relevant foreign authorities are effectively restricted in obtaining data maintained by SEC-registered repositories, the Commission's own ability to access security-based swap data may similarly be restricted.[213] More generally, the resulting restrictions on regulatory access may likely lead to duplication and fragmentation of security-based swap data among trade

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210 See part III.A, supra.

211 See Proposing Release, 75 FR at 77307 (describing expected benefits of SDRs, including the market transparency benefits of access by regulators); id. at 77356 ("The ability of the Commission and other regulators to monitor risk and detect fraudulent activity depends on having access to market data."); see also part VI.B.1 of this release discussing transparency in the security-based swap market.

212 See part IV.B, supra (discussing information sharing under Exchange Act sections 21 and 24); see also Proposing Release, 75 FR at 77319.

213 See note 94, supra, and accompanying text.

repositories in multiple jurisdictions, which may increase other costs that relevant authorities may incur, including, for example, the difficulty of aggregating data across multiple repositories.[214]

The Commission preliminarily believes that the proposed indemnification exemption further would be beneficial by mitigating the risks associated with permitting relevant authorities to obtain access to data maintained by repositories. The exemption would be available only for requests that are consistent with each requesting authority's regulatory mandate, or legal responsibility or authority. The Commission preliminarily believes that these conditions would significantly reduce the confidentiality concerns relating to relevant authorities' access to data maintained by repositories.[215] Limiting an authority's access to data to that relating to its mandate, or legal responsibility or authority would reduce the opportunity for improper disclosure of the data in part because such limits reduce the quantity of data that is subject to potential improper disclosure, and because an authority is likely to be familiar with the need to maintain the confidentiality of data that relates to its mandate or legal responsibility or authority. Further, the Commission will have an opportunity to evaluate the confidentiality protections provided by the relevant authority in the context of negotiations of an MOU or other arrangement.[216] Should the Commission believe the relevant authority has failed to comply with

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214 See Proposing Release, 75 FR at 77358. The costs associated with aggregating the data of multiple repositories would likely be significantly higher under the circumstances described here, as different jurisdictions might impose different requirements regarding how data is to be reported and maintained.

215 See, e.g., ESMA comment (Jan. 17, 2011) at 2 (noting that relevant authorities must ensure the confidentiality of security-based swap data provided to them).

216 For the indemnification exemption to apply to the requests of a particular requesting authority, the authority would be required to enter into an MOU or other arrangement with the Commission, which would enable the Commission to determine, prior to operation of the indemnification exemption, that the authority has a regulatory mandate, or legal responsibility or authority to access data maintained by

the confidentiality provisions of the MOU, it may terminate access by revoking a determination by the Commission that the relevant entity was appropriate, or by terminating the MOU or other arrangement used to satisfy the confidentiality condition, or, as applicable, the indemnification exemption.[217]

b. Costs

The Commission recognizes that the proposed approach to providing access to relevant authorities other than the Commission to security-based swap data held in repositories has the potential to involve certain costs and risks.

The relevant authorities requesting securities-based swap data would incur some costs in seeking a Commission order deeming the authority appropriate to receive security-based swap data. These costs would include the negotiation of an MOU to address the confidentiality of the security-based swap information it seeks to obtain and providing information to justify that the security-based swap data relates to the entity's regulatory mandate or legal responsibility or authority. As discussed above, the Commission estimates that up to 300 entities potentially might enter into such MOUs or other arrangements.[218] Based on the Commission staff's experience in negotiating MOUs that address regulatory cooperation, the Commission preliminarily estimates the cost to each relevant authority requesting data associated with

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SDRs, that the authority agrees to protect the confidentiality of any security-based swap information provided to it and that the authority will provide reciprocal assistance in securities matters within the Commission's jurisdiction. See part III, supra (discussing the proposed indemnification exemption).

217 See part II.A.3, supra.

218 See part VI.C.3.a.ii, supra.

negotiating such an arrangement of approximately $205,000 per entity for a total of $61,500,000.[219]

In addition, authorities that are not specified by the proposed rule may request that that the Commission determine them to be appropriate to receive access to such security-based swap data. Given the relevant information that the Commission preliminarily would consider in connection with such designations (apart from the MOU issues addressed above) – including information regarding how the authority would be expected to use the information, information regarding the authority's regulatory mandate or legal responsibility or authority, and information regarding reciprocal access – the Commission preliminarily estimates the cost associated with such a request to be approximately $15,200 per requesting entity for a total of $4,560,000.[220]

Security-based swap data repositories would incur some costs to verify that an entity requesting data entered into the requisite agreements concerning confidentiality with the Commission, and that the entity either has agreed to indemnify the Commission and the repository, or that the indemnification exemption applies. The Commission generally expects

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219 These figures are based on 300 entities each requiring 500 personnel hours on average to negotiate an MOU. See part V.D.1.a, supra. The cost per entity is 400 hours x attorney at $380 per hour + 100 hours x deputy general counsel at $530 per hour = $205,000, or a total of $61,500,000. 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 year-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

220 These figures are based on roughly 300 entities (noting that certain entities designated by statute or rule would not need to prepare such requests) requiring 40 personnel hours to prepare a request for access. See part V.D.1.b, supra. The cost per entity is 40 hours x attorney at $380 per hour = $15,200, or a total of $4,560.000. 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 year-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

that such verification costs would be minimal because information regarding such Commission arrangements would generally be readily available.[221]

To the extent that the security-based swap data repository provides the requested data through direct electronic means, the repository may incur some cost in providing the requesting authority access to the system that provides such access and setting data permissions to allow access only to the information that relates to the authority's regulatory mandate, or legal responsibility or authority. The Commission preliminarily believes most of the costs associated with providing such access would be the fixed costs incurred in designing and building the systems to provide the direct electronic access required by the recently adopted SDR rules.[222] The Commission preliminarily believes the marginal cost of providing access to an additional relevant authority and setting the associated permissions is approximately \$6,295.[223] Based on an estimated 300 entities requesting access to each of ten registered SDRs, we estimate the total cost of connecting entities to SDRs to be approximately \$18,885,000.

The Commission further recognizes that the conditions in the proposed indemnification exemption would not necessarily provide repositories and the Commission with the same level of

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221 As a general matter, the Commission provides a list of MOUs and other arrangements on its public website, which are available at: http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml.

222 See SDR Adopting Release, 80 FR at 14523 (estimating the aggregate one-time systems costs for ten respondents to be 420,000 hours and \$10 million, and estimating the aggregate ongoing systems costs as being 252,000 hours and \$60 million); see also part IV.D.1.c, supra.

223 This figure is based on the view that, for each recipient requesting data, a repository would incur an 25 hour burden associated with programming or otherwise inputting the relevant parameters, encompassing 20 hours of programmer analyst time and five hours of senior programmer time. The estimate also encompasses one hour of attorney time in connection with each such recipient. See part V.D.1.c, supra. The cost per entity is 20 hours x programmer analyst at \$220 per hour + 5 hours x senior programmer at \$303 per hour + 1 hour x attorney at \$380 per hour = \$6,295, 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 year-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

confidentiality-related protection that an indemnification agreement would provide (i.e., coverage for any expenses arising from litigation relating to information provided to a relevant authority). The Commission preliminarily believes, however, that the conditions in the proposed indemnification exemption, related to the need for a confidentiality arrangement and requiring that the information provided relate to a regulatory mandate, or legal responsibility or authority of the recipient entity, would provide appropriate protection of the confidentiality of data maintained by SDRs, albeit one that is different from the protection provided by an indemnification agreement that addresses potential costs of litigation associated with the data provided to it by the SDR.

In addition, under the Commission's proposed notification compliance rule, SDRs would be required to notify the Commission of the initial request for data but would not have to inform the Commission of all relevant authorities' requests for data prior to a SDR fulfilling such requests. Based on the estimate that approximately 300 relevant authorities may make requests for data from security-based swap data repositories, the Commission estimates that a repository would provide the Commission with actual notice approximately 300 times.[224] Moreover, based on the estimate that ten persons may register with the Commission as SDRs,[225] this suggests that repositories in the aggregate would provide the Commission with actual notice up to a total of 3,000 times. The Commission preliminarily estimates that the total of providing such notice to be $57,000 per SDR for a total of $570,000.[226]

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224 See part VI.C.3.ii, supra.

225 See note 117, supra, and accompanying text

226 These figures are based each of ten SDRs providing notice for each of 300 requesting entities. See part V.D.1.d, supra. The cost per SDR is 300 requesting entities x 0.5 hours x attorney at $380 per hour = $57,000, or a total of $570,000. We use salary figures from SIFMA's Management &

Pursuant to rule, SDRs would be required to maintain records of subsequent requests.[227] Not receiving actual notice of all requests may impact the Commission's ability to track such requests, but the Commission preliminarily believes that the benefits of receiving actual notice of each request would not justify the additional costs that repositories would incur in providing such notices and the potential delay in relevant authorities receiving data that they need to fulfill their regulatory mandate, or legal responsibility or authority. At the same time, providing notice of initial requests will help to preserve the Commission's ability to monitor whether the repository provides data to each relevant entity consistent with the applicable conditions. As discussed above, the Commission preliminarily estimates that the average initial paperwork burden associated with maintaining certain records related to data requests or access would be roughly 360 hours, and that the annualized burden would be roughly 280 hours and $120,000 for each repository.[228] Assuming a maximum of ten security-based swap data repositories, the estimated aggregate one-time dollar cost would be roughly $1 million,[229] and the estimated aggregate annualized dollar cost would be roughly $1.2 million.[230]

Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for a 1800-hour year-week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[227] See part V.D.1.d, supra. As noted above, existing rules require SDRs to maintain copies of all documents they make or receive in their course of business, including electronic documents. See note 77, supra.

[228] See part V.D.1.d, supra.

[229] The Commission preliminarily anticipates that a repository would assign the associated responsibilities primarily to a compliance manager and a senior systems analyst. The total estimated dollar cost would be roughly $100,000 per repository, reflecting the cost of a compliance manager at $283 per hour for 300 hours, and a senior systems analyst at $260 per hour for 60 hours. Across the estimated ten repositories, this would amount to roughly $1 million.

[230] The Commission preliminarily anticipates that a repository would assign the associated responsibilities primarily to a compliance manager. The total estimated dollar cost would be roughly $120,000 per repository, reflecting $40,000 annualized information technology costs, as well as a

D. Alternatives

The Commission considered a number of alternative approaches to implementing the Exchange Act data access provisions, including the indemnification requirement, but, for the reasons discussed below, is not proposing them.

1. No indemnification exemption

The Commission considered not proposing any exemptive relief from the indemnification requirement. As discussed above, application of the indemnification requirement may prevent some relevant authorities from accessing security-based swap data directly from repositories registered with the Commission.[231] Although relevant authorities could obtain such data from the Commission,[232] that alternative would be expected to be associated with delays and higher costs, particularly during periods of market stress and particularly since repositories are likely to have expertise in providing such data to relevant authorities and economic incentives for doing so efficiently.[233]

To the extent that relevant foreign authorities are effectively restricted in obtaining data maintained by SEC-registered repositories, the Commission's own ability to access security-based swap data may similarly be restricted.[234] More generally, the resulting restrictions on regulatory access may likely lead to duplication and fragmentation of security-based swap data

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compliance manager at $283 per hour for 280 hours. Across the estimated ten repositories, this would amount to roughly $1.2 million.

231 See, e.g., DTCC comment (Nov. 15, 2010) at 3 (discussing how the indemnification requirement would result in the reduction of information accessible to regulators on a timely basis and would greatly diminish regulators' ability to carry out oversight functions).

232 See part IV.B, supra, discussing information sharing under Exchange Act sections 21 and 24; see also SDR Proposing Release, 75 FR at 77319.

233 See part VI.C.3.a.iv, supra.

234 See note 94, supra, and accompanying text.

among trade repositories in multiple jurisdictions, which may increase other costs that relevant authorities may incur, including, for example, the difficulty of aggregating data across multiple repositories.[235]

2. Repository option to waive indemnification

The Commission also considered whether to adopt the approach set forth in the Cross-Border Proposing Release, to allow the SDR the option to waive the indemnification requirement.[236] As discussed above, however, the Commission preliminarily believes that the proposed approach would more effectively address the relevant concerns associated with implementing the indemnification provision.[237] Also, requiring each repository to elect whether to waive the indemnification requirement for each requesting entity would likely impose additional costs on repositories and may result in inconsistent treatment of data requests across repositories.

3. Additional conditions to indemnification requirement or proposed indemnification exemption

The Commission also considered whether to prescribe additional conditions or limitations to the indemnification requirement or the proposed indemnification exemption. In part, the Commission considered one commenter's suggestion that the Commission provide model indemnification language in connection with the indemnification requirement, but concluded preliminarily that the benefits of such model language are largely mitigated by an indemnification exemption that would condition the indemnification exemption upon there being in effect one or more arrangements (in the form of an MOU or otherwise) between the

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235 See note 214, supra

236 See note 91, supra, and accompanying text.

237 See part III.A, supra.

Commission and the entity that addresses the confidentiality of the security-based swap information provided and other matters as determined by the Commission.[238]

4. Use of confidentiality arrangements directly between repositories and recipients

The Commission considered the alternative approach of permitting confidentiality agreement between SDRs and the recipient of the information to satisfy the confidentiality condition to the data access requirement. The Commission preliminarily believes, however, that the proposed approach, which would make use of confidentiality arrangements between the Commission and the recipients of the data, would avoid difficulties such as questions regarding the parameters of the confidentiality agreement, and the presence of uneven and inconsistent confidentiality protections.[239] This also would avoid the need for SDRs to potentially negotiate and enter into dozens of confidentiality agreements, instead such costs would be borne by the Commission.

6. Notice of individual requests for data access

Finally, the Commission considered requiring repositories to provide notice to the Commission of all requests for data prior to repositories fulfilling such requests, rather than the proposed approach of requiring such notice only of the first request from a particular recipient, with the repository maintaining records of all subsequent requests.[240] The Commission preliminarily believes that the benefits of receiving actual notice for each and every request would not justify the additional costs that would be imposed on repositories to provide such

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238 See note 98, supra.

239 See part II.B.1, supra.

240 See part II.A.4, supra.

notice, and providing notice of subsequent requests may not be feasible if data is provided by direct electronic access.

E. Comments on the Economic Analysis

The Commission requests comment on all aspects of this economic analysis. Commenters particularly are requested to address whether there are other costs or benefits – not addressed above – that the Commission should take into account when adopting final rules. Commenters also are requested to address whether the Commission has appropriately weighed the costs and benefits of the potential alternative approaches addressed above, and whether there are other potential alternative approaches that the Commission should assess.

VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")[241] the Commission must advise OMB whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation.

The Commission requests comment on the potential impact of the proposed rules and amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

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

VIII. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act of 1980 ("RFA")[242] requires the Commission to undertake an initial regulatory flexibility analysis of the proposed rules on "small entities." Section 605(b) of the RFA[243] provides that this requirement shall not apply to any proposed rule or proposed rule amendment which, if adopted, would not have a significant economic impact on a substantial number of small entities. Pursuant to 5 U.S.C. 605(b), the Commission hereby certifies that the proposed rules would not, if adopted, have a significant economic impact on a substantial number of small entities. In developing these proposed rules, the Commission has considered their potential impact on small entities. For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less;[244] 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,[245] 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

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242 5 U.S.C. 603(a).

243 5 U.S.C. 605(b).

244 See 17 CFR 240.0-10(a).

245 17 CFR 240.17a-5(d).

business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[246]

In initially proposing rules regarding the registration process, duties and core principles applicable to SDRs, the Commission stated that it preliminarily did not believe that any persons that would register as repositories would be considered small entities.[247] The Commission further stated that it preliminarily believed that most, if not all, SDRs would be part of large business entities with assets in excess of $5 million and total capital in excess of $500,000, and, as a result, the Commission certified that the proposed rules would not have a significant impact on a substantial number of small entities and requested comments on this certification.[248] The Commission reiterated that conclusion earlier this year in adopting final rules generally addressing repository registration, duties and core principles.[249]

The Commission continues to hold the view that any persons that would register as SDRs would not be considered small entities. Accordingly, the Commission certifies that the proposed rules – related to regulatory access to data held by SDRs and providing a conditional exemption from the associated indemnification requirement – would not have a significant economic impact

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[246] See 17 CFR 240.0-10(c).

For purposes of the Regulatory Flexibility Act, the definition of "small entity" also encompasses "small governmental jurisdictions," which in relevant part means governments of locales with a population of less than fifty thousand. 5 U.S.C. 601(5), (6). Although the Commission anticipates that this proposal may be expected to have an economic impact on various governmental entities that access data pursuant to Dodd-Frank's data access provisions, the Commission does not anticipate that any of those governmental entities would be small entities.

[247] See 75 FR at 77365.

[248] See id. (basing the conclusions on review of public sources of financial information about the current repositories that are providing services in the OTC derivatives market).

[249] See SDR Adopting Release, 80 FR at 14549 (noting that the Commission did not receive any comments that specifically addressed whether the applicable rules would have a significant economic impact on small entities).

on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this certification. The Commission solicits comment as to whether the proposed rules could have an effect on small entities that has not been considered. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

Statutory Basis and Text of Proposed Rules

Pursuant to the Exchange Act, and particularly sections 3(b), 13(n), 23(a) and 36 thereof, 15 U.S.C. 78c(b), 78m(n), 78w(a) and 78mm, the Commission is proposing to amend rule 13n-4 by adding paragraphs (b)(9), (b)(10), (d) and (e) to that rule.

List of Subjects in 17 CFR Part 240

[Confidential business information, Reporting and recordkeeping requirements, Securities.]

Text of Proposed Rules

For the reasons stated in the preamble, the Commission is proposing to amend Title 17, Chapter II, of the Code of Federal Regulations as follows:

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

1. The 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, 78*l*, 78m, 78n, 78n-1, 78*o*, 78*o*-4, 78*o*-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, 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.

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2. Amend § 240.13n-4 by revising paragraph (b)(8) to remove the "and" at the end of the line and adding paragraphs (b)(9), (b)(10), (d) and (e) to read as follows:

§ 240.13n–4 Duties and core principles of security-based swap data repository.

* * * * *

(b) Duties. * * *

(9) On a confidential basis, pursuant to section 24 of the Act (15 U.S.C. 78x), upon request, and after notifying the Commission of the request in a manner consistent with paragraph (e) of this section, make available security-based swap data obtained by the security-based swap data repository, including individual counterparty trade and position data, to the following:

(i) The Board of Governors of the Federal Reserve System and any Federal Reserve Bank;

(ii) The Office of the Comptroller of the Currency;

(iii) The Federal Deposit Insurance Corporation;

(iv) The Farm Credit Administration;

(v) The Federal Housing Finance Agency;

(vi) The Financial Stability Oversight Council;

(vii) The Commodity Futures Trading Commission;

(viii) The Department of Justice;

(ix) The Office of Financial Research;

and

(x) Any other person that the Commission determines to be appropriate, conditionally or unconditionally, by order, including, but not limited to –

(A) Foreign financial supervisors (including foreign futures authorities);

(B) Foreign central banks; and

(C) Foreign ministries;

(10) Before sharing information with any entity described in paragraph (b)(9) of this section, there shall be in effect an arrangement between the Commission and the entity (in the form of a memorandum of understanding or otherwise) to address the confidentiality of the security-based swap information made available to the entity; this arrangement shall be deemed to satisfy the requirement, set forth in section 13(n)(5)(H)(i) of the Act (15 U.S.C. 78m(n)(5)(H)(i)), that the security-based swap data repository receive a written agreement from the entity stating that the entity shall abide by the confidentiality requirements described in section 24 of the Act (15 U.S.C. 78x) relating to the information on security-based swap transactions that is provided; and

* * * * *

(d) Exemption from the indemnification requirement. The indemnification requirement set forth in section 13(n)(5)(H)(ii) of the Act (15 U.S.C. 78m(n)(5)(H)(ii)) shall not be applicable to an entity described in paragraph (b)(9) of this section with respect to disclosure of security-based swap information by the security-based swap data repository to such entity if:

(1) Such information relates to persons or activities within the entity's regulatory mandate, or legal responsibility or authority; and

(2) There is in effect one or more arrangements (in the form of memoranda of understanding or otherwise) between the Commission and such entity that:

(i) Address the confidentiality of the security-based swap information provided and any other matters as determined by the Commission; and

(ii) Specify the types of security-based swap information that would relate to persons or activities within the entity's regulatory mandate, legal responsibility or authority for purposes of paragraph (d)(1) of this section.

(e) Notification requirement compliance. To satisfy the notification requirement of the data access provisions of paragraph (b)(9) of this section, a security-based swap data repository shall inform the Commission upon its receipt of the first request for security-based swap data from a particular entity (which may include any request to be provided ongoing online or electronic access to the data), and the repository shall maintain records of all information related to the initial and all subsequent requests for data access from that entity, including records of all instances of online or electronic access, and records of all data provided in connection with such requests or access.

By the Commission.

Brent J. Fields
Secretary

Date: September 4, 2015

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75847 / September 4, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16784

In the Matter of **Robert A. Hanner,** **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 Robert A. Hanner ("Hanner" 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 matter involves insider trading by Respondent in the securities of Pioneer Behavioral Health, Inc. ("PHC") in advance of the May 24, 2011 announcement that Acadia Healthcare Company, Inc. ("Acadia") had agreed to acquire PHC.

2. In late March 2011, while at Acadia's headquarters discussing a potential business relationship between Hanner and Acadia, Hanner learned material nonpublic information about the proposed acquisition of PHC by Acadia. Hanner knew that this information about the proposed acquisition was material and nonpublic.

3. On May 4, 2011, Respondent made his first purchase of PHC shares. Respondent made additional purchases of PHC shares on May 12, 13, and 16. Respondent purchased these shares based on the information he had received that Acadia would be acquiring PHC. As a result of his improper use of the insider information, Respondent generated gains of $20,805.

4. As a result of the conduct described above, Hanner violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent

5. *Robert A. Hanner*, age 51, resides in Columbia, SC. During the relevant time, Hanner was engaged in confidential discussions with Acadia and then was employed by Acadia as a Vice-President of Development.

Other Relevant Persons

6. *Pioneer Behavioral Health, Inc.* was a Massachusetts company headquartered in Peabody, MA. It provided behavioral health services. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until after it was acquired by Acadia. PHC's common stock traded on the American Stock Exchange (former ticker symbol PHC).

7. *Acadia Healthcare Company, Inc.* is an SEC reporting company incorporated in Delaware and headquartered in Franklin, TN. It provides behavioral health services. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act. Acadia's common stock is quoted on NASDAQ Global Market under the ticker symbol ACHC.

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

Facts

8. For several years, until approximately November 2010, Hanner worked at another behavioral health company. While there, Hanner worked closely with several other individuals, many of whom were executives at the behavioral health company.

9. In January 2011, Hanner's former colleagues joined Acadia, many of them in senior executive positions.

10. On or around January 31, 2011, Acadia's Chief Executive Officer contacted PHC's Chief Executive Officer to discuss Acadia's proposed acquisition of PHC. Discussions concerning Acadia's proposed acquisition of PHC continued throughout the next few months. Negotiations culminated in the execution of a final agreement on May 23, 2011. The agreement was announced publicly on the morning of May 24, 2011.

11. In March and April 2011, Hanner engaged in discussions with his former colleagues, who were then senior executives at Acadia. These discussions initially concerned Hanner's proposal that Acadia participate in the acquisition of a proposed behavioral health facility that Hanner was developing, and later culminated in Acadia offering Hanner in April a position as its Vice-President of Development.

12. In late March 2011, Hanner traveled to Acadia's headquarters in Franklin, TN to discuss with his former colleagues the potential business relationship. While Hanner was at Acadia's headquarters, he learned that Acadia would be acquiring PHC soon. Hanner knew that the information about the impending acquisition was confidential.

13. On May 2, 2011, Hanner traveled to Acadia's Atlanta office, where he met with the co-President of Acadia and accepted his offer of employment.

14. On May 4, 2011, Hanner made his first purchase of PHC securities. On May 12, 13 and 16, 2011, Hanner purchased additional shares of PHC. Hanner purchased these shares on the basis of the material nonpublic information he had learned regarding Acadia's impending acquisition of PHC. On May 17, Respondent began work at Acadia as Vice President of Development.

15. On May 23, 2011, PHC and Acadia executed the merger agreement. At 8:45 a.m. on May 24, 2011, PHC and Acadia issued joint press releases announcing that the companies had entered into a definitive merger agreement.

16. The market reacted positively to the news. The closing last sale price of PHC on the day of the announcement was $3.61, an increase of approximately 20% over the prior day's close. Trading volume on the day of the announcement was 1.8 million shares, compared to PHC's historical average daily volume of approximately 56,700 shares.

17. As of the close of market on May 24, 2011, the PHC shares Hanner had purchased in May 2011 had increased in value by $20,805.

18. At the time that he purchased PHC securities, Hanner had a duty to Acadia to maintain the information about Acadia's impending acquisition of PHC in confidence and to refrain from trading on it. Hanner knew or was reckless in not knowing that he violated that duty when he traded on the basis of material nonpublic information about PHC.

19. As a result of the conduct described above, Hanner 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.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Hanner cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of $20,805, which represents profits gained as a result of the conduct described herein; prejudgment interest of $2,490; and a civil money penalty in the amount of $20,805 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 SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Robert A. Hanner 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 Friestad, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75848 / September 4, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16785

In the Matter of **DONALD E. ROBAR,** **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 Donald E. Robar ("Robar" 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 Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This matter involves insider trading by Respondent in the securities of Pioneer Behavioral Health, Inc. ("PHC") in advance of the May 24, 2011 announcement that Acadia Healthcare Company, Inc. ("Acadia") had agreed to acquire PHC.

2. On or about January 31, 2011, through his role as a director on PHC's board, Robar received material nonpublic information about the proposed acquisition of PHC by Acadia. Robar knew that he had a fiduciary duty to maintain this information in confidence.

3. On February 10, 2011, Respondent placed trades in a family member's brokerage account on the basis of the information he had received. As a result of his improper use of the insider information, Respondent generated gains of $4,617.25.

4. As a result of the conduct described above, Robar violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Respondent

5. *Donald E. Robar*, age 77, resides in New London, NH. During the relevant time, Robar was a director on the board of PHC and resided in New London, NH.

Other Relevant Persons

6. *Pioneer Behavioral Health, Inc.* was a Massachusetts company headquartered in Peabody, MA. It provided behavioral health services. Its common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act until after it was acquired by Acadia. PHC's common stock traded on the American Stock Exchange (former ticker symbol PHC).

7. *Acadia Healthcare Company, Inc.* is an SEC reporting company incorporated in Delaware and headquartered in Franklin, TN. It provides behavioral health services. Its common stock is quoted on NASDAQ Global Market under the ticker symbol ACHC.

8. *Individual A* is a member of Robar's family. Individual A resided in Minnesota during the relevant time period, and currently resides in Minnesota. Individual A holds an

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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.

individual retirement account at a brokerage firm. Individual A provided Robar with login and password to this IRA account, for the purpose of permitting Robar to make trades in the account.

Facts

9. On or around January 31, 2011, Acadia's Chief Executive Officer contacted PHC's Chief Executive Officer to discuss Acadia's proposed acquisition of PHC. That same day, the PHC CEO updated the PHC board of directors, including Donald Robar, on the discussions with Acadia and the proposed acquisition. Discussions continued throughout the next few months. Negotiations culminated in the execution of a final agreement on May 23, 2011. The agreement was announced publicly on the morning of May 24, 2011.

10. Donald Robar learned of the possible acquisition of PHC by Acadia on January 31, 2011, through a discussion between PHC's CEO and the PHC board of directors, of which Robar was a member. Robar knew that the information about the possible acquisition of PHC by Acadia was material and nonpublic, and that he had an obligation to maintain the confidentiality of the information. Robar violated his fiduciary duty to PHC and PHC's shareholders by trading while in possession of this information.

11. Between February 1 and February 5, 2011, Robar visited family members in Minnesota. During this visit, Robar discussed with Individual A the sale of all of the securities held in the IRA retirement account at that time, and the purchase of PHC shares in the same account.

12. On February 9, 2011, Robar used Individual A's login and password to access Individual A's brokerage account. Robar proceeded to sell all of the securities held in Individual A's IRA account at that time.

13. On February 10, 2011, Robar again used Individual A's login and password to access the IRA account. He used the funds in the account, made available by the previous day's sales, to purchase shares of PHC.

14. On May 23, 2011, PHC and Acadia executed the merger agreement. At 8:45 a.m. on May 24, 2011, PHC and Acadia issued joint press releases announcing that the companies had entered into a definitive merger agreement.

15. The market reacted positively to the news. The closing last sale price of PHC on the day of the announcement was $3.61, an increase of approximately 20% over the prior day's close. Trading volume on the day of the announcement was 1.8 million shares, compared to PHC's historical average daily volume of approximately 56,700 shares.

16. On May 24, 2011, at approximately 7:30 p.m., Robar used Individual A's login and password to access the brokerage account. As of the close of market on May 24, 2011, the PHC shares purchased on February 10, 2011 had increased in value by $4,617.25.

17. Robar's purchase of PHC shares on February 10, 2011 was while in possession of material, nonpublic information about the proposed acquisition of PHC. Robar had learned this information through his role as a PHC director, and knew that he had a fiduciary duty to maintain the information in confidence and to refrain from trading on it.

18. As a result of the conduct described above, Robar 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.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Robar cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Robar 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 [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)].

C. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of $4,617.25, which represents profits gained as a result of the conduct described herein; prejudgment interest of $446.72; and a civil money penalty in the amount of $4,617.25 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 SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Donald Robar 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 Friestad, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

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

Commissioner Gallagher
Commissioner Piwowar
Dissents as to Corporate
penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9901 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75849 / September 8, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3683 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16786

In the Matter of

BANKRATE, INC.,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING CEASE-AND-DESIST ORDER AND CIVIL PENALTY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Bankrate, Inc. ("Bankrate" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order and Civil Penalty ("Order") as set forth below.

III.

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

SUMMARY

This proceeding results from Bankrate, through its chief financial officer, Edward DiMaria, vice president and director of accounting, Matthew Gamsey, and vice president of finance, Hyunjin Lerner, intentionally manipulating its financial results for the second quarter of 2012 in order to meet and/or exceed analyst consensus estimates for key financial metrics. As a result of this manipulation, Bankrate materially overstated its financial results for the second quarter of 2012.

After reviewing Bankrate's preliminary financial results for the second quarter 2012, which fell short of analyst estimates for certain key metrics, DiMaria arbitrarily decided to increase Bankrate's revenue following the end of the quarter in order to meet those metrics. As a result, DiMaria, through Lerner, improperly directed two Bankrate divisions, the Insurance and Credit Cards divisions, to book additional revenue of $300,000 and $500,000, respectively, without any support or analysis.

The Insurance division immediately booked the $300,000 of revenue directed by DiMaria to a dormant customer account, with no intention of justifying the revenue until the company's outside auditor asked for additional information about it five days later. In response to the auditor's inquiry, the Insurance division quickly devised a purported justification for the improperly booked revenue – a justification that changed shortly thereafter. These purported justifications were not, however, provided to Bankrate's auditor. Instead, Lerner sent a misleading, generic explanation to the auditor – an explanation that was reviewed and approved by DiMaria and Gamsey. Further, although the Insurance division's ultimate justification was reviewed and approved by DiMaria, Gamsey, and Lerner, the three most senior employees in Bankrate's accounting department, each of them knew, or was reckless in not knowing, that the purported justification did not support the recognition of revenue under Generally Accepted Accounting Principles ("GAAP").

The accountants from the Credit Cards division were only willing to record $176,000 of the $500,000 in revenue directed by DiMaria, thereby infuriating DiMaria. Refusing to accept the Credit Cards division's unwillingness to record the full $500,000 of revenue he had directed, DiMaria insisted that the approximate difference be recorded as revenue on the books of Bankrate's mortgage business, Bankrate Core. As a result, Bankrate recorded an additional $305,000 of unsupported revenue to two arbitrary Bankrate Core customers. After learning of the Commission staff's investigation in this matter, DiMaria further attempted to conceal this fraud by retroactively attributing this revenue to a purported contractual dispute with an Insurance division

[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.

customer. In fact, this dispute had been resolved several months earlier. In addition, Bankrate's recording of both the $176,000 and the $305,000 in revenue was contrary to GAAP.

Further manipulating Bankrate's financial results for the second quarter, DiMaria, without any support or analysis, improperly directed a Bankrate Core accountant to reduce the accrual for certain marketing expenses by $400,000. Bankrate, through DiMaria and with Lerner's knowledge, had been allowing this marketing accrual account to accrue as a "cushion" account for more than a year, and then selectively decided to reduce the accrual in the second quarter of 2012 in order to improve the company's financial results. In the second quarter 2012, DiMaria improperly reversed $400,000 of the accrual amount, thereby reducing second quarter expenses, to help Bankrate meet analyst estimates. Finally, as part of its effort to artificially inflate its financial results to meet or exceed analyst estimates for the second quarter 2012, Bankrate intentionally failed to book approximately $99,000 in known accounting expenses that had been incurred in the second quarter.

As a result of these improper accounting entries, entries that the company reversed as part of a broader restatement on June 17, 2015, Bankrate's second quarter 2012 earnings release and associated Form 8-K, filed on July 31, 2012, reported adjusted earnings before interest, taxes, depreciation, and amortization ("Adjusted EBITDA") of $37.5 million, exceeding analyst consensus estimates by approximately $300,000, and adjusted earnings per share ("Adjusted EPS") of $0.18, thereby meeting analyst consensus estimates.[2] Further, due to these improper accounting entries, Bankrate materially overstated its second quarter 2012 net income reported in its Form 10-Q filed on August 13, 2012. During the two week period following the issuance of Bankrate's second quarter 2012 earnings release, DiMaria and Lerner each sold Bankrate stock, thereby profiting from a stock price that had been artificially inflated by the company's materially overstated financial results.

RESPONDENT

1. **Bankrate, Inc.** is a Delaware corporation based in North Palm Beach, Florida, that owns and operates an Internet-based consumer banking and personal finance network. Bankrate's common stock is registered with the Commission pursuant to Exchange Act Section 12(b) and traded on the New York Stock Exchange (ticker: RATE). Bankrate files periodic reports, including Forms 10-K, 10-Q, and 8-K, with the Commission pursuant to Section 13(a) of the Exchange Act and the related rules thereunder. On June 17, 2011, Bankrate filed an S-8 registration statement for an offering relating to its equity compensation plan. This offering, which was ongoing at the time of the misconduct described herein, incorporated future company filings with the Commission, including the Form 8-K containing the company's materially false second quarter 2012 earnings release and the second quarter 2012 Form 10-Q that materially overstated the company's net income.

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[2] Bankrate defines Adjusted EBITDA as earnings before interest, taxes, depreciation and amortization, excluding stock based compensation expense and IPO and deal related expenses, and defines Adjusted EPS as earnings per fully diluted share, excluding stock based compensation expense, amortization, IPO and deal related expenses.

FACTS

Bankrate's Business And Structure.

2. Bankrate is engaged in the business of providing consumers with personal finance information across multiple vertical categories including mortgages, deposits, insurance, credit cards, and other categories, such as retirement, automobile loans, and taxes. Bankrate also aggregates rate information from over 4,800 institutions on more than 300 financial products. Its principal platform is its Bankrate.com Internet website.

3. During the relevant period, Bankrate had three primary divisions: (1) Bankrate Core, the original mortgage information business; (2) Bankrate Insurance, comprised of numerous insurance information companies acquired by Bankrate; and (3) Bankrate Credit Cards, comprised of a number of credit card information companies acquired by Bankrate.

4. Bankrate generates revenue by selling consumer information ("leads") gleaned from users of its websites in the insurance and credit cards vertical categories. Its other sources of revenue include display advertising, performance-based advertising, distribution arrangements, and traditional media avenues, such as syndication of editorial content and subscriptions. Some of its customers pay Bankrate each time that a consumer clicks through a link on Bankrate's website to the customer's website.

Bankrate's Manipulation Of Second Quarter 2012 Revenue and Expenses.

5. On July 6, 2012, after being provided with preliminary second quarter financial results for Bankrate Core and Credit Cards (the Insurance division's financial results had not yet been added to the consolidated numbers), DiMaria, unwilling to accept the company's second quarter 2012 financial results, informed Lerner that Adjusted EBITDA needed to be $37 million for the quarter.

6. On July 7, 2012, the first version of Bankrate's consolidated financial results was circulated to DiMaria, Lerner, and Gamsey, as well as others on the accounting team, reflecting current Adjusted EBITDA for the second quarter of $36,144,000, which DiMaria knew was below analyst consensus estimates.

7. Three days later, after realizing it had double-counted $286,000 of revenue, the Credit Cards division submitted revised financials for consolidation. The next day, DiMaria was informed that Bankrate's second quarter revenue had decreased by $286,000 due to the correction for the Credit Cards division's double-counting of revenue, further jeopardizing the company's prospects of meeting its metrics. Shortly thereafter, at DiMaria's instruction, Lerner emailed the Insurance and Credit Cards divisions directing them to book additional revenue of $300,000 and $500,000, respectively. Lerner's July 11, 2012 email instructions to both Credit Cards and Insurance, which were copied to DiMaria, did not specify a legitimate justification for the revenue, but rather contained an ambiguous description of what the revenue purportedly related to, and did not identify any specific customers with which it was associated.

8. Within a few minutes of sending these email instructions, Lerner forwarded the emails (and subsequent related emails) to Gamsey. In emails between themselves using strong expletives, Lerner and Gamsey expressed serious concerns about the validity of the revenue the divisions had just been directed to book and commiserated about the improper accounting entries directed by DiMaria. Their emails also stated that DiMaria's improper accounting entries would have to be reversed in the third quarter, thereby creating an even larger revenue shortfall and a need to record additional improper revenue in the third quarter.

Bankrate Insurance Records $300,000 in Baseless Revenue.

9. Without any support or analysis, the Insurance division immediately recorded the $300,000 of additional revenue directed by DiMaria, booking the revenue to a dormant customer account. Although the Insurance division did not have any intention of justifying the $300,000 of additional revenue, on July 16, 2012, five days after the revenue was booked, Bankrate's auditors asked for an explanation for the $300,000 as part of its accounts receivable variance review, thereby prompting Bankrate to quickly create a purported explanation for this revenue.

10. Within twenty-four hours of Bankrate's auditors asking about the $300,000 entry, the Insurance division, with the knowledge and/or involvement of DiMaria, Lerner, Gamsey, and others, prepared a draft chart purportedly supporting the $300,000 in revenue – a chart that was changed shortly thereafter. Tellingly, although this second chart changed the amounts of revenue assigned to certain categories and replaced certain initial explanations for the revenue with new purported explanations for the revenue, the second chart still totaled the $300,000 in revenue that DiMaria and Lerner had directed the Insurance division to book.

11. The purported explanations for the $300,000 in revenue were baseless. For example, in the second purported explanation for the $300,000 in revenue, $179,000 related to estimated June 2012 revenue from a brand new bonus provision with a customer of the Insurance division. However, as DiMaria, Gamsey, and Lerner knew, at the time this revenue was recognized, the Insurance division did not have any actual data from the customer indicating that a June bonus had been earned. In addition, both Gamsey and Lerner knew that the Insurance division was not performing at a level that would have triggered a bonus in the months leading up to June 2012. Similarly, DiMaria knew, or was reckless in not knowing, that a few weeks prior to the purported justification attributing $179,000 to this bonus, the Insurance division had estimated only a medium probability of a $30,000 bonus by August 2012. Indeed, the Insurance division employee who prepared the high-level, conclusory "support" for the bonus revenue advised Lerner at the time that she was not comfortable with the Insurance division recognizing revenue on the basis of this type of analysis in the future. When the actual data on which a potential bonus was based were later reported to the Insurance division, the Insurance division's performance did not qualify for a bonus. In fact, the Insurance division missed the bonus under the two applicable bonus formulas by approximately 50% and 200%, respectively.

12. For these reasons, among others, Bankrate's recognition of the $300,000 in revenue was contrary to GAAP.[3]

13. In addition, Bankrate did not share either of the purported explanations for the $300,000 in revenue with its auditor, despite the auditor specifically asking for information about the $300,000. Rather, at approximately the same time the initial chart attempting to explain the $300,000 entry was being circulated internally, Lerner sent a misleading, generic explanation that had been reviewed and approved by DiMaria and Gamsey to the auditor, implicitly affirming that the revenue was associated with the single customer account to which it was booked. Moreover, Bankrate did not forward either chart to its auditor, nor did Bankrate update its misleading, generic explanation for the $300,000 in revenue.

Credit Cards Does not Fully Comply with the Directive to Book Baseless Revenue, Causing Bankrate to Immediately and Arbitrarily Record Revenue to A Different Business Unit.

14. Unlike Insurance, the Credit Cards accountants initially refused to book the $500,000 of unsupported revenue directed by DiMaria. Unwilling to accept, and angered by, the Credit Cards accountants' reaction to his improper directive, DiMaria told other Bankrate personnel that he was "going to rip [the Credit Cards CEO's] f[***]ing head off" and fire the Credit Cards accountants if they "f[***] up the accounting."

15. Credit Cards personnel eventually recorded an additional $176,000 in revenue to the second quarter 2012, revenue that was contrary to Bankrate's revenue recognition policy. On July 12, 2012, upon learning that Credit Cards had only booked $176,000 of the $500,000 in additional revenue he had directed, DiMaria informed Lerner that the difference should be booked to Bankrate Core. Thirty-five minutes later, Lerner instructed the Bankrate Core accounting personnel to book $305,000 in additional revenue. Conveniently using two of the Core customers on a revenue spreadsheet that had legitimate revenue listed as $234,000 and $71,000, Bankrate Core simply doubled the revenue attributable to these customers without any basis to arrive at the $305,000 of additional revenue, a fact that soon became known to DiMaria, Lerner, and Gamsey.

16. By adding this improper revenue directly to the revenue spreadsheet rather than through a manual journal entry, Bankrate avoided the questions that its auditors typically directed toward post-quarter manual journal entries. This manner of booking the $305,000 also circumvented Bankrate's accounting controls, as the revenue spreadsheet had already been approved for entry into the general ledger and did not require additional approvals.

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[3] The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605-10-25-1 provides that revenue may be properly recognized only when it is both a) realized or realizable and b) earned. See also Staff Accounting Bulletin Topic 13, *Revenue Recognition,* as codified in ASC 605-10-S99, which provides that revenue is generally realized or realizable and earned when all of the following criteria are met: 1) persuasive evidence of an arrangement exists; 2) delivery has occurred or services have been rendered; 3) the seller's price to the buyer is fixed or determinable; and 4) collectability is reasonably assured.

17. In approximately September 2012, after learning of the staff's investigation in this matter, DiMaria for the first time attributed the $305,000 revenue item to an alleged contractual dispute with an Insurance customer. After DiMaria offered this justification, the $305,000 of previously unexplained revenue was transferred from Bankrate Core's books to the Insurance division's books.

18. Notwithstanding DiMaria's retroactive justification of the $305,000, the alleged contractual dispute with the Insurance customer had been resolved by June 2012. In fact, in August 2012, Bankrate confirmed with the customer that the only outstanding money owed by the customer was for June and July 2012 invoices.

19. For these reasons, among others, the recognition of both the $176,000 in revenue booked with the Credit Cards division and the $305,000 in revenue booked with Bankrate Core was contrary to GAAP.

<u>Bankrate Makes Additional Baseless Reductions In Marketing Expense Accrual.</u>

20. On July 13, 2012, the day after Bankrate improperly recorded $305,000 of additional revenue on Bankrate Core's books, a revised version of Bankrate's consolidated financial results for the second quarter 2012 was circulated to DiMaria, Lerner, and Gamsey that reflected Adjusted EBITDA of $36,656,000.

21. Shortly after the circulation of the revised financial results, results that continued to fall short of the $37 million in Adjusted EBITDA dictated by DiMaria one week earlier, DiMaria directed a Core accountant to reduce a marketing accrual account for Search Engine Marketing (known as "SEM") by $400,000. Reducing the SEM accrual (a balance sheet account) led to a corresponding reduction in the SEM expense (an income statement account), thereby artificially increasing Bankrate's quarterly earnings.

22. DiMaria's email instruction to the Core accountant did not reference or contain any support for the accounting entry. Similarly, the manual journal entry executing DiMaria's instruction to reduce the SEM marketing accrual by $400,000 did not have any support beyond DiMaria's email instruction.

23. Upon learning of this $400,000 reduction in the SEM accrual, Gamsey questioned Lerner as to whether there was any basis for DiMaria's reduction in the SEM accrual, or whether DiMaria directed this entry instead of additional unsupported revenue entries.

24. In fact, Bankrate had been using the SEM accrual account as one of its "cushion" or "cookie jar reserve" accounts (i.e., an account known to have excess accruals that could be selectively used to boost the financial results of particular quarters) since at least early 2011. It was inappropriate for Bankrate to use the SEM account as a "cushion" account, and to reduce the SEM accrual without a proper basis, in order to meet the Adjusted EBITDA number being dictated by DiMaria.

25. Following the booking of this $400,000 reduction in the SEM accrual, a revised version of Bankrate's second quarter 2012 financial results was circulated to DiMaria, Lerner, and Gamsey, reflecting Adjusted EBITDA of $37,056,000.

Bankrate Fails to Book Additional Second Quarter Expenses.

26. The baseless accounting entries detailed above were not the only steps in Bankrate's scheme to meet analyst estimates. On July 6, 2012 – indeed, within a few hours of being told by DiMaria that second quarter Adjusted EBITDA needed to be $37 million – Lerner instructed Bankrate Core to reverse certain second quarter accounting fees associated with Bankrate's Sarbanes-Oxley compliance provider. This instruction was made without any basis.

27. After realizing that accounting fees incurred in the second quarter had not yet been recorded, Lerner, instead of reversing these fees, decided not to record the proper amount of fees to the second quarter, but to instead record those fees to the third quarter. As a result, Bankrate improperly failed to book at least $99,000 in known accounting fees that were incurred during the second quarter.

Bankrate's Reported Financial Results Met And/Or Exceeded Analyst Consensus Estimates.

28. As a result of its improper entries as described above, Bankrate released artificially inflated financial results on July 31, 2012, and just met analyst targets. Analyst consensus estimates for Bankrate's second quarter 2012 financial results were $37.2 million for Adjusted EBITDA and $0.18 for Adjusted EPS. In its July 31, 2012 earnings release, which was incorporated in a Form 8-K filed by Bankrate on the same date, Bankrate reported second quarter 2012 Adjusted EBITDA of $37.5 million and Adjusted EPS of $0.18. The above-described improper entries were therefore material, as they allowed Bankrate to meet and/or exceed analyst consensus estimates for these key financial metrics. Due to the improper entries, Bankrate also materially misstated its reported net income in its second quarter 2012 Form 10-Q, filed on August 13, 2012.

29. The day after Bankrate's announcement of its financial results for the second quarter 2012 on July 31, 2012, Bankrate's stock price rose from $15.95 to $17.57 per share. Both DiMaria and Lerner sold Bankrate stock during the two-week period following the announcement of Bankrate's second quarter 2012 financial results, a period during which Bankrate's stock price was artificially inflated as a result of Bankrate's scheme to inflate its financial results.

VIOLATIONS

30. As a result of the conduct described above, Bankrate violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities, and 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.

31. Also as a result of the conduct described above, Bankrate violated Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13, and 12b-20 thereunder, which require that every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the

Commission, among other things, information, documents, quarterly reports, and current reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

32. Because Bankrate improperly recorded its revenue, expenses, and accruals, its books, records, and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

33. In addition, Bankrate failed to implement internal accounting controls relating to its revenue, expense, and accrual accounts which were sufficient to provide reasonable assurances that these accounts were accurately stated in accordance with GAAP.

34. As a result of the conduct described above, Bankrate violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, which require 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, and 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.

Bankrate's Remedial Efforts

In determining to accept Bankrate's Offer, the Commission considered remedial acts undertaken by Bankrate.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent Bankrate cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-11, and 13a-13 thereunder.

B. Respondent Bankrate shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $15,000,000 to the Securities and Exchange Commission. The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to Exchange Act Section 21F(g)(3), transfer them to the general fund of the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Bankrate as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Ian Karpel, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 1961 Stout Street, Denver, CO 80294-1961.

C. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9902 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75850 / September 8, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3684 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16787

In the Matter of **HYUNJIN LERNER, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Hyunjin Lerner ("Respondent" or "Lerner") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

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

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

SUMMARY

This proceeding results from Bankrate, Inc., through its chief financial officer, Edward DiMaria, vice president and director of accounting, Matthew Gamsey, and vice president of finance, Hyunjin Lerner, intentionally manipulating its financial results for the second quarter of 2012 in order to meet and/or exceed analyst consensus estimates for key financial metrics. As a result of this manipulation, Bankrate materially overstated its financial results for the second quarter of 2012.

> to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

[2] Rule 102(e)(1)(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's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

After reviewing Bankrate's preliminary financial results for the second quarter 2012, which fell short of analyst estimates for certain key metrics, DiMaria arbitrarily decided to increase Bankrate's revenue following the end of the quarter in order to meet those metrics. As a result, DiMaria, through Lerner, improperly directed two Bankrate divisions, the Insurance and Credit Cards divisions, to book additional revenue of $300,000 and $500,000, respectively, without any support or analysis.

The Insurance division immediately booked the $300,000 of revenue directed by DiMaria to a dormant customer account, with no intention of justifying the revenue until the company's outside auditor asked for additional information about it five days later. In response to the auditor's inquiry, the Insurance division quickly devised a purported justification for the improperly booked revenue – a justification that changed shortly thereafter. These purported justifications were not, however, provided to Bankrate's auditor. Instead, Lerner sent a misleading, generic explanation to the auditor – an explanation that was reviewed and approved by DiMaria and Gamsey. Further, although the Insurance division's ultimate justification was reviewed and approved by Lerner and others, Lerner knew, or was reckless in not knowing, that the purported justification did not support the recognition of revenue under Generally Accepted Accounting Principles ("GAAP").

The accountants from the Credit Cards division were only willing to record $176,000 of the $500,000 in revenue directed by DiMaria, thereby infuriating DiMaria. Refusing to accept the Credit Cards division's unwillingness to record the full $500,000 of revenue he had directed, DiMaria insisted that the approximate difference be recorded as revenue on the books of Bankrate's mortgage business, Bankrate Core. As a result, Bankrate recorded an additional $305,000 of unsupported revenue to two arbitrary Bankrate Core customers. Bankrate's recording of both the $176,000 and the $305,000 in revenue was contrary to GAAP.

Further manipulating Bankrate's financial results for the second quarter, DiMaria, without any support or analysis, improperly directed a Bankrate Core accountant to reduce the accrual for certain marketing expenses by $400,000, which was known to Lerner. Bankrate, through DiMaria and with Lerner's knowledge, had been allowing this marketing accrual account to accrue as a "cushion" account for more than a year, and then selectively decided to reduce the accrual in the second quarter of 2012 in order to improve the company's financial results. In the second quarter 2012, DiMaria improperly reversed $400,000 of the accrual amount, thereby reducing second quarter expenses, to help Bankrate meet analyst estimates. Finally, as part of its effort to artificially inflate its financial results to meet or exceed analyst estimates for the second quarter 2012, Bankrate, through Lerner and others, intentionally failed to book approximately $99,000 in known accounting expenses that had been incurred in the second quarter.

As a result of these improper accounting entries, entries that the company reversed as part of a broader restatement, Bankrate's second quarter 2012 earnings release and associated Form 8-K, filed on July 31, 2012, reported adjusted earnings before interest, taxes, depreciation, and amortization ("Adjusted EBITDA") of $37.5 million, exceeding analyst consensus estimates by approximately $300,000, and adjusted earnings per share ("Adjusted EPS") of $0.18, thereby meeting analyst consensus estimates.[4] Further, due to these improper accounting entries, Bankrate materially overstated its second quarter 2012 net income reported in its Form 10-Q filed on August 13, 2012. During the two week period following the issuance of Bankrate's second quarter 2012 earnings release, DiMaria and Lerner each sold Bankrate stock, thereby profiting from a stock price that had been artificially inflated by the company's materially overstated financial results.

RESPONDENT

1. **Hyunjin Lerner**, age 46, is a resident of Stuart, Florida. During the relevant period, Lerner was Bankrate's vice president of finance. Lerner obtained his certified public accountant license in California in 1996, but his license is currently delinquent. Lerner, whose employment was terminated by Bankrate due to the improper accounting practices described herein, sold $30,045 worth of Bankrate stock on August 6, 2012, six days after Bankrate issued its materially false second quarter 2012 earnings release.

OTHER RELEVANT ENTITY

2. **Bankrate, Inc.** is a Delaware corporation based in North Palm Beach, Florida, that owns and operates an Internet-based consumer banking and personal finance network. Bankrate's common stock is registered with the Commission pursuant to Exchange Act Section 12(b) and trades on the New York Stock Exchange (ticker: RATE). Bankrate files periodic reports, including Forms 10-K, 10-Q, and 8-K, with the Commission pursuant to Section 13(a) of the Exchange Act and the related rules thereunder. On June 17, 2011, Bankrate filed an S-8 registration statement for an offering relating to its equity compensation plan. This offering, which was ongoing at the time of the misconduct described herein, incorporated future company filings with the Commission, including the Form 8-K containing the company's materially false second quarter 2012 earnings release and the second quarter 2012 Form 10-Q that materially overstated the company's net income.

FACTS

<u>Bankrate's Business And Structure.</u>

3. Bankrate is engaged in the business of providing consumers with personal finance information across multiple vertical categories including mortgages, deposits, insurance, credit cards, and other categories, such as retirement, automobile loans, and taxes. Bankrate also aggregates rate information from over 4,800 institutions on more than 300 financial products. Its principal platform is its Bankrate.com Internet website.

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[4] Bankrate defines Adjusted EBITDA as earnings before interest, taxes, depreciation and amortization, excluding stock based compensation expense and IPO and deal related expenses, and defines Adjusted EPS as earnings per fully diluted share, excluding stock based compensation expense, amortization, IPO and deal related expenses.

4. During the relevant period, Bankrate had three primary divisions: (1) Bankrate Core, the original mortgage information business; (2) Bankrate Insurance, comprised of numerous insurance information companies acquired by Bankrate; and (3) Bankrate Credit Cards, comprised of a number of credit card information companies acquired by Bankrate.

5. Bankrate generates revenue by selling consumer information ("leads") gleaned from users of its websites in the insurance and credit cards vertical categories. Its other sources of revenue include display advertising, performance-based advertising, distribution arrangements, and traditional media avenues, such as syndication of editorial content and subscriptions. Some of its customers pay Bankrate each time that a consumer clicks through a link on Bankrate's website to the customer's website.

Bankrate's Manipulation Of Second Quarter 2012 Revenue And Expenses.

6. On July 6, 2012, after being provided with preliminary second quarter financial results for Bankrate Core and Credit Cards (the Insurance division's financial results had not yet been added to the consolidated numbers), DiMaria, unwilling to accept the company's second quarter 2012 financial results, informed Lerner that Adjusted EBITDA needed to be $37 million for the quarter.

7. On July 7, 2012, the first version of Bankrate's consolidated financial results was circulated to DiMaria, Lerner, and Gamsey, as well as others on the accounting team, reflecting current Adjusted EBITDA for the second quarter of $36,144,000, which DiMaria knew was below analyst consensus estimates.

8. Three days later, after realizing it had double-counted $286,000 of revenue, the Credit Cards division submitted revised financials for consolidation. The next day, DiMaria was informed that Bankrate's second quarter revenue had decreased by $286,000 due to the correction for the Credit Cards division's double-counting of revenue, further jeopardizing the company's prospects of meeting its metrics. Shortly thereafter, at DiMaria's instruction, Lerner emailed the Insurance and Credit Cards divisions directing them to book additional revenue of $300,000 and $500,000, respectively. Lerner's July 11, 2012 email instructions to both Credit Cards and Insurance, which were copied to DiMaria, did not specify a legitimate justification for the revenue, but rather contained an ambiguous description of what the revenue purportedly related to, and did not identify any specific customers with which it was associated.

9. Within a few minutes of sending these email instructions, Lerner forwarded the emails (and subsequent related emails) to Gamsey. In emails between themselves using strong expletives, Lerner and Gamsey expressed serious concerns about the validity of the revenue the divisions had just been directed to book and commiserated about the improper accounting entries directed by DiMaria. Their emails also stated that DiMaria's improper accounting entries would have to be reversed in the third quarter, thereby creating an even larger revenue shortfall and a need to record additional improper revenue in the third quarter.

<u>Bankrate Insurance Records $300,000 in Baseless Revenue.</u>

10. Without any support or analysis, the Insurance division immediately recorded the $300,000 of additional revenue directed by DiMaria, booking the revenue to a dormant customer account. Although the Insurance division did not have any intention of justifying the $300,000 of additional revenue, on July 16, 2012, five days after the revenue was booked, Bankrate's auditors asked for an explanation for the $300,000 as part of its accounts receivable variance review, thereby prompting Bankrate to quickly create a purported explanation for this revenue.

11. Within twenty-four hours of Bankrate's auditors asking about the $300,000 entry, the Insurance division, with the knowledge and/or involvement of DiMaria, Lerner, Gamsey, and others, prepared a draft chart purportedly supporting the $300,000 in revenue – a chart that was changed shortly thereafter. Tellingly, although this second chart changed the amounts of revenue assigned to certain categories and replaced certain initial explanations for the revenue with new purported explanations for the revenue, the second chart still totaled the $300,000 in revenue that DiMaria and Lerner had directed the Insurance division to book.

12. The purported explanations for the $300,000 in revenue were baseless. For example, in the second purported explanation for the $300,000 in revenue, $179,000 related to estimated June 2012 revenue from a brand new bonus provision with a customer of the Insurance division. However, as DiMaria, Gamsey, and Lerner knew, at the time this revenue was recognized, the Insurance division did not have any actual data from the customer indicating that a June bonus had been earned. In addition, both Gamsey and Lerner knew that the Insurance division was not performing at a level that would have triggered a bonus in the months leading up to June 2012. Indeed, the Insurance division employee who prepared the high-level, conclusory "support" for the bonus revenue advised Lerner at the time that she was not comfortable with the Insurance division recognizing revenue on the basis of this type of analysis in the future. When the actual data on which a potential bonus was based were later reported to the Insurance division, the Insurance division's performance did not qualify for a bonus. In fact, the Insurance division missed the bonus under the two applicable bonus formulas by approximately 50% and 200%, respectively.

13. For these reasons, among others, Bankrate's recognition of the $300,000 in revenue was contrary to GAAP.[5]

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[5] The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 605-10-25-1 provides that revenue may be properly recognized only when it is both a) realized or realizable and b) earned. <u>See also</u> Staff Accounting Bulletin Topic 13, *Revenue Recognition,* as codified in ASC 605-10-S99, which provides that revenue is generally realized or realizable and earned when all of the following criteria are met: 1) persuasive evidence of an arrangement exists; 2) delivery has occurred or services have been rendered; 3) the seller's price to the buyer is fixed or determinable; and 4) collectability is reasonably assured.

14. In addition, Bankrate did not share either of the purported explanations for the $300,000 in revenue with its auditor, despite the auditor specifically asking for information about the $300,000. Rather, at approximately the same time the initial chart attempting to explain the $300,000 entry was being circulated internally, Lerner sent a misleading, generic explanation that had been reviewed and approved by DiMaria and Gamsey to the auditor, implicitly affirming that the revenue was associated with the single customer account to which it was booked. Moreover, Bankrate did not forward either chart to its auditor, nor did Bankrate update its misleading, generic explanation for the $300,000 in revenue.

Credit Cards Does not Fully Comply with the Directive to Book Baseless Revenue, Causing Bankrate to Immediately and Arbitrarily Record Revenue to A Different Business Unit.

15. Unlike Insurance, the Credit Cards accountants initially refused to book the $500,000 of unsupported revenue directed by DiMaria. Unwilling to accept, and angered by, the Credit Cards accountants' reaction to his improper directive, DiMaria told other Bankrate personnel that he was "going to rip [the Credit Cards CEO's] f[***]ing head off" and fire the Credit Cards accountants if they "f[***] up the accounting."

16. Credit Cards personnel eventually recorded an additional $176,000 in revenue to the second quarter 2012, revenue that was contrary to Bankrate's revenue recognition policy. On July 12, 2012, upon learning that Credit Cards had only booked $176,000 of the $500,000 in additional revenue he had directed, DiMaria informed Lerner that the difference should be booked to Bankrate Core. Thirty-five minutes later, Lerner instructed the Bankrate Core accounting personnel to book $305,000 in additional revenue. Conveniently using two of the Core customers on a revenue spreadsheet that had legitimate revenue listed as $234,000 and $71,000, Bankrate Core simply doubled the revenue attributable to these customers without any basis to arrive at the $305,000 of additional revenue, a fact that soon became known to DiMaria, Lerner, and Gamsey.

17. By adding this improper revenue directly to the revenue spreadsheet rather than through a manual journal entry, Bankrate avoided the questions that its auditors typically directed toward post-quarter manual journal entries. This manner of booking the $305,000 also circumvented Bankrate's accounting controls, as the revenue spreadsheet had already been approved for entry into the general ledger and did not require additional approvals.

18. For these reasons, among others, the recognition of both the $176,000 in revenue booked with the Credit Cards division and the $305,000 in revenue booked with Bankrate Core was contrary to GAAP.

Bankrate Makes Additional Baseless Reductions In Marketing Expense Accrual.

19. On July 13, 2012, the day after Bankrate improperly recorded $305,000 of additional revenue on Bankrate Core's books, a revised version of Bankrate's consolidated financial results for the second quarter 2012 was circulated to DiMaria, Lerner, and Gamsey that reflected Adjusted EBITDA of $36,656,000.

20. Shortly after the circulation of the revised financial results, results that continued to fall short of the $37 million in Adjusted EBITDA dictated by DiMaria one week earlier, DiMaria directed a Core accountant to reduce a marketing accrual account for Search Engine Marketing (known as "SEM") by $400,000. Reducing the SEM accrual (a balance sheet account) led to a corresponding reduction in the SEM expense (an income statement account), thereby artificially increasing Bankrate's quarterly earnings.

21. DiMaria's email instruction to the Core accountant did not reference or contain any support for the accounting entry. Similarly, the manual journal entry executing DiMaria's instruction to reduce the SEM marketing accrual by $400,000 did not have any support beyond DiMaria's email instruction.

22. Upon learning of this $400,000 reduction in the SEM accrual, Gamsey questioned Lerner as to whether there was any basis for DiMaria's reduction in the SEM accrual, or whether DiMaria directed this entry instead of additional unsupported revenue entries.

23. In fact, Bankrate, through DiMaria and Lerner, had been using the SEM accrual account as one of its "cushion" or "cookie jar reserve" accounts (i.e., an account known to have excess accruals that could be selectively used to boost the financial results of particular quarters) since at least early 2011. It was inappropriate for Bankrate to use the SEM account as a "cushion" account, and to reduce the SEM accrual without a proper basis, in order to meet the Adjusted EBITDA number being dictated by DiMaria.

24. Given these circumstances, Lerner knew, or was reckless in not knowing, that the $400,000 SEM adjustment was improper.

25. Following the booking of this $400,000 reduction in the SEM accrual, a revised version of Bankrate's second quarter 2012 financial results was circulated to DiMaria, Lerner, and Gamsey, reflecting Adjusted EBITDA of $37,056,000.

Bankrate Fails to Book Additional Second Quarter Expenses.

26. The baseless accounting entries detailed above were not the only steps in Bankrate's scheme to meet analyst estimates. On July 6, 2012 – indeed, within a few hours of being told by DiMaria that second quarter Adjusted EBITDA needed to be $37 million – Lerner instructed Bankrate Core to reverse certain second quarter accounting fees associated with Bankrate's Sarbanes-Oxley compliance provider. This instruction was made without any basis.

27. After realizing that accounting fees incurred in the second quarter had not yet been recorded, Lerner, instead of reversing these fees, decided not to record the proper amount of fees to the second quarter, but to instead record those fees to the third quarter. As a result, Bankrate improperly failed to book at least $99,000 in known accounting fees that were incurred during the second quarter.

Lerner, Together with DiMaria and Gamsey, Made Material Misrepresentations and Omissions to Bankrate's Auditor Concerning the Improper Accounting Entries in the Second Quarter 2012.

28. As set forth in paragraph 14 above, Lerner, after receiving approval from DiMaria and Gamsey, provided Bankrate's auditor with a generic and misleading explanation for the $300,000 in improper revenue booked by the Insurance division, and took no steps to advise the auditor that Bankrate's explanation for this revenue later changed significantly.

29. In addition, Lerner and others again made material misrepresentations and omissions to Bankrate's auditor in the August 13, 2012 management representation letter that he (and others) signed for the second quarter 2012. Although Lerner knew about the improper accounting practices taking place at the company, he falsely represented to the company's auditor that: 1) the company's financial statements had been prepared and were fairly presented in conformity with GAAP; 2) there were no material transactions that had not been properly recorded in the company's accounting records; and 3) he had no knowledge of fraud or suspected fraud affecting the company involving management, employees with significant internal control roles, or others where the fraud could materially affect the company's financial statements.

Bankrate's Reported Financial Results Met And/Or Exceeded Analyst Consensus Estimates.

30. As a result of its improper entries as described above, Bankrate released artificially inflated financial results on July 31, 2012, and just met analyst targets. Analyst consensus estimates for Bankrate's second quarter 2012 financial results were $37.2 million for Adjusted EBITDA and $0.18 for Adjusted EPS. In its July 31, 2012 earnings release, which was incorporated in a Form 8-K filed by Bankrate on the same date, Bankrate reported second quarter 2012 Adjusted EBITDA of $37.5 million and Adjusted EPS of $0.18. The above-described improper entries were therefore material, as they allowed Bankrate to meet and/or exceed analyst consensus estimates for these key financial metrics. Due to the improper entries, Bankrate also materially misstated its reported net income in its second quarter 2012 Form 10-Q, filed on August 13, 2012.

31. The day after Bankrate's announcement of its financial results for the second quarter 2012 on July 31, 2012, Bankrate's stock price rose from $15.95 to $17.57 per share. Lerner sold Bankrate stock during a one-week period following the announcement of Bankrate's second quarter 2012 financial results, a period during which Bankrate's stock price was artificially inflated as a result of Bankrate's scheme to inflate its financial results.

32. At the time Lerner sold Bankrate stock on August 6, 2012, he was in possession of material, nonpublic information concerning Bankrate's reported second quarter financial results (*i.e.*, that Bankrate had overstated its financial results as a result of the improper accounting entries described herein). As a result of these stock sales, Lerner improperly benefited by as much as $30,045.

VIOLATIONS

33. As a result of the conduct described above, Lerner willfully[6] violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities, and 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.

34. As a result of the conduct described above, Lerner also willfully violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, which prohibit persons from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, knowingly falsifying any book, record or account, and directly or indirectly falsifying or causing to be falsified any book, record, or account.

35. In addition, as a result of the conduct described above, Lerner willfully violated Rule 13b2-2 of the Exchange Act, which prohibits an officer or director of an issuer from, directly or indirectly: (1) making or causing to be made a materially false or misleading statement to an accountant or (2) 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, among other things, a required audit, review or examination of the issuer's financial statements or the preparation or filing of any document or report required to be filed with the Commission.

36. Also as a result of the conduct described above, Lerner willfully aided and abetted and caused Bankrate's violation of Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13, and 12b-20 thereunder, which require that every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission, among other things, information, documents, quarterly reports, and current reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

37. Because Bankrate improperly recorded its revenue, expenses, and accruals, its books, records, and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

38. In addition, Bankrate failed to implement internal accounting controls relating to its revenue, expense, and accrual accounts which were sufficient to provide reasonable assurances that these accounts were accurately stated in accordance with GAAP.

39. As a result of the conduct described above, Lerner willfully aided and abetted and caused Bankrate's violation of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, which

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

require 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, and 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.

40. Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) of the Commission's Rules of Practice provide, in pertinent part, that "[t]he Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . [t]o have willfully violated, or willfully aided and abetted the violation of, any provision of the Federal securities laws or the rules and regulations thereunder." 17 C.F.R. § 201.102(e)(1)(iii). As a result of the conduct described above, Lerner willfully violated, and willfully aided and abetted the violation of, the aforementioned provisions of the Securities Act and Exchange Act within the meaning of Section 4C(a)(3) and Rule 102(e)(1)(iii).

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 4C and 21C of the Exchange Act, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice it is hereby ORDERED that:

A. Respondent Lerner cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-11, 13a-13, 13b2-1, and 13b2-2 thereunder.

B. Respondent Lerner is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After 5 years from the date of this Order, Respondent may request that the Commission consider his reinstatement by submitting an application (Attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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

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

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

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

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

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

D. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent Lerner is prohibited for a period of 5 years from the date of this Order from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

F. Respondent Lerner shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $150,000 and disgorgement of $30,045 and prejudgment interest of $2,571 to the Securities and Exchange Commission. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to 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 pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. If timely payment is not made, additional interest shall accrue pursuant to Rule 600 of the Commission's Rules of Practice or 31 U.S.C. §3717, as applicable. 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 Lerner as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Ian Karpel, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 1961 Stout Street, Denver, CO 80294-1961.

G. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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

Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9903 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75851 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16788

In the Matter of

MusclePharm Corporation,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against MusclePharm Corporation ("MSLP" or "Respondent").

II.

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

MSLP is a Denver-based sports nutrition company that develops, manufactures, and markets sports nutrition products. When MSLP became a public company in 2010, it was unprepared for the Commission's reporting requirements and lacked sufficient infrastructure to support its rapid growth. MSLP's revenues greatly increased each year (MSLP's reported revenue was $3M in 2010, $17M in 2011, $67M in 2012 and $111M in 2013). MSLP's senior management lacked public company or accounting experience. While the company focused on revenue growth, it failed to establish sufficient internal controls and keep proper books and records. As a result, between 2010 and 2013, MSLP engaged in a series of accounting and disclosure failures that resulted in the company filing materially false and misleading filings with the Commission from 2010 through July 2014. Specifically, as described further below, MSLP failed to disclose perquisite compensation to its executive officers, failed to disclose related party transactions, failed to disclose bankruptcies of its executive officers, and committed other financial statement, accounting, and disclosure failures. Additionally, MSLP engaged in the unregistered offer and sale of its securities.

Respondent

1. MSLP is a Nevada corporation, based in Denver, Colorado, that manufactures and markets sports nutrition products. From 2010 to present, MSLP's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was quoted on the OTC Bulletin Board.

MSLP's Failure to Disclose Perquisites from 2010 through July 2014

2. From 2010 through July 2014, MSLP significantly understated its disclosed perquisites by approximately $482,000 or 76% in Forms 10-K, Forms S-1, and proxy statements filed with the Commission. MSLP understated its disclosed perquisites in (1) 2010 by approximately $37,000 or 100%; (2) in 2011 by approximately $160,000 or 100%; (3) in 2012 by approximately $214,000 or 93%; and (4) in 2013 by approximately $71,000 or 35%.

3. MSLP paid its chief executive officer ("CEO") approximately $244,000 of undisclosed perquisites during this time period. The perquisites included perquisites related to meals, autos, apparel, personal professional tax and legal services, and two golf club memberships. During this time, MSLP also paid for perquisites of other executives that were not disclosed, including items such as the medical costs of the birth of a child, eye surgery, and personal golf club memberships.

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

4. From 2010 until mid-2012, MSLP executives knew or should have known that executive compensation was required to be disclosed in Commission filings and failed to educate themselves regarding the required reporting of executive compensation in Commission filings or what were considered perquisites with respect to executive officers. As a consequence, MSLP did not disclose any perquisites in its filings with the Commission prior to October 2012.

5. From mid-2012 through 2013, MSLP executives failed to properly identify or fully investigate undisclosed perquisites. As a consequence, MSLP continued to fail to identify or disclose many perquisites in its filings with the Commission through July 2014.

6. In September 2012, the MSLP board of directors determined perquisites related to autos, golf club memberships, and private plane usage would be disclosed in Commission filings. MSLP, however, filed several Commission filings through July 2014, which failed to include complete disclosure of the perquisites identified at the board meeting and otherwise known by senior management.

7. By summer 2013, MSLP began an internal review to determine the amount of undisclosed perquisites paid by MSLP to its executives since 2010. MSLP identified over $100,000 of undisclosed perquisites, including jet use, autos, and golf club memberships. MSLP, however, filed a Form S-1 in August 2013 with incorrect perquisite disclosures that were identical to amounts previously disclosed before the internal review began.

8. MSLP continued its internal investigation of undisclosed perquisites from fall 2013 through spring 2014. On March 31, 2014, MSLP filed its 2013 Form 10-K. In the summary compensation table, MSLP set forth previously undisclosed perquisites for 2011 and 2012 totaling approximately $189,000 (previously undisclosed perquisites of $74,000 for 2011 and $115,000 for 2012). The table also disclosed approximately $134,000 of perquisites in 2013. These disclosures, however, still significantly understated perquisites paid to MSLP executives.

9. MSLP reexamined its perquisite investigation results from spring 2014 through fall 2014. On October 31, 2014, MSLP filed amended Forms 10-K for the years ended 2012 and 2013. The 2013 Form 10-K/A disclosed an additional $252,000 of undisclosed perquisites that were not included in the 2013 Form 10-K or its July 2014 proxy statement. The 2012 Form 10-K/A disclosed an additional $37,000 of perquisites for 2010. In total, MSLP failed to report perquisites totaling approximately $482,000 from 2010-2013.

MSLP's Failure to Disclose Related Party Transactions with a Major Customer from 2011 through 2012

10. MSLP knew or should have known that policies regarding identifying and disclosing related party transactions were required and MSLP failed to implement sufficient policies regarding identifying and disclosing related party transactions. As a result, from May 2011 through 2012, MSLP failed to disclose in Commission filings significant related party transactions with a major customer.

11. In May 2011, MSLP hired a new chief marketing officer ("CMO"). The CMO was a former executive and co-founder of a major customer of MSLP. The CMO's brother remained the CEO of the major customer and a greater than 10% owner of the major customer. From May 2011 to April 2012, MSLP did not identify the related party relationship or consider if disclosure was necessary.

12. In March 2012, MSLP's auditor informed MSLP that transactions with the major customer were related party transactions requiring disclosure. In April 2012, MSLP provided a memo to its auditors concluding that transactions with the major customer did not require disclosure under generally accepted accounting principles ("GAAP"). The memo contained inaccurate information about the relationship between MSLP, the CMO, and the major customer. MSLP did not consider whether transactions with its major customer needed to be disclosed as related party transactions under Item 404 of Regulation S-K. The 2011 Form 10-K was filed three days after the memo, without any related party disclosure regarding the major customer.

13. In July 2012, MSLP hired a new CFO. The CFO had previously been CFO of MSLP's major customer (where the CMO's brother was CEO) and acquired a 1.75% indirect interest in the major customer. The CFO also continued to perform work for the CEO of the major customer personally at no charge while he worked at MSLP.

14. In August 2012, MSLP's auditor requested that MSLP update the April 2012 memo to address whether the major customer was a related party requiring disclosure under GAAP, specifically due to the CMO's or CFO's employment. The August memo concluded that transactions with the major customer did not require disclosure under GAAP. The memo contained inaccurate information about the relationship between MSLP, the CMO, the CFO, and the major customer. As a result, MSLP failed to disclose transactions with its major customer as related party transactions in Commission filings until it filed its Form 10-Q for the quarter ended March 30, 2013 in May 2013.

MSLP's Failure to Disclose Bankruptcies Related to Executive Officers from 2010-2012

15. MSLP's CEO filed for personal bankruptcy in 2008 in the United States District Court for the District of Colorado. Two companies owned by one of MSLP's former CFOs also filed for bankruptcy in 2008 in the United States District Court for the Southern District of Florida. From April 2011 through July 2012, MSLP's filings did not include disclosure of the CEO's bankruptcy. MSLP never disclosed the bankruptcies of the CFO's former companies. From April 2011 through October 2012, MSLP's filings also included a misstatement that "[n]one of the members of the board of directors or other executives has been involved in any bankruptcy proceedings."

Other Financial Statement, Accounting, and Disclosure Failures from 2010-2013

16. MSLP improperly accounted for advertising and promotional related costs for 2010 and 2011. Instead of accounting for advertising and promotional related costs as a reduction of revenue as required under GAAP, MSLP recorded these costs as advertising expenses resulting in it overstating revenue by $845,000 or 26% in 2010 and $3.6 million or 21%

in 2011. As a result, MSLP filed an amended Form 10-K for the year ended December 31, 2011 on July 2, 2012 restating its 2010 and 2011 financial statements.

17. MSLP recorded approximately $1.5 million of loss on settlement of accounts payable in the first quarter of 2011, when GAAP required it be disclosed in 2010. By reporting the loss in the wrong quarter, MSLP understated its 2010 loss on settlement of accounts payable as presented on its income statement by 78% and overstated it by 455% in the first quarter of 2011. MSLP's net loss was understated 8% in 2010 and overstated 42% in 2011.

18. MSLP failed to disclose continuing sponsorship commitments in its Form 10-K for the year ended December 31, 2011 and its Forms S-1 filed during 2012 as required under GAAP. The future sponsorship commitments required MSLP to make future payments totaling $6.9 million through 2013.

19. MSLP failed to disclose that it had one supplier that accounted for nearly 100% of its product purchases in its 2011 and 2012 Commission filings as required under GAAP.

20. MSLP failed to disclose $100,000 of rent expense related to an August 2012 aircraft lease agreement in its 2012 Commission filings as required under GAAP. As a result, MSLP understated its disclosed rent expense by 23%.

21. MSLP failed to disclose the amount of its international sales in its 2011 through 2013 Commission filings as required under GAAP. MSLP's international sales accounted for 23%, 30% and 31% of its sales for 2011, 2012, and 2013 respectively.

Stock Issuances without a Registration Statement

22. In 2011, MSLP lacked funds to pay approximately $1.1 million of outstanding invoices to vendors dating back to services and products purchased in 2009 and 2010. To pay off the vendors, MSLP entered into numerous transactions with third-parties who were willing to pay MSLP's vendors in cash in exchange for shares of MSLP stock that the third-parties immediately sold into the market after counsel representing MSLP opined to the transfer agent that the shares could be issued without a restrictive legend. No registration statement was filed with the Commission for these transactions and no exemption from registration was available.

Retention of Signature Pages for Commission Filings

23. MSLP failed to maintain signed signature pages for most of its filings with the Commission from 2010 through 2013 as required under Rule 302 of Regulation S-T. MSLP failed to receive or maintain any manually signed signature pages prior to December 2012. After December 2012, while MSLP had made over 23 Commission filings, MSLP only received or maintained original signature pages for all signatories on eight filings.

Books, Records, and Lack of Internal Controls

24. Because MSLP improperly recorded and/or reported its perquisites, related parties, revenue, losses on settlement of accounts payable, sponsorship commitments, manufacturing concentration, leases, and international sales, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

25. In addition, MSLP failed to implement internal accounting controls relating to its perquisites, related parties, revenue, losses on settlement of accounts payable, sponsorship commitments, manufacturing concentration, leases, and international sales, which were sufficient to provide reasonable assurances that transactions were recorded as necessary to permit the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets.

Violations

26. As a result of the conduct described above, MSLP violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, which make it unlawful for any person in the offer or sale of any securities by the use of interstate commerce to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

27. As a result of the conduct described above, MSLP violated Sections 5(a) and 5(c) of the Securities Act, which prohibits directly or indirectly offering to sell, selling, and delivering after sale to the public, or offering to sell or to buy through the use or medium of any prospectus or otherwise, certain securities, as to which no registration statement was or is in effect or on file with the Commission, and for which no exemption was or is available.

28. As a result of the conduct described above, MSLP violated Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, which prohibits solicitations by means of a proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing a statement which, at the time and in the light of the circumstances under which it was made, was false or misleading with respect to any material fact, or which omitted to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

29. As a result of the conduct described above, MSLP 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 pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

30. As a result of the conduct described above, MSLP 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 assets.

31. Aa result of the conduct described above, MSLP violated Section 13(b)(2)(B) of the Exchange Act, which require all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and to maintain the accountability of assets.

32. Lastly, as a result of the conduct described above, MSLP violated Rule 302 of Regulation S-T of the Exchange Act, which requires that (1) a signatory to an electronic filing manually sign the signature page either before or at the time of the electronic filing; (2) the filer retain the original executed document for five years; and (3) that the filer provide the Commission staff with a copy of the document upon request.

IV.

Undertakings

Respondent has undertaken to:

Retain an independent consultant (the "Independent Consultant") for a period of one year, not unacceptable to the staff of the Commission, to conduct a comprehensive review of MSLP's policies, procedures, controls, and training relating to payment of expenses, related party transactions, and required financial statement disclosures in accordance with GAAP; and to recommend, if and where appropriate, policies, procedures, controls, and training reasonably designed to ensure:

(a) MSLP's compliance with Item 402 of Regulation S-K requiring, among other things, the disclosure of perquisites as executive compensation;

(b) MSLP has processes and internal controls in place to reasonably ensure payments for private club memberships, private airplane use, meals and entertainment, financial services, and other expenses that have a personal element are properly evaluated for perquisite disclosure;

(c) MSLP's related party disclosures are complete, not misleading, and in accordance with Item 404 of Regulation S-K and FASB ASC Topic 850, Related Party Disclosures; and

(d) MSLP's financial statements, including related notes, for external purposes are prepared in accordance with GAAP.

Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the

Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with MSLP, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Denver Regional Office of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with MSLP 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.

Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), 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 Mary S. Brady, Assistant 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.

V.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent MSLP cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), 17(a)(2) and 17(a)(3) of the Securities Act, Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, and 14a-9 thereunder, and Rule 302 of Regulation S-T of the Exchange Act.

B. Respondent shall comply with the undertakings enumerated in Section IV above.

C. Respondent shall pay civil penalties of $700,000 to the Commission. Payment shall be made in the following installments:

a. $175,000.00 within 10 days of the entry of this Order;
b. $175,000.00 within 120 days of the entry of this Order;
c. $175,000.00 within 240 days of the entry of this Order;
d. $175,000.00 plus interest on the payments described in Section V.C(a)-(d) pursuant to 31 U.S.C. 3717 within 365 days of the entry of this Order.

Prior to making the payment described in Section V.C(d), MSLP shall contact the Commission staff to ensure the inclusion of interest. 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, at the discretion of the Commission staff, 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 MSLP 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 Thomas J. Krysa, Division of Enforcement, Securities and Exchange Commission, 1961 Stout Street, Suite 1700, Denver, CO 80294.

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. 9904 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75852 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16789

In the Matter of Brad J. Pyatt, Respondent.	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Brad J. Pyatt ("Pyatt" 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 8A of the Securities Act of 1933 and Section 21C of the 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

Pyatt served as the chief executive officer ("CEO") of the MusclePharm Corporation ("MSLP") since it became a public company in 2010. MSLP is a Denver-based sports nutrition company that develops, manufactures, and markets sports nutrition products. When MSLP became a public company, it was unprepared for the Commission's reporting requirements and lacked sufficient infrastructure to support its rapid growth. MSLP's revenues greatly increased each year (MSLP's reported revenue was $3M in 2010, $17M in 2011, $67M in 2012 and $111M in 2013). Pyatt lacked public company or accounting experience and failed to hire executives with the required expertise. While Pyatt focused on revenue growth, he failed to ensure sufficient internal controls were enacted and proper books and records were kept. As a result, between 2010 and 2013, MSLP had a series of accounting and disclosure failures that resulted in the company filing materially false and misleading filings with the Commission from 2010 through July 2014. Specifically, as described further below, MSLP failed to disclose perquisite compensation to its executive officers, failed to disclose related party transactions, failed to disclose Pyatt's bankruptcy, and failed to properly disclose rent expense in the financial statements in Commission filings that Pyatt reviewed, approved, and signed. Additionally, MSLP and Pyatt engaged in the unregistered offer and sale of its securities.

Respondent

1. Brad J. Pyatt, age 34, is the current chairman of the board and CEO of MSLP. Pyatt co-founded MSLP in 2008.

Relevant Entity

2. MSLP is a Nevada corporation, based in Denver, Colorado, that manufactures and markets sports nutrition products. From 2010 to present, MSLP's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was quoted on the OTC Bulletin Board.

MSLP's Failure to Disclose Perquisites from 2010 through July 2014

3. From 2010 through July 2014, MSLP significantly understated its disclosed perquisites by approximately $482,000 or 76% in Forms 10-K, Forms S-1, and proxy statements filed with the Commission that were reviewed, approved, and signed by Pyatt. MSLP understated

[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.

its disclosed perquisites in (1) 2010 by approximately $37,000 or 100%; (2) in 2011 by approximately $160,000 or 100%; (3) in 2012 by approximately $214,000 or 93%; and (4) in 2013 by approximately $71,000 or 35%.

4. Pyatt knew or should have known that executive compensation was required to be disclosed in Commission filings and failed to educate himself regarding the required reporting of executive compensation in the Commission filings or what were considered perquisites with respect to executive officers, despite being involved in approving expense reports. As a consequence, MSLP did not disclose any perquisites in its filings with the Commission prior to October 2012.

5. From 2010 through 2013, Pyatt received approximately $244,000 of undisclosed perquisites. The perquisites included perquisites related to meals, autos, apparel, personal professional tax and legal services, and two golf club memberships. Pyatt made material omissions and misrepresentations to the auditors about his receipt of perquisites. During this time, Pyatt also approved MSLP's payment for perquisites of other executives that were not disclosed, including items such as the medical costs of the birth of a child, eye surgery, and personal golf club memberships.

6. In September 2012, at a meeting attended by Pyatt, who was also chairman of the board of directors, the MSLP board of directors determined perquisites related to autos, golf club memberships, and private plane usage would be disclosed in Commission filings. MSLP, however, filed several Commission filings through July 2014, reviewed, approved, and signed by Pyatt, which failed to include complete disclosure of the perquisites identified at the board meeting and otherwise known by Pyatt.

7. In January 2013, Pyatt distributed a letter to the MSLP executives specifically instructing that there would be "no more payment of personal items" and requiring that all reimbursed expenses must be supported by receipt. Executives, however, including Pyatt, continued to submit reimbursement forms and make charges on company credit cards for personal items without providing original receipts. MSLP continued paying for these items without properly identifying them as perquisites.

8. By summer 2013, MSLP was conducting an internal review to determine the amount of undisclosed perquisites paid by MSLP to its executives since 2010. By July 2013, at least $100,000 of undisclosed perquisites had been identified. This review was discussed at an August board meeting attended by Pyatt. Despite not having completed its perquisite review, MSLP filed a Form S-1, reviewed, approved, and signed by Pyatt, in August 2013 with incorrect perquisite disclosures that were identical to amounts previously disclosed before the internal review began.

9. MSLP continued its internal investigation of undisclosed perquisites from fall 2013 through spring 2014. On March 31, 2014, MSLP filed its 2013 Form 10-K, which was reviewed, approved, and signed by Pyatt. In the summary compensation table, MSLP set forth previously undisclosed perquisites for 2011 and 2012 totaling approximately $189,000 (previously

undisclosed perquisites of $74,000 for 2011 and $115,000 for 2012). The table also disclosed approximately $134,000 of perquisites in 2013. These disclosures, however, still significantly understated perquisites paid to MSLP executives, including perquisites received by Pyatt.

10. MSLP reexamined its perquisite investigation results from spring 2014 through fall 2014. On October 31, 2014, MSLP filed amended Forms 10-K for the years ended 2012 and 2013, which were reviewed, approved, and signed by Pyatt. The 2013 Form 10-K/A disclosed an additional $252,000 of undisclosed perquisites that were not included in the 2013 Form 10-K or its July 2014 proxy statement. The 2012 Form 10-K/A disclosed an additional $37,000 of perquisites for 2010. In total, MSLP failed to report perquisites totaling approximately $482,000 from 2010-2013.

MSLP's Failure to Disclose Related Party Transactions with a Major Customer from 2011 through 2012

11. As CEO and chairman of the board of directors, Pyatt was responsible for reviewing related party transactions at MSLP. Pyatt knew or should have known that policies regarding identifying and disclosing related party transactions were required and Pyatt failed to identify or implement sufficient policies regarding identifying and disclosing related party transactions. As a result, from May 2011 through 2012, MSLP failed to disclose significant related party transactions with a major customer in Commission filings that were reviewed, approved, and signed by Pyatt.

12. In May 2011, MSLP hired a new chief marketing officer ("CMO"). The CMO was a former executive and co-founder of a major customer of MSLP. Pyatt knew that the CMO's brother remained the CEO of the major customer. The CMO's brother was also a greater than 10% owner of the major customer. From May 2011 to April 2012, Pyatt did not identify the related party relationship or consider if disclosure was necessary.

13. In March 2012, MSLP's auditor informed MSLP that transactions with the major customer were related party transactions requiring disclosure. In April 2012, MSLP provided a memo to its auditors concluding that transactions with the major customer did not require disclosure under generally accepted accounting principles "GAAP." Pyatt reviewed, edited, and signed the memo. The memo contained inaccurate information about the relationship between MSLP, the CMO, and the major customer. Pyatt did not consider whether transactions with the major customer needed to be disclosed as related party transactions under Item 404 of Regulation S-K. The 2011 Form 10-K was filed three days after the memo, without any related party disclosure regarding the major customer.

14. In July 2012, MSLP hired a new CFO. Pyatt was aware that the CFO had previously been CFO of MSLP's major customer (where the CMO's brother was CEO) and acquired a 1.75% indirect interest in the major customer. The CFO also continued to perform work for the CEO of the major customer personally at no charge while he worked at MSLP.

15. In August 2012, MSLP's auditor requested that MSLP update the April 2012 memo to address whether the major customer was a related party requiring disclosure under GAAP, specifically due to the CMO's or CFO's employment. The August memo concluded that transactions with the major customer did not require disclosure under GAAP. Pyatt reviewed, edited, and signed the memo. The memo contained inaccurate information about the relationship between MSLP, the CMO, the CFO, and the major customer. As a result, MSLP failed to disclose transactions with its major customer as related party transactions in Commission filings that were reviewed, approved, and signed by Pyatt, until it filed its Form 10-Q for the quarter ended March 30, 2013 in May 2013.

Pyatt's Failure to Disclose his Personal Bankruptcy from 2011-2012

16. Pyatt filed for personal bankruptcy in 2008 in the United States District Court for the District of Colorado. From April 2011 through July 2012, MSLP's Commission filings, which Pyatt, reviewed, approved, and signed, did not include disclosure of Pyatt's bankruptcy. From April 2011 through October 2012, MSLP's Commission filings, which Pyatt, reviewed, approved, and signed, included a misstatement that "[n]one of the members of the board of directors or other executives has been involved in any bankruptcy proceedings." Pyatt did not correct the misstatement or omission in the Commission filings. Pyatt also misrepresented to the auditors that he had not filed for bankruptcy.

Other Financial Statement, Accounting, and Disclosure Failures from 2010-2013

17. MSLP failed to disclose $100,000 of rent expense related to an August 2012 aircraft lease agreement in its 2012 Commission filings as required under GAAP. As a result, MSLP understated its disclosed rent expense by 23%. Pyatt, who negotiated and signed the August 2012 contract, failed to provide the contract to the CFO.

Stock Issuances without a Registration Statement

18. In 2011, MSLP lacked funds to pay approximately $1.1 million of outstanding invoices to vendors dating back to services and products purchased in 2009 and 2010. To pay off the vendors, MSLP entered into numerous agreements, negotiated and signed by Pyatt, with third-parties who were willing to pay MSLP's vendors in cash in exchange for shares of MSLP stock that the third-parties immediately sold into the market after counsel representing MSLP opined to the transfer agent that the shares could be issued without a restrictive legend. No registration statement was filed with the Commission for these transactions and no exemption from registration was available.

Books, Records, and Lack of Internal Controls

19. Because MSLP improperly recorded and/or reported its perquisites, related parties, and leases, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

20. In addition, MSLP failed to implement internal accounting controls relating to its perquisites, related parties, and leases, which were sufficient to provide reasonable assurances that transactions were recorded as necessary to permit the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets.

Violations

21. As a result of the conduct described above, Pyatt violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and caused MSLP's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, which make it unlawful for any person in the offer or sale of any securities by the use of interstate commerce to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

22. As a result of the conduct described above, Pyatt violated Sections 5(a) and 5(c) of the Securities Act, which prohibits directly or indirectly offering to sell, selling, and delivering after sale to the public, or offering to sell or to buy through the use or medium of any prospectus or otherwise, certain securities, as to which no registration statement was or is in effect or on file with the Commission, and for which no exemption was or is available.

23. As a result of the conduct described above, Pyatt violated Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, which prohibits solicitations by means of a proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing a statement which, at the time and in the light of the circumstances under which it was made, was false or misleading with respect to any material fact, or which omitted to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

24. As a result of the conduct described above, Pyatt caused MSLP's violations of 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 pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

25. As a result of the conduct described above, Pyatt caused MSLP's violations of 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 assets.

26. As result of the conduct described above, Pyatt caused MSLP's violations of Section 13(b)(2)(B) of the Exchange Act and violated Rule 13b2-1 thereunder, which require 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 the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets; and prohibit persons from directly or indirectly falsifying or causing to be falsified any book, record, or account.

27. Lastly, as a result of the conduct described above, Pyatt violated Exchange Act Rule 13b2-2, which prohibits any director or officer of an issuer from, directly or indirectly: (a) making or causing to be made a materially false or misleading statement; or (b) omitting or causing another person to omit to state a 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.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent Pyatt cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), 17(a)(2), and 17(a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, 13b2-1, 13b2-2, and 14a-9 thereunder.

B. Respondent shall pay civil penalties of $150,000 to the Commission. Payment shall be made in the following installments:

a. $37,500.00 within 10 days of the entry of this Order;
b. $37,500.00 within 120 days of the entry of this Order;
c. $37,500.00 within 240 days of the entry of this Order;
d. $37,500.00 plus interest on the payments described in Section IV.B(a)-(d) pursuant to 31 U.S.C. 3717 within 365 days of the entry of this Order.

Prior to making the payment described in Section IV.B(d), Pyatt shall contact the Commission staff to ensure the inclusion of interest. 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, at the discretion of the Commission staff, 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 Brad J. Pyatt 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 Thomas J. Krysa, Division of Enforcement, Securities and Exchange Commission, 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, 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. 9905 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75853 / September 8, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3685 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16790

In the Matter of **Lawrence S. Meer, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against, Lawrence S. Meer, CPA ("Respondent" or "Meer") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

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

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

Meer served as the chief financial officer ("CFO") of the MusclePharm Corporation ("MSLP") from July 1, 2010 through July 2, 2012. MSLP is a Denver-based sports nutrition company that develops, manufactures, and markets sports nutrition products. When MSLP became a public company in 2010, Meer was unprepared for the Commission's reporting requirements and failed to develop sufficient infrastructure to support its rapid growth. MSLP's revenues greatly increased each year (MSLP's reported revenue was \$3M in 2010, \$17M in 2011, and \$67M in 2012). Meer lacked public company experience and failed to educate himself with the required expertise. Meer failed to ensure sufficient internal controls were enacted and proper books and records were kept. As a result, between 2010 and July 2012, when Meer ceased being

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> to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

[2] Rule 102(e)(1)(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's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

CFO, MSLP had a series of accounting and disclosure failures that resulted in the company filing materially false and misleading filings with the Commission. Specifically, as described further below, MSLP failed to disclose perquisite compensation to its executive officers, failed to disclose related party transactions, failed to disclose bankruptcies related to Meer's companies, and committed other financial statement, accounting, and disclosure failures.

Respondent

1. Lawrence S. Meer, CPA, age 54, was the CFO of MSLP from July 1, 2010 through July 2, 2012. From October 2009 until July 1, 2010, Meer was the Director of Finance of MSLP. Meer then served as treasurer of MSLP from July 2, 2012 through March 1, 2013. Meer was licensed as a CPA in Colorado from approximately 1987 to 2002, when his license lapsed.

Relevant Entity

2. MSLP is a Nevada corporation, based in Denver, Colorado, that manufactures and markets sports nutrition products. From 2010 to present, MSLP's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was quoted on the OTC Bulletin Board.

MSLP's Failure to Disclose Perquisites from 2010 through 2012

3. From 2010 through 2012, MSLP materially understated its disclosed perquisites by approximately $411,000 or 96% in Forms 10-K, Forms S-1, and proxy statements filed with the Commission. Meer reviewed, approved, and signed Forms 10-K and Forms S-1 while CFO. MSLP understated its disclosed perquisites in (1) 2010 by approximately $37,000 or 100%; (2) in 2011 by approximately $160,000 or 100%; and (3) in 2012 by approximately $214,000 or 93%.

4. From 2010 until July 2012, Meer reviewed expense reimbursements and charges coming through the accounting department. Meer knew or should have known that executive compensation was required to be disclosed in Commission filings and Meer failed to educate himself regarding the required reporting of executive compensation in Commission filings or what were considered perquisites with respect to executive officers. Meer failed to ensure sufficient internal controls were enacted relating to perquisites and proper books and records were kept. Meer did not identify any potential perquisites. As a consequence, MSLP did not disclose any perquisites in its filings with the Commission while Meer was CFO.

5. From 2010 through 2012, MSLP's chief executive officer ("CEO") received approximately $198,000 of undisclosed perquisites. The perquisites included perquisites related to meals, autos, apparel, personal professional tax and legal services, and two golf club memberships. During this time, MSLP also paid for perquisites of other executives that were not disclosed, including items such as the medical costs of the birth of a child, eye surgery, and personal golf club memberships. Additionally, Meer received approximately $22,000 in perquisites from MSLP, which Meer also failed to record as additional compensation in the form of perquisites. Meer also made material omissions and misrepresentations to the auditors about receipt of perquisites.

6. After Meer was no longer working for MSLP, on October 31, 2014, MSLP filed amended Forms 10-K for the years ended 2012 and 2013. In total, MSLP failed to report perquisites totaling approximately $411,000 from 2010-2012.

MSLP's Failure to Disclose Related Party Transactions with a Major Customer from 2011 through 2012

7. Meer knew or should have known that policies regarding identifying and disclosing related party transactions were required and Meer failed to identify or implement sufficient policies regarding identifying and disclosing related party transactions. As a result, from May 2011 through July 2, 2012, while Meer was CFO, MSLP failed to disclose material related party transactions with a major customer in Commission filings that were reviewed, approved, and signed by Meer.

8. In May 2011, MSLP hired a new chief marketing officer ("CMO"). The CMO was a former executive and co-founder of a major customer of MSLP. Meer knew that the CMO's brother remained the CEO of the major customer. The CMO's brother was also a greater than 10% owner of the major customer. From May 2011 to April 2012, Meer did not identify the related party relationship or consider if disclosure was necessary.

9. In March 2012, MSLP's auditor informed MSLP that transactions with the major customer were related party transactions requiring disclosure. In April 2012, MSLP provided a memo to its auditors concluding that transactions with the major customer did not require disclosure under generally accepted accounting principles "GAAP." Meer reviewed and signed the memo. The memo misapplied GAAP, which Meer, the only accountant signing the memo, did not correct. The memo also contained inaccurate information about the relationship between MSLP, the CMO, and the major customer that Meer did not correct. Meer did not consider whether transactions with the major customer needed to be disclosed as related party transactions under Item 404 of Regulation S-K. The 2011 Form 10-K was filed three days after the memo was reviewed, approved, and signed by Meer, without any related party disclosure regarding the major customer.

10. MSLP continued to fail to disclose transactions with its major customer as related party transactions in Commission filings, until it filed its Form 10-Q for the quarter ended March 30, 2013 in May 2013.

Meer's Failure to Disclose the Bankruptcies of his Former Companies from 2010-2012

11. Two companies owned by Meer filed for bankruptcy in 2008 in the United States District Court for the Southern District of Florida. MSLP never disclosed the bankruptcies of Meer's former companies in Commission filings. From April 2011 through October 2012, MSLP's filings also included a misstatement that "[n]one of the members of the board of directors or other executives has been involved in any bankruptcy proceedings." Meer did not correct the misstatement or omissions in the Commission filings that he reviewed, approved, and signed. Meer also omitted to inform the auditors that his companies had filed for bankruptcy.

Other Financial Statement, Accounting, and Disclosure Failures from 2010-2012

12. MSLP improperly accounted for advertising and promotional related costs for 2010 and 2011. Instead of accounting for advertising and promotional related costs as a reduction of revenue as required under GAAP, MSLP recorded these costs as advertising expenses resulting in it overstating revenue by $845,000 or 26% in 2010 and $3.6 million or 21% in 2011. As a result, MSLP filed an amended Form 10-K for the year ended December 31, 2011 on July 2, 2012 restating its 2010 and 2011 financial statements. Meer did not read the applicable GAAP and did not evaluate the accounting for the various sales incentives MSLP offered. This issue was first raised by MSLP's auditor in mid-2012.

13. MSLP recorded approximately $1.5 million of loss on settlement of accounts payable in the first quarter of 2011, when GAAP required it be disclosed in 2010. By reporting the loss in the wrong quarter, MSLP understated its 2010 loss on settlement of accounts payable as presented on its income statement by 78% and overstated it by 455% in the first quarter of 2011. MSLP's net loss was understated 8% in 2010 and overstated 42% in 2011. Meer was aware of MSLP's past due accounts payable and the eventual settlement in early 2011 using MSLP stock. Meer, however, failed to consider whether the settlements should have been booked in the prior accounting period.

14. MSLP failed to disclose continuing sponsorship commitments in its Form 10-K for the year ended December 31, 2011 and its Forms S-1 filed during 2012 as required under GAAP. The future sponsorship commitments required MSLP to make future payments totaling $6.9 million through 2013. Meer failed to consider whether the scheduled future payments needed to be disclosed.

15. MSLP failed to disclose that it had one supplier that accounted for nearly 100% of its product purchases in its 2011 and 2012 Commission filings as required under GAAP. Meer did not identify that this was required to be disclosed.

16. MSLP failed to disclose the amount of its international sales in its 2011 through 2012 Commission filings as required under GAAP. MSLP's international sales accounted for 23% for 2011 and 30% for 2012. Meer did not identify that this was required to be disclosed.

Books, Records, and Lack of Internal Controls

17. Because MSLP improperly recorded and/or reported its perquisites, related parties, revenue, losses on settlement of accounts payable, sponsorship commitments, manufacturing concentration, and international sales, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

18. In addition, MSLP failed to implement internal accounting controls relating to its perquisites, related parties, revenue, losses on settlement, sponsorship commitments, manufacturing concentration, and international sales, which were sufficient to provide reasonable

assurances that transactions were recorded as necessary to permit the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets.

Violations

19. As a result of the conduct described above, Meer willfully[4] violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and was a cause of MSLP's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, which make it unlawful for any person in the offer or sale of any securities by the use of interstate commerce to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

20. As a result of the conduct described above, Meer was a cause of MSLP's violations of Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, which prohibits solicitations by means of a proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing a statement which, at the time and in the light of the circumstances under which it was made, was false or misleading with respect to any material fact, or which omitted to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

21. As a result of the conduct described above, Meer was a cause of MSLP's violations of 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 pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

22. As a result of the conduct described above, Meer was a cause of MSLP's violations of 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 assets.

23. Aa result of the conduct described above, Meer was a cause of MSLP's violations of Section 13(b)(2)(B) of the Exchange Act and willfully violated Rule 13b2-1 thereunder, which

[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)).

require 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 the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets; and prohibit persons from directly or indirectly falsifying or causing to be falsified any book, record, or account.

24. As a result of the conduct described above, Meer willfully violated Exchange Act Rule 13b2-2, which prohibits any director or officer of an issuer from, directly or indirectly: (a) making or causing to be made a materially false or misleading statement; or (b) omitting or causing another person to omit to state a 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.

Disgorgement and Civil Penalties

Respondent has submitted a sworn Statement of Financial Condition dated February 4, 2015 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 Meer's Offer.

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

A. Meer shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, 13b2-1, 13b2-2, and 14a-9 promulgated thereunder.

B. Meer 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 Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company

for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

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

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

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

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

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

D. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Based upon Respondent's sworn representations in his Statement of Financial Condition dated February 4, 2015 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

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

By the Commission.

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. 9906 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75854 / September 8, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3686 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16791

In the Matter of **L. Gary Davis, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against L. Gary Davis, CPA ("Respondent" or "Davis") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

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

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

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 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

Davis served as the chief financial officer ("CFO") of the MusclePharm Corporation ("MSLP") from July 3, 2012 until April 15, 2014. MSLP is a Denver-based sports nutrition company that develops, manufactures, and markets sports nutrition products. When Davis became CFO of MSLP, he discovered that MSLP had almost no internal controls, policies or procedures. Davis worked to bring MSLP's accounting and disclosures in compliance with generally accepted accounting principles ("GAAP") and the Commission's reporting requirements. During his tenure as CFO, however, Davis failed to ensure sufficient internal controls were enacted and proper books and records were kept. Additionally, Davis became aware of issues regarding undisclosed perquisites and undisclosed related parties, yet continued to sign MSLP Commission filings with misstatements and omissions. As a result, between July 2012 and April 2014, when Davis ceased being CFO, MSLP had a series of accounting and disclosure failures that resulted in the company

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> 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's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

filing materially false and misleading filings with the Commission. Specifically, as described further below, MSLP failed to disclose perquisite compensation to its executive officers, failed to disclose related party transactions, and failed to properly disclose manufacturing concentration, rent expense, and international sales in the financial statements in Commission filings that Davis reviewed, approved, and signed.

Respondent

1. L. Gary Davis, CPA, was the CFO of MSLP from July 3, 2012 through April 15, 2014. Davis continued to be employed by MSLP in a special projects role until December 31, 2014. Davis has been licensed as a CPA in Ohio since 1985 and licensed in Idaho since 1992.

Relevant Entity

2. MSLP is a Nevada corporation, based in Denver, Colorado, that manufactures and markets sports nutrition products. From 2010 to present, MSLP's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was quoted on the OTC Bulletin Board.

MSLP's Failure to Disclose Perquisites from 2012 through 2014

3. From 2012 through April 2014, MSLP materially understated its disclosed perquisites by approximately $285,000 or 66% in Forms 10-K and Forms S-1 filed with the Commission. Davis reviewed, approved, and signed Forms 10-K and Forms S-1 while CFO. MSLP understated its disclosed perquisites in 2012 by approximately $214,000 or 93% and in 2013 by approximately $71,000 or 35%. From 2012 through 2013, MSLP's chief executive officer ("CEO") received approximately $152,000 of undisclosed perquisites. The perquisites included perquisites related to meals, autos, apparel, and two golf club memberships.

4. In July 2012, MSLP hired Davis as the CFO. Davis realized that MSLP had almost no internal controls or policies or procedures. Davis focused on maintaining MSLP's daily operations and focused on developing the accounting department by hiring additional accounting staff with CPAs. Soon after starting, however, Davis received information that MSLP was reimbursing executives for expenses, including a golf club membership and executive auto use, which were not disclosed as perquisites.

5. In October 2012, Davis received a draft Form S-1, which included a summary compensation table that for the first time included disclosure amounts under the "All Other Compensation" column for 2009, 2010, and 2011. A few weeks later, on October 26, MSLP filed the final Form S-1, which had removed items from the draft and failed to list several undisclosed perquisites. Davis reviewed, approved, and signed the Form S-1.

6. Beginning in November 2012, Davis began to implement travel and expense policies, which required MSLP employees to provide original receipts for their expenses. Davis, however, did not implement any formal policies or procedures to ensure perquisites were being

properly identified and disclosed. Executives continued to submit reimbursement forms and make charges on company credit cards for personal items without providing original receipts. MSLP continued paying for these items without properly identifying them as perquisites. As a result, MSLP filed several Commission filings through April 2014, which failed to include complete disclosure of the perquisites.

7. By summer 2013, Davis had begun conducting an internal review to determine the amount of undisclosed perquisites paid by MSLP to its executives since 2010. In July 2013, Davis identified at least $100,000 of undisclosed perquisites. Despite the perquisite review not being complete, MSLP filed a Form S-1 in August 2013 with incorrect perquisite disclosures that were identical to amounts previously disclosed before the internal review began. Davis reviewed, approved, and signed the Form S-1.

8. On March 31, 2014, MSLP filed its 2013 Form 10-K, which was reviewed, approved, and signed by Davis. In the summary compensation table, MSLP set forth previously undisclosed perquisites for 2011 and 2012 totaling approximately $189,000 (previously undisclosed perquisites of $74,000 for 2011 and $115,000 for 2012). The table also disclosed approximately $134,000 of perquisites in 2013. These disclosures, however, still understated perquisites paid to MSLP executives.

9. After Davis was no longer working for MSLP, on October 31, 2014, MSLP filed amended Forms 10-K for the years ended 2012 and 2013. In total, MSLP failed to report perquisites totaling approximately $285,000 from 2012-2013.

MSLP's Failure to Disclose Related Party Transactions with a Major Customer

10. From August 2012 through the end of the year, MSLP failed to disclose material related party transactions with a major customer in Commission filings that were reviewed, approved, and signed by Davis.

11. In May 2011, MSLP had hired a new chief marketing officer ("CMO"). The CMO was a former executive and co-founder of a major customer of MSLP. Davis knew that the CMO's brother remained the CEO of the major customer. The CMO's brother was also a greater than 10% owner of the major customer. Additionally, Davis had previously been CFO of MSLP's major customer (where the CMO's brother was CEO) and acquired a 1.75% indirect interest in the major customer. Davis also continued to perform work for the CEO of the major customer personally at no charge while he worked at MSLP.

12. In August 2012, MSLP's auditor requested that MSLP update an April 2012 memo it had provided to the auditors addressing whether the major customer was a related party requiring disclosure under GAAP, specifically due to the CMO's or Davis' employment. The August memo concluded that transactions with the major customer did not require disclosure under GAAP. The memo misapplied GAAP, which Davis, the only accountant signing the memo, did not correct. The memo also contained inaccurate information about the relationship between MSLP, the CMO,

Davis, and the major customer. As a result, MSLP failed to disclose transactions with its major customer as related party transactions in Commission filings until it filed its Form 10-Q for the quarter ended March 30, 2013 in May 2013.

Other Financial Statement, Accounting, and Disclosure Failures from 2012-2013

13. MSLP, while Davis was CFO, failed to disclose that it had one supplier that accounted for nearly 100% of its product purchases in its 2012 Commission filings as required under GAAP.

14. MSLP, while Davis was CFO, failed to disclose $100,000 of rent expense related to an August 2012 aircraft lease agreement in its 2012 Form 10-K as required under GAAP. As a result, MSLP understated its disclosed rent expense by 23%. In addition, MSLP, while Davis was CFO, instead of recognizing no gain or loss on the settlement since the $100,000 paid equaled the $100,000 owed per the lease agreement, MSLP recorded a $35,000 gain in 2013 related to the January 2013 settlement.

15. MSLP, while Davis was CFO, failed to disclose the amount of its international sales in its 2012 and 2013 Commission filings as required under GAAP. MSLP's international sales accounted for 30% for 2012 and 31% for 2013.

Books, Records, and Lack of Internal Controls

16. Because MSLP improperly recorded and/or reported its perquisites, related parties, manufacturing concentration, leases, and international sales, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

17. In addition, MSLP failed to implement internal accounting controls relating to its perquisites, related parties, manufacturing concentration, leases, and international sales, which were sufficient to provide reasonable assurances that transactions were recorded as necessary to permit the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets.

Violations

18. As a result of the conduct described above, Davis willfully[4] violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and caused MSLP's violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, which make it unlawful for any person in the offer or sale of any

[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)).

securities by the use of interstate commerce to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

19. As a result of the conduct described above, Davis caused MSLP's violations of Section 13(a) of the Exchange Act Rules 13a-1, 13a-13, and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

20. As a result of the conduct described above, Davis caused MSLP's violations of 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 assets.

21. As a result of the conduct described above, Davis caused MSLP's violations of Section 13(b)(2)(B) of the Exchange Act and willfully violated Rule 13b2-1 thereunder, which require 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 the preparation of financial statements in conformity with GAAP and to maintain the accountability of assets; and prohibit persons from directly or indirectly falsifying or causing to be falsified any book, record, or account.

IV.

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

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

A. Davis shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, and 13b2-1 promulgated thereunder.

B. Davis is denied the privilege of appearing or practicing before the Commission as an accountant.

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

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

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

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

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

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

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

D. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $30,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying L. Gary Davis 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 Thomas J. Krysa, Division of Enforcement, Securities and Exchange Commission, 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, 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
Dissent as to the
Corporate Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9907 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16794

In the Matter of **Ditto Holdings, Inc. (now known as SoVesTech, Inc.)** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

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

II.

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

[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. **Ditto Holdings, Inc.** is a Delaware corporation with offices in Los Angeles, California and Chicago, Illinois.[2] It is not registered with the Commission in any capacity. Ditto Holdings owns 100% of Ditto Trade, Inc. ("Ditto Trade"), an Illinois corporation with headquarters in Chicago, Illinois. According to its website, Ditto Trade is a "first-of-its-kind social brokerage firm." Ditto Trade has been registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act since July 2010.

Offerings of Ditto Holdings, Inc. Securities

2. From April 2009 to September 2013, Ditto Holdings raised approximately $10 million from more than two hundred investors located throughout the United States through a series of common and preferred stock offerings as follows:

a. Ditto Holdings raised approximately $2.1 million from the sale of common stock to at least 68 individual investors from April 2009 to March 2012. At least 13 non-accredited investors purchased common stock from Ditto Holdings during those offerings.

b. Ditto Holdings raised approximately $1.7 million from the sale of Series A preferred stock to at least 36 accredited investors from April 2011 to June 2012.

c. Ditto Holdings raised approximately $2.6 million from the sale of Series B preferred stock to at least 39 individual investors from June 2012 to January 2013. At least 10 non-accredited investors purchased preferred stock from Ditto Holdings during those offerings.

d. Ditto Holdings raised approximately $3.8 million from the sale of common stock to at least 104 individual investors from December 2012 to September 2013. At least 31 non-accredited investors purchased common stock from Ditto Holdings during those offerings.

3. Ditto Holdings did not maintain a complete and accurate set of financial records from its inception through at least September 2013. Ditto Holdings did not regularly prepare financial statements during that time period and has never had an audit performed on any of its financial statements.[3]

4. Ditto Holdings prepared offering documents for several of its securities offerings, but it did not provide the offering documents to everyone who was offered the opportunity to

[2] Ditto Holdings, Inc. was formed in December 2010 as a successor to FB Financial Group, Inc., an Illinois corporation that was formed in January 2009. Ditto Holdings changed its name to SoVesTech, Inc. in December 2014. For simplicity, we refer to all of these entities as Ditto Holdings throughout this Order.

[3] Ditto Trade, Ditto Holdings' sole operating subsidiary, has had its financial statements audited annually since 2010. Some investors were provided with certain historical and projected financial information about Ditto Trade.

purchase its securities. Further, the offering documents did not include financial statements or certain other required financial information about Ditto Holdings, and Ditto Holdings did not otherwise provide this information to any investors.

5. Beginning in August 2012, Ditto Holdings entered into a series of agreements with Marc Mandel ("Mandel"). Under the agreements, Mandel agreed to co-develop with Ditto Holdings an internet-based radio show covering the stock markets and provided a number of services to Ditto Holdings, including, among other things, marketing, product offerings, industry trends, and investor offerings. Mandel also hosted a radio program, on which Ditto Trade advertised, and distributed an investing newsletter. Mandel introduced his newsletter subscribers to Ditto Holding's securities offerings and also to Ditto Trade's features and services. From September 2012 to September 2013, Ditto Holdings paid Mandel at least $265,000 and granted him warrants to purchase more than 800,000 shares of Ditto Holdings' common stock at a favorable exercise price.

6. Mandel sent numerous emails to his roughly 350 newsletter subscribers about Ditto Holdings and hosted a series of online webinars and in-person meetings for investors with Ditto Holdings' Chief Executive Officer.

7. From late 2012 to September 2013, more than seventy of Mandel's subscribers purchased securities from Ditto Holdings at a total cost of approximately $3.7 million.

8. No registration statement was filed in connection with any of Ditto Holdings' securities offerings, and an exemption from registration was not available to all of the transactions.

Violation

9. As a result of the conduct described above, Ditto Holdings violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the direct or indirect offer and sale of securities through the mails or interstate commerce unless a registration statement has been filed or is in effect or an exemption from registration is available.

Undertaking

10. In determining whether to accept the Respondent's Offer, the Commission has considered the following undertaking:

a. Respondent agrees to cooperate fully with the Commission with respect to this action and any judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party relating to the matters in this Order or other matters related to Ditto Holdings' securities or officers. Respondent's cooperation shall include, but is not limited to:

i. Production of Information. At the Commission's request on reasonable notice and without a subpoena, Respondent shall truthfully and completely disclose information and documents requested by

Commission staff in connection with the Commission's related investigation, litigation or other proceedings. Respondent will have no obligation to provide information or documents voluntarily that it is not able to provide without a subpoena.

ii. Production of Cooperative Personnel. At the Commission's request on reasonable notice and without a subpoena, Respondent shall use reasonable efforts to secure the attendance and truthful statements or testimony of any current partner, officer, agent, or employee of Respondent, at any meeting, interview, testimony, deposition, trial or other legal proceeding.

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:

1. Pursuant to Section 8A of the Securities Act, Respondent Ditto Holdings cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act;

2. Respondent Ditto Holdings shall pay a civil money penalty in the amount of $50,000 to the Securities and Exchange Commission. Payment shall be made in the following installments:

(1) $16,667 within twenty days of entry of this Order;

(2) $16,667 within eighty days of entry of this Order; and

(3) $16,666 within one hundred forty days of entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

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

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

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341

6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Ditto Holdings, Inc. 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 Anne C. McKinley, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

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. 9908 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75857 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16795

In the Matter of Joseph J. Fox, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Joseph J. Fox ("Fox" 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 VI, 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 Section 15(b) of the Securities Exchange Act of 1934, Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order and Notice of Hearing ("Order"), as set forth below:

III.

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

Respondent

1. **Joseph J. Fox**, also known as Yosef Yehuda Fox, age 49, is a resident of Los Angeles, California. He is the current Chief Executive Officer of Ditto Holdings, Inc. and served as the Chief Executive Officer of Ditto Trade, Inc. from its inception until December 2014. Fox held various FINRA licenses between 1993 and 2003, and since 2010 he has held the following FINRA licenses: Series 7 (General Securities Representative), Series 24 (General Securities Principal), Series 28 (Introducing Broker/Dealer Financial and Operations Principal) and Series 63 (Uniform Securities Agent State Law Examination). He was a registered representative with Ditto Trade from 2010 to December 2014. Fox voluntarily withdrew his broker's license in December 2014.

Relevant Entity

2. **Ditto Holdings, Inc.** is a Delaware corporation with offices in Los Angeles, California and Chicago, Illinois.[2] It is not registered with the Commission in any capacity. Ditto Holdings owns 100% of Ditto Trade, Inc. ("Ditto Trade"), an Illinois corporation with headquarters in Chicago, Illinois. According to its website, Ditto Trade is a "first-of-its-kind social brokerage firm." Ditto Trade has been registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act since July 2010.

Ditto Holdings, Inc.'s Securities Offerings

3. As Chief Executive Officer and a member of the Board of Directors of Ditto Holdings, Fox played an integral role in Ditto Holdings' efforts to raise capital. Among other things, Fox was involved in determining when Ditto Holdings would offer to sell securities, what types of securities it would offer to sell, the terms of the securities offerings, and the manner in which the securities offerings would be communicated to potential investors.

4. From April 2009 to September 2013, Ditto Holdings raised approximately $10 million from more than two hundred investors located throughout the United States through a series of common and preferred stock offerings as follows:

   a. Ditto Holdings raised approximately $2.1 million from the sale of common stock to at least 68 individual investors from April 2009 to March 2012. At least 13 non-accredited investors purchased common stock from Ditto Holdings during those offerings.

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

[2] Ditto Holdings, Inc. was formed in December 2010 as a successor to FB Financial Group, Inc., an Illinois corporation that was formed in January 2009. Ditto Holdings changed its name to SoVesTech, Inc. in December 2014. For simplicity, we refer to all of these entities as Ditto Holdings throughout this Order.

b. Ditto Holdings raised approximately $1.7 million from the sale of Series A preferred stock to at least 36 accredited investors from April 2011 to June 2012.

c. Ditto Holdings raised approximately $2.6 million from the sale of Series B preferred stock to at least 39 individual investors from June 2012 to January 2013. At least 10 non-accredited investors purchased preferred stock from Ditto Holdings during those offerings.

d. Ditto Holdings raised approximately $3.8 million from the sale of common stock to at least 104 individual investors from December 2012 to September 2013. At least 31 non-accredited investors purchased common stock from Ditto Holdings during those offerings.

5. Ditto Holdings did not maintain a complete and accurate set of financial records from its inception through at least September 2013. Ditto Holdings did not regularly prepare financial statements during that time period and has never had an audit performed on any of its financial statements.[3]

6. Ditto Holdings prepared offering documents for several of its securities offerings, but it did not provide the offering documents to everyone who was offered the opportunity to purchase its securities. Further, the offering documents did not include financial statements or certain other required financial information about Ditto Holdings, and Ditto Holdings did not otherwise provide this information to any investors.

7. Beginning in August 2012, Ditto Holdings entered into a series of agreements with Marc Mandel ("Mandel"). Under the agreements, Mandel agreed to co-develop with Ditto Holdings an internet-based radio show covering the stock markets and provided a number of services to Ditto Holdings, including, among other things, advice on marketing, product offerings, industry trends, and investor offerings. Mandel also hosted a radio program, on which Ditto Trade advertised, and distributed an investing newsletter. Mandel introduced his newsletter subscribers to Ditto Holding's securities offerings and also to Ditto Trade's features and services. From September 2012 to September 2013, Ditto Holdings paid Mandel at least $265,000 and granted him warrants to purchase more than 800,000 shares of Ditto Holdings' common stock at a favorable exercise price.

8. Mandel sent numerous emails to his roughly 350 newsletter subscribers about Ditto Holdings and hosted a series of online webinars and in-person meetings for investors with Fox.

9. From late 2012 to September 2013, more than seventy of Mandel's subscribers purchased securities from Ditto Holdings at a total cost of approximately $3.7 million.

[3] Ditto Trade, Ditto Holdings' sole operating subsidiary, has had its financial statements audited annually since 2010. Some investors were provided with certain historical and projected financial information about Ditto Trade.

10. No registration statement was filed in connection with any of Ditto Holdings' securities offerings, and an exemption from registration was not available to all of the transactions.

Fox's Sales of Ditto Holdings, Inc. Securities

11. At the time that Ditto Holdings was formed in 2009, it issued shares of common stock to its founders, including Fox.

12. Beginning in February 2013, Fox discussed selling some of Fox's shares of Ditto Holdings common stock with Mandel. Fox discussed with Mandel whether any of his newsletter subscribers were interested in purchasing any of the shares. Fox provided Mandel with a stock purchase agreement, which included instructions for how to wire investment funds to Fox, and told Mandel that the stock purchase agreement was the only document interested purchasers would need to complete.

13. In March 2013, Mandel began sending emails to some of his roughly 350 newsletter subscribers praising Ditto Holdings and telling them about the opportunity to buy shares of Ditto Holdings stock. When individuals indicated an interest in buying shares of Ditto Holdings stock, Mandel provided them with a copy of the stock purchase agreement and told them to contact Fox if they needed more information.

14. From April 2013 to July 2013, approximately 28 of Mandel's subscribers purchased approximately 1.21 million shares of stock from Fox at a total cost of approximately $1.25 million. Fox did not sell shares to anyone who was not associated with Mandel.

15. During the same period, Fox paid Mandel at least $124,000 in three installments. The payments Fox made to Mandel corresponded to roughly 10% of the amount of Fox's sales.

16. Neither Fox nor anyone acting on his behalf took any steps to determine whether any of the individuals who purchased Fox's shares of Ditto Holdings stock were sophisticated investors. At least two of the purchasers had previously identified themselves to Ditto Holdings as non-accredited investors.

17. The investors did not have access to financial statements or other required information about Ditto Holdings in connection with Fox's sales of Ditto Holdings common stock.

18. No registration statement was filed in connection with any of Ditto Holdings' securities, and no exemption from registration was applicable to Fox's sales.

Violation

19. As a result of the conduct described above, Fox willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the direct or indirect offer and sale of securities through the mails or interstate commerce unless a registration statement has been filed or is in effect or an exemption from registration is available.[4]

IV.

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

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

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

2. Respondent shall pay disgorgement of $125,210, which represents profits gained as a result of the conduct described herein, prejudgment interest of $5,426, and a civil penalty of $75,000 to the Securities and Exchange Commission. Payment shall be made in the following installments:

(1) $10,000 within 14 days of entry of this Order;

(2) $10,000 within 104 days of entry of this Order;

(3) $10,000 within 194 days of entry of this Order; and

(4) $175,636 within 284 days of entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

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

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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)).

(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 Joseph Fox 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 Anne C. McKinley, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

IT IS FURTHER ORDERED, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party to the proceeding, that a public hearing for the purpose of taking evidence on the questions set forth in Section V hereof shall be convened at a time and place to be fixed by, 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.

If Respondent Fox fails to appear at a hearing after being duly notified, he 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), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondent Fox 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.

V.

Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, additional non-financial remedial sanctions against Respondent pursuant to Section 15(b)(6) of the Exchange Act are in the public interest. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws as described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the findings of this Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence or in-person testimony at a public hearing.

VI.

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).

VII.

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 Aguilar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9909 / September 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75858 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16796

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Marc S. Mandel ("Mandel" 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 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. **Marc S. Mandel**, age 63, is a resident of Boulder, Colorado. Since 1998, he has been the President and Chief Executive Officer of Wall Street Radio, Inc., through which he hosts a daily financial talk radio program and distributes a financial newsletter to paid subscribers.

Relevant Entity & Individual

2. **Ditto Holdings, Inc.** ("Ditto Holdings") is a Delaware corporation with offices in Los Angeles, California and Chicago, Illinois.[2] It is not registered with the Commission in any capacity. Ditto Holdings owns 100% of Ditto Trade, Inc. ("Ditto Trade"), an Illinois corporation with headquarters in Chicago, Illinois. According to its website, Ditto Trade is a "first-of-its-kind social brokerage firm." Ditto Trade has been registered with the Commission as a broker-dealer pursuant to Section 15 of the Exchange Act since July 2010.

3. **Joseph J. Fox** ("Fox"), also known as Yosef Yehuda Fox, age 49, is a resident of Los Angeles, California. He is the current Chief Executive Officer of Ditto Holdings and served as the Chief Executive Officer of Ditto Trade from its inception until December 2014. He was a registered representative with Ditto Trade from 2010 to December 2014.

Ditto Holdings, Inc.'s Securities Offerings

4. Ditto Holdings conducted a series of common and preferred stock offerings ending in September 2013.

5. Beginning in late 2012, Ditto Holdings sought help from Mandel to, among other things, introduce his newsletter subscribers to Ditto Trade's services and Ditto Holdings' securities offerings.

6. Mandel discussed Ditto Holdings' securities offerings with Fox and obtained special pricing and incentives for the investors that he brought to Ditto Holdings.

7. Mandel sent a number of emails to his roughly 350 newsletter subscribers describing Ditto Holdings as the "best opportunity of his lifetime" and suggesting that Ditto

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

[2] Ditto Holdings, Inc. was formed in December 2010 as a successor to FB Financial Group, Inc., an Illinois corporation that was formed in January 2009. Ditto Holdings changed its name to SoVesTech, Inc. in December 2014. For simplicity, we refer to all of these entities as Ditto Holdings throughout this Order.

Holdings planned to conduct an initial public offering during 2014 at a price that was nearly ten times higher than the price at which Ditto Holdings was then selling its shares. He also co-hosted a series of online webinars and in-person meetings for investors with Fox.

8. From late 2012 to September 2013, more than seventy of Mandel's subscribers purchased securities from Ditto Holdings at a total cost of approximately $3.7 million. Mandel took possession of some of the investors' funds before transferring them to Ditto Holdings.

9. Several of Mandel's subscribers who purchased securities from Ditto Holdings identified themselves to Ditto Holdings as non-accredited investors. The investors were not given financial statements or certain other required financial information about Ditto Holdings.

<u>Fox's Offering of Ditto Holdings, Inc.'s Securities</u>

10. Beginning in February 2013, Fox sought Mandel's help in selling some of Fox's personal shares of Ditto Holdings common stock. Fox told Mandel that he wanted to sell approximately one million shares of Ditto Holdings stock and asked Mandel to see if any of Mandel's newsletter subscribers were interested in purchasing shares. Fox provided Mandel with a stock purchase agreement, which included instructions for how to wire investment funds to Fox, and told him that the stock purchase agreement was the only document interested purchasers would need to complete.

11. In March 2013, Mandel began sending emails to some of his roughly 350 newsletter subscribers describing Ditto Holdings as an excellent investment opportunity, stating that Ditto Holdings planned to have an initial public offering at $10 per share during 2014, and telling them that he had "worked out a sweetheart deal" with Fox to gain access to one million shares at $1 per share. He also co-hosted a series of online webinars and in-person meetings with Fox for investors.

12. When individuals indicated an interest in purchasing shares of Ditto Holdings stock from Fox, Mandel provided them with a copy of the stock purchase agreement and put them in contact with Fox if they wanted more information.

13. From April 2013 to July 2013, approximately 28 of Mandel's subscribers purchased stock from Fox at a total cost of approximately $1.25 million.

14. During the same period, Fox paid Mandel at least $124,000 in three installments. Each of the payments was worth approximately 10% of the amount of money that Fox had received from his sales of Ditto Holdings stock as of the date of the payment.

15. Mandel took no steps to determine whether any of the individuals who purchased Fox's shares of Ditto Holdings stock were sophisticated investors. At least two of the purchasers had previously identified themselves to Ditto Holdings as non-accredited investors.

16. Mandel did not provide the purchasers with access to any financial statements or other required information about Ditto Holdings.

17. During 2012 and 2013, Mandel was not registered with the Commission in any capacity or associated with a registered broker or dealer.

18. No registration statement was filed in connection with any of Ditto Holdings' securities, and no exemption from registration was applicable to either Ditto's or Fox's sales through Mandel.

Violations

19. As a result of the conduct described above, Mandel willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the direct or indirect offer and sale of securities through the mails or interstate commerce unless a registration statement has been filed or is in effect or an exemption from registration is available.[3]

20. As a result of the conduct described above, Mandel willfully violated Section 15(a) of the Exchange Act, which prohibits the use of 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 security without being registered with the Commission pursuant to Section 15(b) of the Exchange Act or being associated with a registered broker or dealer.

Disgorgement and Civil Penalties

21. Respondent has submitted a sworn Statement of Financial Condition dated September 20, 2014 (updated March 18, 2015) and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest and a civil penalty.

Undertaking

22. In determining whether to accept the Respondent's Offer, the Commission has considered the following undertaking:

a. Respondent agrees to cooperate fully with the Commission with respect to this action and any judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party relating to the matters in this Order or other matters related to Ditto Holdings' securities or officers. Respondent's cooperation shall include, but is not limited to:

   i. Production of Information. At the Commission's request on reasonable notice and without a subpoena, Respondent shall truthfully and completely disclose information and documents requested by Commission staff in connection with the Commission's related

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

investigation, litigation or other proceedings. Respondent will have no obligation to provide information voluntarily that it is not able to provide without a subpoena.

ii. Statements and Testimony. At the Commission's request on reasonable notice and without a subpoena, Respondent shall attend and provide truthful statements or testimony at any meeting, interview, testimony, deposition, trial or other legal proceeding in connection with the Commission's related investigation, litigation or other proceedings.

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's Offer.

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

A. Respondent Mandel cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act and Section 15(a) of the Exchange Act;

B. Respondent Mandel be, and hereby is:

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

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

with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

D. Respondent shall pay disgorgement of $124,000 which represents profits gained as a result of the conduct described herein, and prejudgment interest of $5,374, but that payment of such amount except for $62,000 is waived and the Commission is not imposing a penalty against Respondent based upon Respondent's sworn representations in his Statement of Financial Condition dated September 20, 2014 (updated March 18, 2015) and other documents submitted to the Commission. The payment required by this Order shall be made to the Securities and Exchange Commission. Payment shall be made in the following installments:

(1) $1,033 no later than the 28th day of each month beginning in September 2015 and continuing through July 2020; and

(2) $1,053 no later than the 28th day of August 2020.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, 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 Marc Mandel 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 Anne C. McKinley, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; (2) seek an order directing payment of disgorgement and pre-judgment interest; and (3) 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 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 EXCHANGE ACT OF 1934
Release No. 75855 / September 8, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3687 / September 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16792

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

I.

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

MusclePharm Corporation ("MSLP") is a Denver-based sports nutrition company that develops, manufactures, and markets sports nutrition products. When MSLP became a public company in 2010, it was unprepared for the Commission's reporting requirements and lacked sufficient infrastructure to support its rapid growth. MSLP's revenues greatly increased each year (MSLP's reported revenue was $3M in 2010, $17M in 2011, $67M in 2012 and $111M in 2013). MSLP's senior management lacked public company or accounting experience. While the company focused on revenue growth, it failed to establish sufficient internal controls and keep proper books and records. From July 2012 through April 10, 2014, Prosser was a member of MSLP's board of directors and chair of the audit committee. Beginning in September 2012, Prosser, the board of directors and members of senior management had reason to know that MSLP had not disclosed certain perquisite compensation paid to its executive officers. Prosser, however, knew or should have known that he signed materially false and misleading filings with the Commission that failed to disclose all perquisites MSLP was required to disclose under the securities laws. By summer 2013, MSLP began an internal review to determine the amount of undisclosed perquisites paid by MSLP to its executives since 2010. In July 2013, Prosser became directly involved in MSLP's internal perquisite review. MSLP nevertheless continued to make filings with the Commission that materially understated perquisite compensation through July 2014.

Respondent

1. Donald W. Prosser, CPA, age 64, a resident of Denver, Colorado, was a member of the MSLP board of directors from July 2012 through April 10, 2014. As an independent member of the MSLP board of directors, Prosser served as chair of the audit committee, a member of the compensation committee, and a member of the nominating and governance committee. From April 10, 2014 through March 2, 2015, Prosser served as interim chief financial officer ("CFO") of MSLP. Prosser has been licensed as a certified public accountant ("CPA") in Colorado since 1977, except for the three year period from June 1, 1998 to June 26, 2001.

Relevant Entity

2. MSLP is a Nevada corporation, based in Denver, Colorado, that manufactures and markets sports nutrition products. From 2010 to present, MSLP's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and was quoted on the OTC Bulletin Board.

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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.

Prosser's Role in MSLP's Executive Compensation Disclosures

3. In September 2012, according to the MSLP board minutes, Prosser attended a meeting of the MSLP board of directors and compensation committee. During the meeting, the MSLP board of directors determined perquisites related to autos, golf club memberships, and private plane usage would be disclosed in Commission filings. MSLP, however, filed several Commission filings in the form of Forms 10-K and Forms S-1, as well as amendments thereto, through July 2014, which failed to include complete disclosure of the perquisites identified at the September 2012 board meeting and otherwise known by senior management. Prosser signed these filings as a director.

4. On January 4, 2013, Prosser attended a meeting of the MSLP Compensation Committee of the board of directors. During the meeting, it was resolved that the cost of the use of a private plane from non-employee relatives of MSLP officers in 2012 would be imputed to the executives. MSLP, however, filed several Commission filings in the form of Forms 10-K and Forms S-1, as well as amendments thereto, through March 2014, which failed to include perquisites related to officer spousal use of a private plane in 2012. Prosser signed these filings as a director.

5. By summer 2013, MSLP began an internal review of its records to determine the amount of undisclosed perquisites paid by MSLP to its executives since 2010. MSLP's CFO began this review and in July identified over $100,000 of undisclosed perquisites, including jet use, autos, and golf club memberships and informed Prosser of the amount of undisclosed perquisites located to date.

6. In July 2013, the audit committee, with Prosser as its chair, became directly involved in MSLP's perquisite review process. MSLP hired an outside consultant to perform a factual review of documents and information related to potential perquisites. MSLP, however, filed a Form S-1 in August 2013 with incorrect perquisite disclosures that were identical to amounts previously disclosed before the internal review. Prosser signed this filing as a director.

7. After the August Form S-1 was filed, Prosser assisted and supervised the independent consultant in connection with his review of perquisites. Prosser also approved the independent consultant's work plan and consulted with the independent consultant during the review.

8. In December 2013, MSLP stopped using the independent consultant. The board approved and MSLP hired an internal auditor and assigned the perquisite review to the internal auditor. Prosser assisted and supervised the work of the internal auditor and consulted with the internal auditor during the review.

9. On March 31, 2014, MSLP filed its Form 10-K for the year ended December 31, 2013. Prosser approved and signed this filing. The 2013 Form 10-K included a revised executive compensation table for the years 2011-2013. In the table, MSLP set forth previously undisclosed perquisites for 2011 and 2012 totaling approximately $189,000 ($73,000 for 2011 and $115,000

for 2012). The table also disclosed approximately $130,000 of perquisites in 2013. These disclosures, however, still significantly understated perquisites paid to MSLP executives.

10. On April 14, 2014, Prosser resigned from the MSLP board, including as a member of the audit committee as its chair, and became MSLP's interim CFO.

11. On July 23, 2014, MSLP filed a Definitive Proxy Statement, which included the same deficient perquisite disclosure as the 2013 Form 10-K.

12. MSLP and its audit committee reexamined its perquisite investigation results from spring 2014 through fall 2014. On October 31, 2014, MSLP filed amended Forms 10-K for the years ended 2012 and 2013. Prosser signed these filings as the Principal Financial Officer and Principal Accounting Officer. The 2013 Form 10-K/A disclosed approximately $252,000 of additional perquisites for the years 2011, 2012, and 2013 that were not included in the 2013 Form 10-K or MSLP's July 2014 proxy statement. The 2012 Form 10-K/A disclosed approximately $37,000 of additional perquisites for 2010. In total, MSLP failed to report perquisites totaling approximately $482,000 from 2010-2013.

13. Because MSLP did not properly identify and record perquisites paid to its executives, MSLP's books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets and its filings with the Commission were materially false and misleading.

Violations

14. As a result of the conduct described above, Prosser caused MSLP's violations of Section 14(a) of the Exchange Act and Rule 14a-9 thereunder, which prohibits solicitations by means of a proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing a statement which, at the time and in the light of the circumstances under which it was made, was false or misleading with respect to any material fact, or which omitted to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

15. As a result of the conduct described above, Prosser caused MSLP's violations of Section 13(a) of the Exchange Act Rules 13a-1 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

16. As a result of the conduct described above, Prosser caused MSLP's violations of 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 assets.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Prosser cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, and 14a-9 thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $30,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Donald W. Prosser 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 Thomas J. Krysa, Division of Enforcement, Securities and Exchange Commission, 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, 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. 9910 / September 9, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75864 / September 9, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4191 / September 9, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31810 / September 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16801

In the Matter of **BENNETT GROUP FINANCIAL SERVICES, LLC** **and** **DAWN J. BENNETT,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 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 Bennett Group Financial Services, LLC ("Bennett Group") and Dawn J. Bennett ("Bennett").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. From at least 2009 through February 2011, Bennett Group and its founder, majority owner, and Chief Executive Officer, Bennett, made material misstatements and omissions regarding assets that were purportedly "managed" for investors and regarding investment returns for the purpose of retaining existing customers and attracting new customers. Then, during the investigation of this matter, Bennett and Bennett Group made additional misstatements in an effort to obstruct the investigation and to "cover up" their prior fraud.

2. In short, Bennett and Bennett Group grossly overstated the amount of assets they "managed," by at least $1.5 billion, in a calculated effort to inflate their profile and prestige. They made the false and fraudulent claims to a national financial advisor ranking service knowing that the ranking service would publish the misstatements. They also made the misstatements on a Washington, D.C.–area radio program hosted by Bennett, and in a variety of other advertisements and communications with existing and prospective customers and clients. The purpose of these overstatements was to create the impression that Bennett and Bennett Group were larger and more successful players in the industry than they were.

3. Bennett and Bennett Group also made material misstatements and omissions during the radio show regarding Bennett Group's investment returns and performance. Bennett frequently touted her firm's highly profitable investment returns and claimed that those returns placed Bennett Group in the "top 1%" of firms worldwide. In violation of her legal disclosure duties and specific advice she received, Bennett failed to disclose that the purported "returns" were simply those of a "model portfolio" and did not reflect actual customer returns.

4. In addition to the material misstatements and omissions about these matters, Bennett and Bennett Group failed to adopt and to implement adequate written policies and procedures related to the calculation and advertisement of assets managed and of investment returns.

5. During the investigation of this matter, in order to substantiate their prior fraudulent claims regarding assets managed and to obstruct this investigation, Respondents made additional false statements. They falsely asserted that they gave advice regarding short-term cash management to three corporate clients regarding over $1.5 billion in corporate assets. In reality, they never provided the advice, and these were simply lies meant to deceive the Division of Enforcement. Bennett and Bennett Group never provided any form of management for assets in excess of approximately $407 million.

B. RESPONDENTS

6. Bennett Group is a Delaware limited liability company and financial services firm headquartered in Chevy Chase, Maryland. At the relevant time, most key Bennett Group employees were registered representatives associated with Western International Securities, Inc. ("Western Securities"), a broker-dealer registered with the Commission, and almost all of Bennett Group's revenue was generated through commissions earned by the registered representatives, who provided nondiscretionary services. In 2008, Bennett Group registered with the Commission as an investment adviser and withdrew that registration in October 2013. Bennett owns approximately ninety-five percent of Bennett Group and controls (and at all relevant times controlled) all aspects of Bennett Group's operations.

7. Bennett, age 53, lives in Chevy Chase, Maryland. She is, and at all relevant times was, the founder, Chief Executive Officer, and majority owner of Bennett Group. Bennett has been a registered representative affiliated with various registered broker-dealers since at least February 1987. Bennett holds, and at all relevant times held, Series 7, 63, and 65 securities licenses. Bennett was the subject of two arbitration proceedings in 2014 in which the complainants were awarded compensation as a result of churning, unauthorized trading, and unsuitability.

C. FACTS

(i) BENNETT AND HER FIRM MADE MATERIAL MISSTAMENTS AND OMISSIONS REGARDING ASSETS "MANAGED"

8. From at least 2009 through 2011, Bennett and Bennett Group falsely claimed to be managing assets totaling \$1.1 billion to over \$2 billion, including through a nationally circulated industry periodical that ranked financial advisors and through a variety of other advertisements and communications directed to existing and prospective customers and clients. In reality, the most Bennett and her firm could, in any sense, be said to be managing during the relevant period was approximately \$407 million.

9. Bennett and her firm misrepresented the amount of assets managed in order to inflate their stature and thereby attract new customers and clients to the firm by creating the impression that they were larger and more successful players than they in fact were. At the time Respondents made these misstatements, they had a fledgling investment advisory business that they hoped to bolster by attracting new advisory clients, lured by their claims of industry success and impressive investment returns.

10. After Bennett and Bennett Group made their false and fraudulent claims regarding assets managed, prospective customers and clients became customers and clients,

thereby generating compensation for Bennett and Bennett Group, including in the form of brokerage commissions generated through the purchase or sale of securities. Further, existing customers and clients bought or sold securities through Bennett and her firm after receiving the false and fraudulent communications, which generated compensation, including commissions, for Bennett and her firm.

11. From 2009 through 2011, Bennett and Bennett Group made three submissions to Barron's magazine for its rankings of independent financial advisors.

12. In these submissions to Barron's, Bennett and Bennett Group falsely claimed that they managed assets of between \$1.1 billion and \$1.8 billion. Barron's used these submissions when compiling and publishing various rankings of financial advisors. As a result of the submissions, Barron's: (a) ranked Bennett fifth in the category of "Top 100 Women Financial Advisors" in its June 9, 2009, issue (based on purported managed assets of \$1.1 billion); (b) ranked Bennett twenty-sixth in the category entitled "Top 100 Independent Financial Advisors" in its August 9, 2009, issue (based on purported managed assets of \$1.3 billion); and (c) ranked Bennett second in its listing of the "2011 Top Advisors" in Washington, D.C. (based on purported managed assets of \$1.8 billion).

13. Bennett and her firm made additional false statements to Barron's, which, in turn, were published by the magazine. In 2011, Bennett and her firm claimed that the typical size of a Bennett Group account was \$3 million. In reality, at the time, only 1% of Bennett Group customers and clients had account values of \$3 million or more. Bennett and her firm also falsely claimed in 2011 that the firm's minimum account size was \$2 million. In fact, at the time, 98% of customer and client accounts were under that threshold. As with the fraudulent claims about assets managed, the Respondents made these fraudulent statements to Barron's knowing that they would be reprinted and distributed to the public, including to current and prospective customers and clients, and that their publication would bolster Bennett and Bennett Group, thereby inducing existing customers and clients to remain and enticing prospective clients and customers to hire Bennett Group.

14. After publication in Barron's, Bennett and Bennett Group promoted their Barron's rankings and repeated the misrepresentations contained in the Barron's publications through e-mail, the firm's Web site, social media, article reprints, and other means to existing and prospective customers and clients.

15. For example, Bennett directed firm employees to send marketing e-mails to current and prospective customers and clients touting her ranking as "#4 [sic] on Barron's list of 'Top 100 Women Financial Advisors'" and claiming that she and the firm had "assets under management of \$1.5 billion."

16. On or about June 26, 2010, Bennett Group ordered 1,125 copies of the Barron's issue ranking Bennett as fifth in its "Top 100 Women Financial Advisors." Bennett Group then sent at least 125 copies of the Barron's article to existing and prospective customers and clients.

17. In at least 2010 and 2011, Bennett Group's Web site linked users to various articles written by Bennett in which she touted the Barron's rankings. In addition, Bennett and Bennett Group frequently referred to the Barron's rankings in e-mail messages and other communications with existing and prospective customers and clients.

18. On or about May 9, 2010, Bennett began hosting a weekly radio show called "Financial Myth Busting with Dawn Bennett" ("Financial Myth Busting") on a Washington, D.C.–area AM radio station. Bennett Group paid for the show, and Bennett hosted it and determined all of its content.

19. On "Financial Myth Busting," Bennett would tout Bennett Group and its services. And Bennett and the firm would promote the show to existing and prospective customers and clients, including by adding references to "our highly regarded weekly talk radio program-Financial Mythbusting" (or the like) to proposal packages prepared for prospective customers and clients and to e-mail messages sent by Bennett Group employees.

20. During at least 18 "Financial Myth Busting" radio programs aired from May 9, 2010, through January 30, 2011, Bennett falsely claimed that she and Bennett Group managed assets ranging from \$1.5 billion to over \$2 billion. Bennett and Bennett Group also fraudulently claimed that they managed "\$1.5 billion of client assets" on the "Facebook" information page they maintained for the "Financial Myth Busting" show.

21. Contrary to their claims regarding managed assets, Bennett and Bennett Group never provided any form of management for assets in excess of at most approximately \$407 million (which included approximately \$1.1 million in advisory assets, \$67 million in pension consulting assets, and \$338 million in brokerage assets).

22. Bennett's and Bennett Group's misstatements and omissions regarding assets managed were material. Among other things, investors use facts about assets managed to draw conclusions about a firm's size, skills, and abilities.

23. With respect to the above-referenced misstatements and omissions, Bennett and Bennett Group acted with scienter, in that, inter alia, they knew or were reckless in not knowing that the information that they were providing to existing and prospective customers and clients was wholly contrived and unsubstantiated.

(ii) DURING THE STAFF'S EXAMINATION AND INVESTIGATION, BENNETT AND BENNETT GROUP PROVIDED FALSE INFORMATION ABOUT ASSETS MANAGED, IN ORDER TO "SUBSTANTIATE" HER CLAIMS AND TO OBSTRUCT THE INVESTIGATION

24. When questioned during the examination and subsequent investigation about the basis for the claims of assets managed, Bennett and Bennett Group made a series of false statements, in an effort to substantiate the claims and to obstruct the staff's examination and investigation.

25. Among other things, Bennett and her firm asserted that the claims of approximately $2 billion of assets managed were defensible because she provided uncompensated short-term cash management advice to three corporate clients, "Company A," "Company B," and "Company C." Bennett even went so far as to identify individuals at the clients, with whom she had communicated about short-term cash management or otherwise would be knowledgeable about the subject. Further, she produced copies of "Project Request Forms" and other documents that purported to set forth information relating to the advice given to these clients. According to Bennett and Bennett Group, the aggregate assets of those Companies, brokerage assets, pension funds, and other advisory assets, substantiated the claims in Barron's, on the radio show, and in other communications.

26. Bennett's and Bennett Group's claims regarding short-term cash management advice for Company A, Company B, and Company C were entirely fictitious. Individuals at Companies A, B, and C (including, in certain instances, ones identified by Bennett) either did not know her or her firm, did not communicate with them regarding short-term cash management, were not at the respective company at the time, or were incapacitated or dead. Further, as to the "Project Request Forms" and other documents, when asked to produce for inspection the originals thereof, Bennett and Bennett Group were unable to do so, claiming that they were "lost" in an office move after the inception of the staff's investigation.

27. In any event, the supposed communications by Bennett with Company A, Company B, and Company C do not constitute the "management" of assets in any sense of the term. Informal and uncompensated conversations about what entities might want to do with assets (which are not held in any account serviced by the brokerage or advisory firm) cannot meaningfully be described as the management of those assets. At a minimum, if Bennett and Bennett Group wanted to "count" such assets among those promoted or advertised as managed by them, then they needed to fully disclose the nature of such "management," including that it merely consisted of informal advice regarding funds not held in any brokerage or investment advisory account serviced by Bennett Group and that Bennett and Bennett Group received no compensation for the service. No such disclosures were ever provided.

(a) Company A

28. Company A is a South Africa–based telecommunications firm.

29. From approximately March 1, 2006, through March 31, 2011, Bennett served as financial advisor to the investment committee overseeing the 401(k) retirement plan for Company A's employees in the United States. In this role, she communicated with Company A's human resources director in Virginia, occasionally attended meetings of the company's 401(k) committee, provided investment recommendations for the 401(k) plan, and monitored the performance of the selected mutual funds. The total amount of

employee assets in the 401(k) plan during her tenure as advisor was approximately $40 million.

30. During a 2011 examination, Bennett and Bennett Group said that they included within the assets managed figure approximately $706 million of Company A's cash assets, for which Bennett and Bennett Group supposedly provided short-term investment advice.

31. When Bennett first testified during the investigation in December 2013, she said that, during weekly telephone calls between 2005 and 2011, she gave advice to the Chief Financial Officer of Company A's U.S.-based business unit ("CFO"), about how to manage over $1 billion in Company A cash. However, CFO had left Company A in February 2006. Upon testifying a second time in January 2015, Bennett changed her story and said that she actually provided the advice to CFO's successor ("Successor"). This iteration of Bennett's story was also false and was undercut by Successor's testimony that he never received such advice from Bennett or anyone else at Bennett Group.

32. Bennett and Bennett Group also produced—between her first and second testimonies —copies of "Project Request Forms" and other documents that purportedly substantiated her claim to have given short-term cash management advice to Company A with respect to as much as $1.575 billion in cash. These documents had been called for by subpoena prior to the first testimony but were not produced until later. Bennett and Bennett Group failed to produce the originals of these documents because they purportedly were lost during a move of the Bennett Group's offices.

33. Bennett also produced an affidavit from Company A's former Chief Operating Officer ("COO"), in which he purported to have indirect knowledge of the short-term cash management advice that Bennett provided. According to the affidavit, COO received "regular briefings" from CFO and Successor about the advice. But, at subsequent testimony, COO retracted the pertinent parts of the affidavit. Given this testimony, it is unclear why COO made the initial averments, but it came to light during Bennett's second testimony that she and COO had a personal relationship.

34. Not only was it the case that no Company A representative would substantiate Bennett's claims, but Company A did not even have that much cash during the relevant period. Indeed, a high-ranking, South Africa–based Company A executive gave the staff a declaration stating that: company investment decisions were made by officials in South Africa (and not the United States); he had never communicated with Bennett or any other Bennett Group employee; he had never heard of Bennett or her firm before; and, in fact, since 2000, the company at no time had more than $650 million in cash assets.

35. In short, Bennett's claims of providing advice to Company A were fictitious, and it appears that Bennett attempted to mislead the Division of Enforcement and obstruct this investigation.

(b) Company B

36. Company B is a Virginia-based travel agency. Bennett and Bennett Group advised Company B's 401(k) plan from approximately 1988 until 2012, when she was terminated by Company B. The largest amount of employee assets in the plan during Bennett's tenure was approximately $35 million.

37. In addition to the $35 million, Bennett testified that she advised Company B on short-term investments of approximately $150 million. Bennett also claimed the first time she testified that her communications about this subject were limited to weekly conversations with Company B's founder and owner ("Company B Founder"). However, Company B Founder's widow ("Widow") said that Company B Founder died in 2011, had been incapacitated by illness since 2004, and was not involved in Company B's business after the onset of his illness. Widow (who herself was involved in Company B's business) also stated that she had never spoken to Bennett about short-term investments, that Bennett Group's only role vis-à-vis Company B was with respect to the 401(k) plan, and that from at least 2008 Company B had no assets available for short-term or other investment.

38. Upon being confronted with the fact that Company B Founder was either deceased or incapacitated at the time Bennett claimed to be speaking with him, Bennett changed her story. Bennett testified that the communications regarding short-term cash management had been with Widow and not her husband. As noted above, Widow does not support this new story either.

(c) Company C

39. Bennett provided financial advisory services to the investment committee of Company C from 2006 to October 27, 2009. Company C is a Virginia-based historical preservation group. From 2006 to 2009, Company C had endowment funds of approximately $100 million.

40. On October 27, 2009—the date Company C terminated her services—Company C directed Bennett to immediately transfer all funds she managed to Company C's bank account.

41. Despite this, Bennett and Bennett Group produced documents during this investigation to support the assertion that she continued to provide short-term cash management advice free of charge through April 2010. And, at her second testimony, Bennett claimed that the advice to Company C likely continued into 2010, which, as noted above, was after the time of her termination.

(iii) BENNETT AND BENNETT GROUP ALSO MADE MATERIAL MISREPRESENTATIONS AND OMISSIONS REGARDING THEIR INVESTMENT RETURNS

42. Bennett touted Bennett Group's investment returns and performance during her "Financial Myth Busting" radio program without disclosing that the returns were for a Bennett Group "model portfolio" and were not representative of actual investor performance. Bennett Group reported model returns and compared them to benchmarks such as the Standard & Poor's 500 index ("S&P 500"): 6.06% (vs. negative 37% for S&P 500) in 2008; 42.48% (vs. 26.47% for S&P 500) in 2009; and 31.06 % (vs. 15.06 % for S&P 500) in 2010.

43. During various "Financial Myth Busting" broadcasts occurring between May 2010 and February 2011, Bennett represented these returns as actual returns. She also claimed on numerous occasions that Bennett Group's returns ranked in the top 1% of investment advisers worldwide in investment performance. In reality, a significant portion of Bennett Group customer accounts were not invested in accordance with the model.

44. At no time during the radio shows did Bennett disclose that the returns she touted were model returns or the fact that actual client returns may differ. Indeed, Bennett Group had actually retained an accounting firm to assist with respect to the model portfolio, and the accounting firm had advised Bennett that such disclosures should be made when making representations regarding returns based on the model portfolio. Despite this—as well as her obligations under the federal securities laws—those disclosures were never made on the radio show.

45. Bennett's and Bennett Group's misstatements and omissions regarding investment returns were material. Investors use facts about investment returns to draw conclusions about a firm's skills and abilities. Further, Bennett and Bennett Group made the above-referenced misstatements and omissions with scienter, in that, inter alia, they knew or were reckless in not knowing that they were making material misstatements and omissions.

(iv) BENNETT GROUP LACKED ADEQUATE COMPLIANCE PROCEDURES AND FAILED TO IMPLEMENT THE PROCEDURES IT HAD

46. Bennett Group adopted a "Written Supervisory Policies and Procedures Manual" in June 2009, which was updated at least in June 2010. In adopting such written supervisory policies and procedures, BGFS used an "off-the-shelf" compliance manual that it did not tailor to BGFS's specific operations and needs, including for calculation and review of managed assets and appropriate review of advertising and promotional content such as the "Financial Myth Busting" radio show. As a result, BGFS did not adopt a full set of compliance policies and procedures that were customized for its advisory business and reasonably designed to prevent violations by BGFS of the Advisers Act and the rules thereunder.

47. Further, even the inadequate policies and procedures were not implemented. For instance, Bennett made the decisions for the firm—including determination of assets managed and how investment returns would be described on the radio show—with effectively no supervision from anyone at Bennett Group. The manual also specifically detailed the appropriate disclosures for discussions of model performance returns, including disclosures of costs, risks, strategies, and variations from actual client performance, and prohibited advertising that contained any untrue or misleading statements. These provisions, too, were not implemented.

48. Bennett was essentially able to operate Bennett Group unchecked, and her firm's policies and procedures otherwise were not implemented with respect to her claims about assets managed and investment returns. She exploited that circumstance to make outlandish claims to bolster her reputation and that of her firm, so that existing customers and clients would be kept and new ones could be obtained. Once caught, she dissembled further, citing nonexistent conversations with a departed CFO and an incapacitated former executive, regarding entirely fictitious assets.

D. TOLLING OF ANY APPLICABLE LIMITATION PERIODS

49. Bennett and Bennett Group, respectively, signed tolling agreements that tolled any applicable statute of limitations for the period from July 31, 2014, through October 1, 2014, and signed additional tolling agreements that further tolled any applicable statute of limitations for the period from October 1, 2014, through January 2, 2015.

E. VIOLATIONS

50. As a result of the conduct described above, Bennett and Bennett Group 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.

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

52. As a result of the conduct described above, Bennett Group willfully violated, and Bennett willfully aided and abetted and caused the violations of, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which make it unlawful for an investment adviser to, directly or indirectly, publish, circulate, or distribute any advertisement, which contains any untrue statement of a material fact or which is otherwise false or misleading.

53. As a result of the conduct described above, Bennett Group willfully violated, and Bennett willfully aided and abetted and caused the violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require an investment

adviser to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules promulgated thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents Bennett and Bennett Group pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent Bennett Group pursuant to Section 203(e) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondent Bennett pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

E. What, if any, remedial action is appropriate in the public interest against Respondents Bennett and Bennett Group pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

F. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder, whether Respondents should be ordered to pay civil penalties pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, and Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, and Section 203 of the Advisers Act.

IV.

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

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

If any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, Respondent may be deemed in default and the proceedings may be determined against it or her 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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75867)

ISE Mercury, LLC; Order Granting Application for a Conditional Exemption Pursuant to Section 36(a) of the Exchange Act from Certain Requirements of Rules 6a-1 and 6a-2 under the Exchange Act

September 9, 2015

I. Introduction

On September 29, 2014, ISE Mercury, LLC ("Applicant") submitted to the Securities and Exchange Commission ("Commission") an application on Form 1 under the Securities Exchange Act of 1934 ("Exchange Act") to register as a national securities exchange. In connection with this application, the Applicant, pursuant to Exchange Act Rule 0-12,[1] has requested an exemption under Section 36(a)(1) of the Exchange Act[2] from certain requirements of Exchange Act Rules 6a-1(a) and 6a-2 ("Exemption Request").[3] This order grants the Applicant's request for exemptive relief, subject to the satisfaction of certain conditions, which are outlined below.

II. Application for Conditional Exemption from Certain Requirements of Exchange Act Rules 6a-1 and 6a-2

A. Filing Requirements under Exchange Act Rule 6a-1(a)

Exchange Act Rule 6a-1(a) requires an applicant for registration as a national securities exchange to file an application with the Commission on Form 1. Exhibit C to Form 1 requires the applicant to provide certain information with respect to each of its subsidiaries and affiliates.[4]

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1 17 CFR 240.0-12.

2 15 U.S.C. 78mm(a)(1).

3 17 CFR 240.6a-1(a) and 6a-2. See letter from Michael Simon, Secretary and General Counsel, ISE Mercury, LLC, to Brent J. Fields, Secretary, Commission, dated June 26, 2015.

4 Specifically, Exhibit C requires the applicant to provide, for each subsidiary or affiliate, and for any entity with whom the applicant has a contractual or other agreement relating

For purposes of Form 1, an "affiliate" is "[a]ny person that, directly or indirectly, controls, is under common control with, or is controlled by, the national securities exchange . . . including any employees."[5] Form 1 defines "control" as "[t]he power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise . . . ."[6] Form 1 provides, further, that any person that directly or indirectly has the right to vote 25% or more of a class of voting securities, or has the power to sell or direct the sale of 25% or more of a class of voting securities, is presumed to control the entity.[7]

Exhibit D to Form 1 requires an applicant for registration as a national securities exchange to provide unconsolidated financial statements for the latest fiscal year for each subsidiary or affiliate. Exhibit D requires the financial statements to include, at a minimum, a balance sheet and an income statement with such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading. Exhibit D provides, in addition, that if any affiliate or subsidiary of the applicant is required by another Commission rule to submit

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to the operation of an electronic trading system used to effect transactions on the exchange: (1) the name and address of the organization; (2) the form of organization; (3) the name of the state and statute citation under which it is organized, and the date of its incorporation in its present form; (4) a brief description of the nature and extent of the affiliation; (5) a brief description of the organization's business or functions; (6) a copy of the organization's constitution; (7) a copy of the organization's articles of incorporation or association, including all amendments; (8) a copy of the organization's by-laws or corresponding rules or instruments; (9) the name and title of the organization's present officers, governors, members of all standing committees, or persons performing similar functions; and (10) an indication of whether the business or organization ceased to be associated with the applicant during the previous year, and a brief statement of the reasons for termination of the association.

5 Form 1 Instructions, Explanation of Terms, 17 CFR 249.1.

6 Id.

7 Id.

annual financial statements, a statement to that effect, with a citation to the other Commission rule, may be provided in lieu of the financial statements required in Exhibit D.

A Form 1 application is not considered filed until all necessary information, including financial statements and other required documents, have been furnished in the proper form.[8]

B. Filing Requirements under Exchange Act Rule 6a-2

Exchange Act Rule 6a-2(a)(2) requires a national securities exchange to update the information provided in Exhibit C within 10 days of any action that causes the information provided in Exhibit C to become inaccurate or incomplete. In addition, Exchange Act Rule 6a-2(b)(1) requires a national securities exchange to file Exhibit D on or before June 30 of each year, and Exchange Act Rule 6a-2(c) requires a national securities exchange to file Exhibit C every three years.

C. Exemption Request

On June 26, 2015, the Applicant requested that the Commission grant an exemption under Section 36 of the Exchange Act from the requirement under Exchange Act Rule 6a-1 to file the information requested of the Applicant in Exhibits C and D to Form 1 for the "Foreign Indirect Affiliates," as defined below.[9] In addition, the Applicant requested an exemption, subject to certain conditions, with respect to the Foreign Indirect Affiliates from the requirements under: (1) Exchange Act Rule 6a-2(a)(2) to amend Exhibit C within 10 days if the information

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8 17 CFR 202.3(b)(2). See also 17 CFR 240.0-3(a). Defective Form 1 applications "may be returned with a request for correction or held until corrected before being accepted as a filing." See 17 CFR 202.3(b)(2). See also Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70881 (December 22, 1998) ("Regulation ATS Adopting Release") at note 329 and accompanying text.

9 See Exemption Request, supra note 3.

in Exhibit C becomes inaccurate or incomplete; and (2) Exchange Act Rules 6a-2(b)(1) and (c) to file periodic updates to Exhibits C and D.

The Applicant is a wholly-owned subsidiary of International Securities Exchange Holdings, Inc. ("ISE Holdings").[10] ISE Holdings is a wholly-owned subsidiary of U.S. Exchange Holdings, Inc., which is 15% owned by Deutsche Börse AG ("Deutsche Börse") and 85% owned by a German stock corporation, Eurex Frankfurt AG ("Eurex Frankfurt"). Eurex Frankfurt is wholly-owned by Deutsche Börse. According to the Applicant, the parent ownership structure of U.S. Exchange Holdings, Inc. is comprised entirely of foreign entities, Eurex Frankfurt and Deutsche Börse (collectively, the "Foreign Direct Affiliates"), which in turn hold ownership interests, either directly or indirectly, in excess of 25% in a large number of other foreign entities, some of which also own interests in other entities in excess of 25% as well (such Foreign Direct Affiliate-owned entities are referred to, collectively, as the "Foreign Indirect Affiliates").[11]

Because of the limited and indirect nature of its connection to the Foreign Indirect Affiliates, the Applicant believes that the corporate and financial information of the Foreign Indirect Affiliates required by Exhibits C and D of Form 1 would have little relevance to the Commission's review of the Applicant's Form 1 application or, if the Commission were to approve the Applicant's Form 1 application, as amended, to the Commission's ongoing oversight of the Applicant as a national securities exchange.[12] In this regard, the Exemption Request states that the Foreign Indirect Affiliates have no ability to influence the management, policies, or

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10 See Exemption Request, supra note 3, at 2.

11 See id.

12 See id. at 2-3.

finances of the Applicant and no obligation to provide funding to, or ability to materially affect the funding of, the Applicant.[13] The Exemption Request also states that: (1) the Foreign Indirect Affiliates have no ownership interest in the Applicant or in any of the controlling shareholders of the Applicant; and (2) there are no commercial dealings between the Applicant and the Foreign Indirect Affiliates.[14] Further, the Exemption Request states that obtaining detailed corporate and financial information with respect to the Foreign Indirect Affiliates (1) is unnecessary for the protection of investors and the public interest and (2) would be unduly burdensome and inefficient because these affiliates are located in foreign jurisdictions and the disclosure of such information could implicate foreign information sharing restrictions in such jurisdictions.[15]

As a condition to the granting of exemptive relief, the Applicant has agreed to provide: (i) a listing of the names of the Foreign Indirect Affiliates; (ii) an organizational chart setting forth the affiliation of the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant; and (iii) in Exhibit C of the Applicant's Form 1 application, a description of the nature of the Foreign Indirect Affiliates' affiliation with the Foreign Direct Affiliates and the Applicant. In addition, as a condition to the granting of exemptive relief from the requirements of Exchange Act Rule 6a-2(a)(2), 6a-2(b)(1), and 6a-2(c), as described above, the Applicant has agreed to provide amendments to the information required under conditions (i) through (iii)

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13 See Exemption Request, supra note 3, at 3.

14 See id. The Applicant states that "commercial dealings" means any direct or indirect arrangement, agreement, or understanding or any other relationship including, but not limited to, the providing of hardware, software, technology services or any other goods or services that support the operation of ISE Mercury or any facility of ISE Mercury. See id., supra note 3, at 3 n. 5.

15 See id. The Applicant also believes that providing the information required by Exhibits C and D with respect to the Foreign Indirect Affiliates could raise confidentiality concerns because many of the Foreign Indirect Affiliates are not public companies. Id.

above on or before June 30th of each year. Further, the Applicant notes that it will provide the information required by Exhibits C and D for all of its affiliates other than the Foreign Indirect Affiliates, including the Foreign Direct Affiliates.[16]

III. Order Granting Conditional Section 36 Exemption

Section 6 of the Exchange Act[17] sets forth a procedure for an exchange to register as a national securities exchange.[18] Exchange Act Rule 6a-1(a)[19] requires an application for registration as a national securities exchange to be filed on Form 1 in accordance with the instructions in Form 1. A Form 1 application is not considered filed until all necessary information, including financial statements and other required documents, has been furnished in the proper form.[20] Exchange Act Rule 6a-2 establishes ongoing requirements to file certain amendments to Form 1.

Section 36(a)(1) of the Exchange Act provides that "the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of [the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of

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16 See Exemption Request, supra note 3, at 3.

17 15 U.S.C. 78f.

18 Specifically, Section 6(a) of the Exchange Act states that "[a]n exchange may be registered as a national securities exchange . . . by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors." Section 6 of the Exchange Act also sets forth various requirements to which a national securities exchange is subject.

19 17 CFR 240.6a-1(a).

20 17 CFR 202.3(b)(2). See also supra note 8.

investors."[21] For the reasons discussed below, the Commission believes that it is appropriate in the public interest and consistent with the protection of investors to exempt the Applicant from the requirement under Exchange Act Rule 6a-1 to provide the information required in Exhibits C and D to Form 1 with respect to the Foreign Indirect Affiliates, subject to the following conditions:

(1) the Applicant must provide a list of the names of the Foreign Indirect Affiliates;

(2) the Applicant must provide an organizational chart setting forth the affiliation of the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant; and

(3) as part of Exhibit C to the Applicant's Form 1 Application, the Applicant must provide a description of the nature of the affiliation between the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant.

The Commission believes, further, that it is appropriate in the public interest and consistent with the protection of investors to exempt the Applicant, with respect to the Foreign Indirect Affiliates, from the requirements under: (a) Exchange Act Rule 6a-2(a)(2) to amend Exhibit C within 10 days of any action that renders the information in Exhibit C inaccurate or incomplete; (b) Exchange Act Rules 6a-2(c) to provide periodic updates of Exhibit C; and (c) Exchange Act Rules 6a-2(b)(1) to provide periodic updates of Exhibit D, subject to the condition that the Applicant provide amendments to the information required under conditions (1) through (3) above on or before June 30th of each year.

As part of an application for exchange registration, the information included in Exhibits C and D is designed to help the Commission make the determinations required under Sections

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21 15 U.S.C. 78mm(a)(1).

6(b) and 19(a) of the Exchange Act[22] with respect to the application. The updated Exhibit C and D information required under Exchange Act Rule 6a-2 is designed to help the Commission exercise its oversight responsibilities with respect to national securities exchanges. Specifically, Exhibit D is designed to provide the Commission with information concerning the financial status of an exchange and its affiliates and subsidiaries,[23] and Exhibit C is designed to provide the Commission with the names and organizational documents of these affiliates and subsidiaries.[24] Such information is designed to help the Commission determine whether an applicant for exchange registration would have, and a national securities exchange continues to have, the ability to carry out its obligations under the Exchange Act.

Since the most recent amendments to Form 1 in 1998,[25] many national securities exchanges that previously were member-owned organizations with few affiliated entities have demutualized. Some of these demutualized exchanges have consolidated under holding companies with numerous affiliates that, in some cases, have only a limited and indirect connection to the national securities exchange, with no ability to influence the management or policies of the registered exchange, and no obligation to fund, or to materially affect the funding of, the registered exchange. The Commission believes that, for these affiliated entities, the information required under Exhibits C and D would have limited relevance to the Commission's review of an application for exchange registration or to its oversight of a registered exchange.

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22 15 U.S.C. 78f(b) and 78s(a).

23 See Securities Exchange Act Release No. 18843 (June 25, 1982), 47 FR 29259 (July 6, 1982) (proposing amendments to Form 1); see also Form 1, 17 CFR 249.1, and supra Section II.A.

24 Form 1, 17 CFR 249.1. See also supra note 4.

25 See Regulation ATS Adopting Release, supra note 8, at Section IV.C.

Based on the Applicant's representations, the indirect nature of the relationship between the Applicant and the Foreign Indirect Affiliates, and the information that the Applicant will provide with respect to the Foreign Direct Affiliates and the Foreign Indirect Affiliates, the Commission believes that it will have sufficient information to review the Applicant's Form 1 application and to make the determinations required under Sections 6(b) and 19(a) of the Exchange Act with respect to its application for registration as a national securities exchange.[26] The Commission believes, further, that if the Commission were to approve the Applicant's Form 1 application, it will have the information necessary to oversee the Applicant's activities as a national securities exchange. In particular, the Commission notes that the Applicant has represented that it would have no direct connection to the Foreign Indirect Affiliates, that the Foreign Indirect Affiliates would have no ability to influence the management or policies of the Applicant, and that the Foreign Indirect Affiliates would have no obligation to fund, or ability to materially affect the funding of, the Applicant. In addition, the Commission notes that the Applicant has represented that: (1) the Foreign Indirect Affiliates have no ownership interest in the Applicant or in any of the controlling equity holders of the Applicant; and (2) there are no commercial dealings between the Applicant and the Foreign Indirect Affiliates.[27]

Given the limited and indirect relationship between the Applicant and the Foreign Indirect Affiliates, as described above, the Commission believes that the detailed corporate and financial information required in Exhibits C and D with respect to the Foreign Indirect Affiliates

[26] 15 U.S.C. 78f(b) and 78s(a). Section 6(b) of the Exchange Act enumerates certain determinations that the Commission must make with respect to an exchange before granting the registration of the exchange as a national securities exchange. The Commission will not grant an exchange registration as a national securities exchange unless the Commission determines that the exchange meets these requirements. See Regulation ATS Adopting Release, supra note 8, at Section IV.B.

[27] See Exemption Request, supra note 3, at 3; supra note 15.

is unnecessary for the Commission's review of the Applicant's Form 1 application and would be unnecessary for the Commission's oversight of the Applicant as a registered national securities exchange following any Commission approval of its Form 1 application.

For the reasons discussed above, the Commission finds that the conditional exemptive relief requested by the Applicant is appropriate in the public interest and is consistent with the protection of investors.

The Commission may modify by order the terms, scope or conditions of this exemption if it determines that such modification is necessary or appropriate in the public interest, or is consistent with the protection of investors. Furthermore, the Commission may limit, suspend, or revoke this exemption if it finds that the Applicant has failed to comply with, or is unable to comply with, any of the conditions set forth in this order, if such action is necessary or appropriate in the public interest, or is consistent with the protection of investors.

IT IS ORDERED, pursuant to Section 36 of the Exchange Act,[28] that the Applicant is exempt from the requirements to: (1) include in its Form 1 application the information required in Exhibits C and D to Form 1 with respect to the Foreign Indirect Affiliates; and (2) with respect to the Foreign Indirect Affiliates, update the information in Exhibits C and D to Form 1 as required by Exchange Act Rules 6a-2(a)(2), 6a-2(b)(1), and 6a-2(c) subject to the following conditions:

(i) the Applicant must provide a list of the names of the Foreign Indirect Affiliates;

(ii) the Applicant must provide an organizational chart setting forth the affiliation of the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant; and

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28 15 U.S.C. 78mm.

(iii) as part of Exhibit C to the Applicant's Form 1 Application, the Applicant must provide a description of the nature of the affiliation between the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant.

In addition, the Applicant must provide amendments to the information required under conditions (i) through (iii) above on or before June 30th of each year.

By the Commission.

Robert W. Errett
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75859 / September 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3689 / September 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16797

In the Matter of	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER
Sean C. Henaghan, CPA, John E. Rainis, CPA, Leland E. Graul, CPA, James J. Gerace, CPA, and Wendy M. Hambleton, CPA,	
Respondents.	

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 Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice[2] against Sean C. Henaghan, CPA ("Henaghan"), John E.

[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 . . . (2) . . . to have engaged in unethical or improper professional conduct.

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

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . .

* * *

Rainis, CPA ("Rainis"), Leland E. Graul, CPA ("Graul"), and James J. Gerace, CPA ("Gerace"), and pursuant to Section 21C of the Exchange Act against Wendy M. Hambleton, CPA ("Hambleton") (Henaghan, Rainis, Graul, Gerace, and Hambleton are referred to collectively as "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which is admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "Order"), as set forth below.

III.

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

A. SUMMARY

1. This matter involves improper professional conduct in BDO USA, LLP's ("BDO")[4] audits of General Employment Enterprises, Inc. ("GEE" or the "Company"), a staffing services

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> (ii) to have engaged in unethical or improper professional conduct.
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> * * *
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> (iv) with respect to persons licensed to practice as accountants, "improper professional conduct" under Rule 102(e)(1)(ii) means:
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> * * *
>
> (B) either of the following two types of negligent conduct:
>
> > (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
> >
> > (2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

[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.

company whose stock trades on the NYSE MKT. During BDO's 2009 audit of GEE's financial statements for its fiscal year ended September 30, 2009, Respondents learned that $2.3 million (comprising approximately half of GEE's assets and substantially all of its cash) was unaccounted for when GEE's chief financial officer (the "GEE CFO") advised BDO, in November 2009, that (a) GEE's purported 90-day non-renewable certificate of deposit ("CD") at a New York bank had not been repaid by the bank after the stated maturity date in mid-October, (b) GEE was missing documentation supporting the CD, and (c) a bank employee had told GEE's CFO that the bank had no record of a CD. Thereafter, BDO received multiple conflicting stories from GEE management and board members concerning both the status of the CD and a series of transfers totaling $2.3 million made to GEE by three entities unaffiliated with the bank, one of which BDO had been told was owned by GEE's Chairman and majority shareholder. After BDO raised questions about these deposits, GEE's chief executive officer claimed the deposits were the proceeds of an agreement to assign the CD to a purported unrelated party.

2. Henaghan, BDO's engagement partner, and Rainis, BDO's concurring partner, consulted with senior BDO partners, including Gerace, the assigned BDO regional technical director, Graul, BDO's national director of accounting and risk management partner, and Hambleton, BDO's national SEC practice director. The consultation resulted in BDO issuing a five-page letter, dated December 21, 2009, in which BDO advised GEE of its belief that BDO had not been provided sufficient audit evidence to formally conclude on the matter and demanded that GEE's audit committee commission a full investigation of the matter by an independent firm. BDO received conflicting information from various sources as to the existence of the CD and never received rational explanations as to why the $2.3 million went missing and why an equivalent amount was later received under suspect circumstances. Only days later, however, after GEE's chief executive officer resigned, Respondents agreed to withdraw BDO's demand for an independent investigation and BDO issued an audit report containing an unqualified opinion on GEE's financial statements. Those financial statements, included in GEE's Form 10-K filed on January 8, 2010, represented that GEE had a $2.3 million cash equivalent in the form of CD as of September 30, 2009, and had entered into an assignment agreement to sell the CD for full face value to an unrelated party.

3. Approximately two months after GEE filed its 2009 Form 10-K with BDO's unqualified audit opinion, Respondents learned of a criminal complaint against the New York bank president. The criminal complaint alleged, in connection with a wide-ranging conspiracy involving, among others, GEE's then-chief executive officer and GEE's then-majority shareholder and chairman of the board, that (i) GEE's purported $2.3 million CD never existed, (ii) the bank president signed a false confirmation to BDO, (iii) GEE's $2.3 million was used to attempt to conceal a loan default connected to the broader conspiracy, and (iv) the entities that transferred the $2.3 million back to GEE were related to the bank president's co-conspirators, including GEE's then-majority shareholder and chairman of the board. The bank president pled guilty in October

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[4] BDO, formerly known as BDO Seidman, LLP, is a Delaware limited liability partnership and a PCAOB-registered public accounting firm with its headquarters in Chicago, Illinois. BDO served as GEE's independent auditor from 2004 through 2012.

2010. Despite this additional new information, Respondents failed to either perform or confirm that others performed appropriate audit procedures to determine whether this new information had any impact on GEE's 2009 financial statements or BDO's audit report thereon. In addition, BDO failed to adequately consider this information during its subsequent audit when it provided an audit report containing an unqualified opinion on GEE's financial statements included in the Company's 2010 Form 10-K.

4. Specifically, among other audit failures during the 2009 and 2010 audits of GEE, BDO: (1) failed to adequately plan, design, and perform audit procedures necessary to determine the existence of a disputed asset and the existence of related party transactions; (2) failed to obtain sufficient competent evidential matter; (3) failed to exercise professional skepticism and due professional care; (4) ignored red flags of fraud, potential illegal acts by GEE's agents, and unidentified related party transactions; (5) placed improper reliance on management representations from individuals they did not trust; and (6) failed to appropriately consider the discovery of new facts.

5. BDO issued audit reports containing unqualified opinions on the financial statements in GEE's 2009 and 2010 Form 10-Ks, which incorrectly stated that GEE had a cash equivalent of \$2.3 million as of September 30, 2009, and did not disclose that the \$2.3 million was returned by entities related to GEE's chairman of the board. BDO's reports, which Respondents knew would be filed with GEE's Form 10-Ks, inaccurately stated that the audits had been conducted in accordance with standards adopted by the Public Company Accounting Oversight Board ("PCAOB") and that GEE's financial statements presented fairly, in all material respects, the company's position and results at September 30, 2009, in conformity with generally accepted accounting principles in the United States of America ("GAAP").

B. RESPONDENTS

6. **Henaghan**, age 42, is a Certified Public Accountant ("CPA") licensed to practice in Illinois and was licensed in Florida from 2010 through 2012. Henaghan served as the BDO engagement partner on the 2009 and 2010 audits of GEE and had final responsibility for the audits.

7. **Rainis**, age 57, is a CPA licensed to practice in Illinois. Rainis served as the BDO concurring reviewer on the 2009 and 2010 audits of GEE.

8. **Graul**, age 66, is a CPA licensed to practice in Illinois. Prior to his retirement, Graul served as BDO's national director of accounting and risk management partner when he was consulted during the 2009 and 2010 audits of GEE.

9. **Gerace**, age 54, is a CPA licensed to practice in Illinois. Gerace served as the regional technical director of BDO when he was consulted during the 2009 and 2010 audits of GEE.

10. **Hambleton**, age 53, is a CPA licensed to practice in Illinois. Hambleton served as BDO's national SEC practice director when she was consulted during the 2009 and 2010 audits of GEE.

C. ISSUER AND OTHER RELEVANT ENTITIES AND INDIVIDUALS

11. **GEE** is an Illinois corporation headquartered in Oakbrook Terrace, Illinois that provides professional placement services and temporary staffing services in certain industries. GEE's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NYSE MKT stock exchange. GEE files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

12. **River Falls Financial Services, LLC** ("River Falls Financial"), **River Falls Investments, LLC f/k/a Oxygen Unlimited II, LLC** ("River Falls Investments"), **River Falls Holdings, LLC** ("RFH"), **Accredited Investor Resources, LLC f/k/a Oxygen Investment Partners, LLC** ("AIR"), **Oxygen Unlimited, LLC** ("Oxygen"), **O2HR, LLC** ("O2HR"), **SDH Realty, LLC** ("SDH"), **WTS Acquisition LLC** ("WTS"), **H2H Holdings, LLC** ("H2H"), and **PSQ, LLC** ("PSQ") (collectively, the "Affiliated Entities") are purported holding, investment, employment-related, and insurance companies. During at least 2009 and 2010, **Wilbur Anthony Huff** ("Huff")[5] exercised substantial financial and management control over numerous entities, including, among others, the Affiliated Entities and their holdings. Huff installed other business partners to perform day-to-day operational functions and/or serve as the listed owners, directors, or managers. As a convicted felon, Huff faced legal and practical barriers to operating business entities in his own name, particularly business in regulated industries, including employment-related, insurance, and banking companies.

13. **Park Avenue Bank** ("PAB" or "the Bank") was a New York State chartered bank until it was closed by the New York State Banking Department on March 12, 2010, and the Federal Deposit Insurance Corporation was named Receiver. The Affiliated Entities primarily conducted their banking business through PAB. **Charles J. Antonucci, Sr.** ("Antonucci") served

[5] Huff pled guilty to federal mail fraud charges for obtaining insurance premium finance loans under false pretenses in the Western District of Kentucky in 2003. In 2008, the Commission filed charges against Huff related to a scheme to misappropriate assets from and to record fake letters of credit at Certified Services, Inc. ("Certified"). *SEC v. Huff*, 08-CV-60315 (S.D. Fla.). On October 22, 2010, the Court entered judgment for the Commission against Huff requiring him to pay more than $13 million, among other relief. Separately, after an October 2012 indictment against him, Huff pled guilty on December 23, 2014 to an information, which alleged, among other things, that: (1) Huff controlled GEE, in whole or in part, by installing other individuals; (2) Huff participated with Antonucci in a conspiracy in which they stole $2.3 million from GEE and Huff later returned the $2.3 million to GEE from three companies he controlled; and (3) a large portion of the $2.3 million received by GEE were funds entrusted to Oxygen by its clients for payment of the clients' employment tax and other obligations. *U.S. v. Huff*, 12-CR-750 (S.D.N.Y.).

as the president and CEO of PAB from June 2004 until October 2009. In October 2010, Antonucci pled guilty to multiple criminal charges, including securities fraud, bank bribery, embezzlement, and providing a false confirmation to BDO of GEE's purported CD at PAB. Separately, **Park Avenue Insurance** was a private insurance company owned by Antonucci that was not affiliated with PAB.

14. **Stephen B. Pence** ("Pence") served as the chairman of the board of GEE from July 1, 2009, through November 17, 2010. Although Pence purported to be the sole member and owner of PSQ, whose sole asset was the GEE shares representing a controlling stake in the Company as of July 1, 2009, PSQ was one of the Affiliated Entities over which Huff exercised substantial financial and management control. PSQ's acquisition of GEE stake was funded by AIR and Oxygen. Pence also represented to BDO that he was the 100% owner of River Falls Financial, another of the Affiliated Entities. Huff directed substantial monthly payments to Pence ($25,000) from several of the Affiliated Entities to ensure his control over, and ability to influence, GEE's operations. Pence formerly served as the lieutenant governor of Kentucky from 2003 to 2007 and the United States Attorney for the Western District of Kentucky from 2001 to 2003.

15. **Ronald E. Heineman** ("Heineman") was appointed as the chief executive officer ("CEO") of GEE on July 1, 2009, in connection with PSQ's acquisition of a controlling stake in GEE. Heineman served as CEO until his resignation on December 23, 2009, in connection with the events described herein. Huff directed substantial monthly payments to Heineman ($15,000) from the Affiliated Entities during this time period.

16. **Salvatore J. Zizza** ("Zizza") served as the CEO of GEE from December 23, 2009, through December 2012. Prior to his appointment as CEO, Zizza received monthly payments of $20,000 from PSQ, which were funded by several of the Affiliated Entities, for purported consulting services, and Zizza frequently attended GEE board meetings as an "invited guest." In 2009, businesses owned or operated by Zizza received loans in excess of $1 million that Huff directed from certain of the Affiliated Entities.

17. **Associate-1** was another of Huff's business partners and was listed or served at various times as a manager of River Falls Investments, Oxygen, and O2HR, and as co-manager of River Falls Financial with Heineman. Associate-1 was also involved in PSQ's acquisition of a controlling stake in GEE and attended several GEE board meetings in 2009. In addition, from July 2009 until September 2009, Associate-1 was a signatory on GEE's bank account at PAB despite the fact that Associate-1 was not an official employee, officer, or director of the Company. Associate-1 also purported to be the owner of WTS (another of the Affiliated Entities), a holding company of **On-Site Services, Inc.** ("On-Site") and **Ameritemps, Inc.** ("Ameritemps"), which WTS had acquired in January 2009 with funding from other Affiliated Entities. Almost immediately after PSQ's acquisition of a controlling stake in GEE, Heineman began presenting proposals to GEE's board for GEE to acquire these companies. For example, at an August 10, 2009, GEE board meeting, attended by Pence and Zizza, the board authorized Heineman to enter into a letter of intent with WTS to acquire On-Site, and Heineman reported that he would present another acquisition candidate, Ameritemps, at the September board meeting.

D. BACKGROUND

18. GEE's May 18, 2009, definitive proxy statement disclosed that, in January 2009, GEE began discussions with representatives of River Falls Financial, including Heineman and Pence, concerning the possibility of a tender offer and direct cash investment in GEE. As Henaghan learned later in 2009, Huff was also present for one of the relevant meetings. The proxy statement further disclosed that, on February 11, 2009, River Falls Financial and PSQ, a special purpose vehicle purportedly formed by Pence, entered into a non-binding letter of intent with GEE for a purchase and tender offer agreement to obtain a controlling stake in GEE.

19. According to GEE's May 18, 2009, definitive proxy statement, on March 30, 2009, after negotiations continued following the February 2009 non-binding letter of intent, Pence signed on behalf of PSQ a definitive securities purchase and tender offer agreement (the "Purchase Agreement"). The Purchase Agreement provided that, subject to shareholder approval, PSQ would acquire a controlling stake in GEE by (1) purchasing 7,700,000 newly-issued shares of GEE common stock in a private placement transaction at a purchase price of $0.25 per share for a total purchase price of $1,925,000; (2) commencing a cash tender offer to purchase from the Company's shareholders up to 2,500,000 shares of common stock at a purchase price of $0.60 per share; (3) appointing three directors to a five-member board of directors, including Pence becoming the chairman of the board; and (4) designating Heineman GEE's CEO. On June 22, 2009, a GEE press release announced that shareholders approved the Purchase Agreement and the closing of the Purchase Agreement was announced on July 1, 2009. As a result, PSQ acquired more than 65% ownership of the Company, Pence became GEE's chairman and appointed two other directors, and Heineman became GEE's CEO.

20. As part of the July 2009 closing of PSQ's purchase agreement with GEE, GEE opened a checking account at PAB into which PSQ's escrowed $1,925,000 would be deposited upon the closing. According to PAB records received by Henaghan in 2009, in June 2009, Associate-1 coordinated with GEE's chief financial officer (the "GEE CFO") to have the GEE checking account opened at PAB and the authorized signatories on the account were the GEE CFO, Pence, and Associate-1. Those PAB records also indicated that the GEE CFO, Pence, and Associate-1 remained the only authorized signatories on the account until September 2009, at which time Associate-1 was removed and Heineman was added. Following the closing in early July 2009, GEE transferred an additional $750,000 from GEE's accounts at other banks to the GEE PAB checking account. The approximately $2.6 million deposited in the GEE PAB checking account constituted substantially all of GEE's cash and half of its assets.

21. According to information received by BDO's engagement partner, Henaghan, GEE's CFO identified that $2.3 million had been withdrawn from the GEE PAB operating account on July 23, 2009, without the GEE CFO's knowledge. The GEE CFO reported to Henaghan that when he asked about the withdrawn funds, GEE's CEO Heineman claimed that he had authorized GEE to invest $2.3 million into a CD at PAB. The GEE CFO also informed Henaghan that, although he had repeatedly requested documentation concerning the purported CD, such as a written approval or account agreement—and cited the lack of documentation as a control deficiency—Heineman only provided the GEE CFO with a one-page PDF of a typewritten

"Certificate of Deposit Receipt" for $2.3 million with a single maturity date of October 21, 2009 and interest rate of two percent.

E. BDO RECEIVED INCONSISTENT EVIDENCE CONCERNING THE PURPORTED CD AND THE EXISTENCE OF RELATED PARTY TRANSCTIONS

22. GEE's fiscal year ended on September 30, 2009. As part of its audit of GEE, BDO addressed confirmations for GEE's bank accounts, including the purported CD, to a PAB vice president and branch manager. In October, BDO received a confirmation signed by that vice president for the operating account and a confirmation signed by the PAB president Antonucci for the purported CD. BDO concurring partner Rainis noted that it was "unusual" for the PAB president to sign the confirmation.

23. On October 19, 2009, the GEE CFO provided to audit committee members and BDO's engagement partner, Henaghan, a report of the evaluation of internal control for fiscal year 2009, which noted the purported PAB CD as an identified control deficiency. The report noted that"[t]he transaction was not executed by the office of the Treasurer, and no written approval or account agreement was provided to the accounting department" and that "it did not conform to the company's investment guidelines" because it did not provide sufficient diversification and PAB did not meet GEE's size requirement. However, the report concluded that the control deficiency did not constitute a material weakness. BDO concurred with this assessment.

24. In early November 2009, the GEE CFO noticed that PAB had not remitted the proceeds of the purported CD of $2.3 million plus interest into GEE's operating account upon the maturity date, October 21, 2009. When the GEE CFO contacted PAB, a PAB representative stated that the Bank had no record of the purported CD in its system and then refused to investigate the matter any further. On November 18, 2009, the GEE CFO conveyed this information to the BDO engagement partner Henaghan. The GEE CFO also communicated this information to GEE's audit committee chairman (the "AC Chair").

25. Also in November 2009, BDO partners Henaghan, the engagement partner, Graul, BDO's national director of accounting and risk management partner, and Gerace, the assigned BDO regional technical director, reviewed background check reports of Heineman and Associate-1 that identified potential concerns. As part of BDO's client retention procedures, BDO had procured a background check of Heineman because he was the new CEO of GEE and of Associate-1 because he purportedly owned On-Site, a subsidiary of WTS that GEE intended to acquire and which BDO agreed to audit, with Henaghan serving as the engagement partner on that audit. Those background checks revealed that:

- A 2009 lawsuit named GEE's CEO Heineman as a defendant and alleged that he received a fraudulent distribution of in excess of $2 million in cash from a bankrupt company he formally ran.

- Associate-1 served as the chief operating officer of a subsidiary of Certified. The Commission had alleged in a 2008 complaint that Huff was an "undisclosed control person" who, with others, stole $30 million from Certified.

- Associate-1 and Heineman were co-managers of River Falls Financial, and participated in negotiating PSQ's acquisition of GEE shares.

- Heineman and Associate-1 had several substantial personal tax liens.

26. At a November 23, 2009, audit committee meeting, attended by BDO engagement partner Henaghan and concurring partner Rainis, the GEE CFO reported his concerns that GEE had little documentation supporting the purported CD, including no written authorization from an account signatory and no deposit agreement. According to the audit committee minutes, Heineman claimed that he authorized the purported CD at Pence's direction, and claimed the lack of documentation was due to "the rapid pace of the transactions in which he had been involved, coupled with reorganization and personnel changes at Park Avenue Bank." Heineman next stated that he had anticipated that the CD would be maintained on a continuing renewal basis but he had asked Pence to liquidate the purported CD and have the funds transferred into the PAB checking account by the end of the week. The minutes also state that Henaghan "said that the audit was substantially completed, pending resolution of the missing funds issue, receipt of legal letters from counsel, and the executed management representation letter" and that BDO "would be issuing an unqualified opinion on the consolidated financial statements."

27. On November 24, 2009, Henaghan emailed the AC Chair, stating that the GEE CFO had "indicated there was an update on the CD and that the funds would be returned in installments. I am not sure if you can provide any further clarity on why this would be. I wanted to check with you before I had another discussion with [Heineman]." The AC Chair replied that he "[could] not provide any clarity" and expressed concern that one of the audit committee members (the "AC Member") "seems to be tied in with this group." The AC Member had been appointed by Pence in connection with the PSQ transaction in July.

28. Henaghan replied to the AC Chair the following day, November 25, 2009, that he had spoken to Heineman that morning and Heineman indicated that Pence and the AC Member "were taking the lead on this as they have a previous working relationship with the bank." Henaghan also noted that Heineman, however, had "disagreed with the fact that the CD would be 'paid back in installments'" and had "indicated that the proceeds of the CD would be in the Company's bank account by Monday."

29. By the following Monday, November 30, 2009, GEE still had not obtained the $2.3 million in proceeds of the purported CD from PAB. That day, Pence, Heineman, and Zizza attended a GEE board of directors meeting. Zizza, who had no formal role at GEE at this time, attended as an "invited guest." The board minutes indicate that the AC Chair explained that the Company's Form 10-K had not yet been filed because BDO's "final" opinion was predicated on the satisfactory accounting for the PAB CD and an explanation for where GEE's funds had been since the CD matured on October 21. During this November 30, 2009, board meeting, the AC

Member stated he believed that the situation occurred as a result of administrative errors on the part of the Bank, and Pence said that the AC Member had agreed to pursue the matter with PAB. Neither Pence nor Heineman mentioned anything about GEE selling or assigning the purported CD to a third party.[6]

30. By December 3, 2009, Henaghan learned that GEE had received four transfers from SDH and Oxygen totaling $1 million. On December 3, 2009, the AC Member, who had been tasked by Pence with contacting PAB about the purported CD, told the AC Chair and BDO engagement partner Henaghan that PAB was sending GEE the $2.3 million proceeds of the purported CD. The AC Member also told Henaghan that the Bank had made an "administrative error" and would provide a short apology note.

31. After consulting with fellow BDO partners Rainis and Gerace, Henaghan sent GEE's AC Chair an email on December 4, 2009, summarizing the open items requiring resolution prior to the issuance of BDO's audit report: (1) the purported CD; (2) identification of potential related parties to Pence; and (3) additional subsequent event procedures. The email begins by noting that after the CD had matured in October 2009, when the GEE CFO had contacted the Bank, a PAB representative informed the GEE CFO that there was no record of the purported CD and that after some investigation by the AC Member, "in late November it was determined that the funds would be returned to GEE in installments." The email then notes that GEE had received the following wire transfers: (i) November 24: $300,000 wire transfer from SDH; (ii) November 25: $300,000 wire transfer from Oxygen; (iii) November 27: $300,000 wire transfer from SDH; and (iv) December 1: $100,000 wire transfer from Oxygen. Henaghan's email then noted that he had discussed the matter with Heineman and Pence, who both referred him to the AC Member who was working directly with PAB on the matter, and that the AC Member left him a voicemail "indicating the bank continues to put money against the CD they owe [GEE] and it should be fully repaid by the close of business on Monday, Dec. 7" and that the Bank would provide a short apology note. Henaghan's email continued:

> [G]iven the highly unusual nature of this issue and the significant amount of time it is taking to recover the funds, it is critical that we understand both the nature of the administrative error as well as the underlying cause of this error.... As I have never encountered such an issue with a bank or CD and any reasonable person (including the PCAOB or SEC) would certainly question such an issue, I need to be in a position to <u>fully explain</u> exactly what occurred.... As such, from an audit perspective I will require the following prior to issuance of the fiscal 2009 financial statements:
>
> > -Source documents (bank statements, etc.) showing the flow of funds from the closing of the PSQ transaction through the date the funds are fully

[6] BDO engagement partner Henaghan and concurring partner Rainis confirmed in the workpaper index that they reviewed all of the minutes for the GEE board and audit committee meetings discussing the purported CD issue.

transferred to Chase bank in December 2009 (including an understanding of where the CD funds were disbursed upon maturity of the CD in October)

-Explanation as to why the funds received in November and December are being wire transferred from entities other than Park Avenue Bank

-To corroborate this documentation, we may request to meet with someone at Park Avenue Bank to understand the nature of the administrative error

-A written report by management or others to fully explain the circumstances surrounding the matter including steps [GEE] took to gain its understanding of what transpired....

Also, as the $2.3 million is critical to our assessment of the Company's ability to continue as a going concern, it is important for us to understand this situation so as to gain comfort that the funds will remain available to the Company to fund operations as needed.

32. Henaghan's December 4 email also noted as an open item that he had a conversation with Pence that day "to gain an understanding of other investments he has to make sure we have appropriately identified any potential related parties and may have a few follow up questions regarding that matter." One of the items Henaghan had spoken to Pence about was the ownership of River Falls Financial, of which Pence had indicated he was the 100% owner.

33. Shortly after receiving it, the AC Chair forwarded Henaghan's email to Heineman, Pence, the AC Member, the GEE CFO, and GEE's board, noting: "Multiple representatives of BDO have told me that they will not sign off on the GEE Audit . . . until they have sufficient documentation of what has transpired. [BDO's] position is that the Liabilities associated with a sign-off far exceed any past or potential future Audit Fees that [they] have received or will receive. The high level message is that a letter of apology from Park Avenue Bank will not be sufficient." Henaghan received a copy of this email and replied to all: "To clarify, [our] primary concern is getting an understanding of exactly what has occurred in order to allow us to complete our audit procedures. As I am sure everyone would agree, what has transpired over the last few weeks with the funds at [PAB] has been highly unusual. I know everyone has been working to resolve the issue. However, time continues to pass and [GEE's] filing deadline will be here before we know it. As such, I wanted to clarify the importance of appropriately addressing the issue as quickly as possible to allow us to complete the audit."

34. Later in the day on December 4, the AC Chair sent an email to Henaghan and Rainis summarizing his call with the AC Member, stating that when he spoke with the AC Member "he told me that [PAB] had reported these transaction [sic] to the FDIC and that the money sent to the various entities that are now sending GEE the money are sending us the banks money rather than sending it back to the bank." The AC Chair continued: "This makes absolutely no sense. It looks like [PAB] is on the verge of failing. The FDIC and a bankruptcy estate are

going to require [PAB] to collect every cent they can under loans or other arrangements to settle with the creditors of the bank before they send money to third parties."

35. The following day, on December 5, 2009, the AC Chair emailed GEE's board and Heineman calling for a special audit committee meeting on December 9 because of "several unanswered questions related to $2.3 million of the Company's cash which supposedly was invested in a Certificate of Deposit ('CD') at Park Avenue Bank which will need to be answered before BDO will complete their Audit Report for the Company's fiscal year ended September 30, 2009." The AC Chair's email noted several issues, including that (i) there was no account agreement with PAB or regular reporting on the CD; (ii) PAB did not remit the proceeds of the CD into GEE's operating account when it reached its maturity date on October 21, 2009; (iii) PAB provided no explanation to the GEE CFO when he attempted to investigate; and (iv) the AC Member who took the lead on this matter with PAB "was informed on or about November 21, 2009 that the funds would be returned to [GEE] in a series of deposits." The email also provided a chart of seven wire transfers totaling $1.7 million, which included the four noted in Henaghan's December 4 email plus a December 2, 2009, wire transfer from Oxygen for $100,000, a December 2, 2009, wire transfer from River Falls Financial of $300,000, and a December 3, 2009, wire transfer from River Falls Financial also for $300,000. The address listed for both SDH and River Falls Financial on each of their wire transfers in the chart was 11921 Brinley Ave, Louisville, KY. BDO's engagement partner Henaghan received a copy of the AC Chair's December 5 email and forwarded it to Rainis, Gerace, and BDO's general counsel.

36. River Falls Financial was the entity that Henaghan had just been told was 100% owned by Pence. BDO had also learned in conducting background investigations that Associate-1 and Heineman were co-managers of River Falls Financial.

37. On December 4 and December 9, 2009, GEE received two additional wire transfers from River Falls Financial for $300,000 each, bringing the total amount received by GEE from River Falls Financial to $1.2 million and the total of the nine wire transfers to $2.3 million, the same amount that Heineman had purported to invest in a CD.

38. On December 8, the AC Chair emailed Henaghan, providing some links he suggested Henaghan review before Henaghan had a conversation with the AC Member and any representatives of PAB, "particularly the Anthony Huff links" and explained that he "met Anthony Huff when we went to New York" to negotiate PSQ's acquisition. The email included links to a press release announcing the Commission's lawsuit against Huff, a link to Huff's website noting the address 11921 Brinley Avenue, Louisville, KY in the text of the email, and a link to the website for Oxygen noting the identical address. This is the same address that appeared in the wires sent to GEE by River Falls Financial and SDH, as noted in the AC Chair's December 5 email described in paragraph 36, above. Also, Huff's website at the time contained references to River Falls Investments, SDH, Oxygen, and O2HR.

39. In addition to the background checks of Heineman and Associate-1 discussed in paragraph 26, on November 23 and December 21, Henaghan, Rainis, and Gerace participated in

phone calls with Associate-1. According to Henaghan's notes of the calls, they discussed Huff's connections to River Falls Financial and River Falls Investments and the Commission's lawsuit against Huff "alleging fraudulent transfer of assets & non-disclosure of related party transactions." Associate-1 told them that Huff's wife was the original 100% owner of River Falls Financial before it was sold to Pence. Associate-1 also told them that, through a family trust, Huff had a 70% ownership interest in River Falls Investments.

40. Also on December 8, 2009, the day before the special audit committee meeting, the AC Chair received an email from Heineman to the audit committee with several attachments. Heineman's email purported to offer a new explanation for why GEE had received $2.3 million from the three entities rather than PAB. Heineman claimed that he had negotiated an assignment agreement with the manager of River Falls Investments (Associate-1), who "offered to purchase" the purported CD from GEE at face value. Heineman also attached to his email an unsigned, draft assignment agreement and a letter from Heineman to PAB, dated July 21, 2009, that purportedly authorized the $2.3 million CD investment. Heineman's email also attached a July 2009 monthly statement for GEE's operating account at PAB, which included the description of the $2.3 million withdrawal as a debit on July 23 with a debit memo stating in handwriting: "To: Park Avenue Insurance, See Attachment Approval, $2,300,000.00."

41. The AC Chair responded to Heineman's email that day, stating: "Given the chain of event[s] you described below, why was GEE not informed immediately when River Falls Investments purchased the CD and why are we just now learning that a law firm has been engaged to document the assignment of the CD? We have been asking questions about the CD now for nearly a month." BDO engagement partner Henaghan received a copy of Heineman's email with attachments and the AC Chair's reply email. On a printout of the AC Chair's reply email, BDO engagement partner Henaghan wrote "$ Anthony Huff."

42. Henaghan also exchanged emails with the AC Chair later that day, noting his agreement with the AC Chair's questions to Heineman and that "the sale of the CD would constitute a related party transaction which typically should be approved by the board." The AC Chair replied to Henaghan that he had just spoken to Heineman and Heineman "claims that RFI (River Falls Investment) is 100% owned by [Associate-1] and is not related to River Falls Financial Services or any of the other entities." Henaghan replied, "That is consistent with what [] Pence told me in my conversation with him. The common names are a little strange though."

43. Prior to the December 9, 2009, special audit committee meeting, BDO had learned of several indications of fraud relating to the purported CD. Moreover, during the 2009 audit of GEE, BDO became aware of multiple indications that the purported assignment agreement with River Falls Investments was a related party transaction, including:

- the common names of River Falls Investments (purportedly owned by a Huff family trust and Associate-1) and River Falls Financial (purportedly owned by Pence, GEE's chairman);

- River Falls Financial had sent GEE $1.2 million in four installments in connection with the assignment agreement ;

- Heineman and Associate-1 were co-managers of River Falls Financial;

- Associate-1 was a signatory for GEE's operating account at PAB from July to September 2009, when the $2.3 million was purportedly invested in a CD;

- Heineman's email address was rheineman@riverfallsfinancialgroup.com;

- The validity of a business purpose for River Falls Investments to purchase the CD at face value was questionable given that (i) PAB stated that it had no record of the purported CD in its system; and (ii) GEE did not have a binding agreement in its possession concerning its purported purchase of the CD with PAB;

- River Falls Investments was not listed in GEE's banking records as the originator of the wire transfers that were purported to be in connection with the assignment agreement. GEE received the payments from SDH, River Falls Financial, and Oxygen—all of which were made before a binding agreement with River Falls Investments was executed; and

- River Falls Financial, River Falls Investments, SDH, Oxygen, and Huff all shared a common address: 11921 Brinley Avenue in Louisville, KY 40234.

44. Prior to the GEE special audit committee meeting scheduled for December 9, 2009, Henaghan alerted Rainis, Gerace, and BDO's Midwest Regional Business Line Leader (the "BDO Midwest Leader") of Heineman's new explanation concerning the assignment agreement and each of them attended the meeting. According to the audit committee meeting minutes:

- Henaghan expressed concern that BDO still did not have a clear understanding of the purported CD transaction.

- Henaghan said that BDO needed to understand the nature of the purported administrative errors at PAB that he had been told were responsible for the lack of proper documentation regarding the CD transaction. Henaghan also explained that BDO required documentation validating the banking transactions, and an explanation as to why there was no existence of an account agreement with the Bank or no record of the CD being at the bank.

- The BDO Midwest Leader said he believed members of GEE's senior management appeared hesitant to provide information related to these transactions.

- Henaghan stated that the assignment agreement did not resolve the outstanding issues as BDO still needed to know what transpired within PAB and make a determination of whether the assignment agreement with River Falls Investments was a related party transaction.

- BDO also advised that although the assignment agreement "may reduce or eliminate the need for going concern disclosure, it would increase the requirement that management provide sufficient disclosure regarding any related party conflicts."

45. On December 14, 2009, GEE's outside counsel sent PAB a formal letter requesting all documentation and information concerning the purported CD. BDO received a copy of this letter. PAB's December 16, 2009, response, also received by BDO, provided only documents relating to GEE's checking account and did not provide any documents or other information about the purported CD. The checking account documentation, however, indicated that only Associate-1, the GEE CFO, and Pence were authorized signers on GEE's account from July to September 2009—not Heineman—and the checking account statements reflected a debit memo for the transfer of $2.3 million of GEE's cash to Park Avenue Insurance on July 23, 2009.

46. On Friday, December 18, 2009, BDO received a letter from GEE's general counsel that attached the final assignment agreement, dated December 11, and a letter from Associate-1 claiming that the $2.3 million sent to GEE by SDH, Oxygen, and River Falls Financial originated from River Falls Investments and its "wholly owned subsidiaries or affiliates." The letter concluded: "The entirety, sans interest, used by the Company for the purchase of the CD was received into the Company's Chase bank account.... Since time is certainly of the essence to complete the audit work for the Form 10-K to be filed by the Company no later than December 31, 2009, we believe that any open concerns your firm had with respect to the source of the initial concerns over the CD are now resolved." The letter did not provide any additional information concerning what had happened with the purported CD and why Associate-1 and River Falls Investments would pay face value for the purported CD which PAB had not honored and had no records to support.

47. Following the receipt of the December 18 letter, BDO partners Henaghan, Rainis, and Gerace requested consultation with Graul, BDO's national director of accounting and risk management partner, Hambleton, BDO's national director of SEC practice, and BDO's general counsel. After discussion of the situation, these BDO partners agreed they should inform GEE that the December 18 letter did not fully address the questions BDO had raised and demand that the audit committee commission an independent investigation to determine exactly what happened.

F. BDO DEMANDED AN INDEPENDENT INVESTIGATION AND, SHORTLY THEREAFTER, WITHDREW THE DEMAND

48. On Monday, December 21, 2009, Henaghan sent an email to Graul and Hambleton, copying Rainis and Gerace, stating: "This morning we informed the [AC Chair] that we will require an independent investigation of the CD matter in order to conclude the audit of General Employment (consistent with our discussions with you on Friday.) Attached is our proposed written communication." The five-page draft communication described in detail much of the inconsistent evidence BDO had received concerning the purported CD and the purported assignment agreement with River Falls Investments and also included a number of proposed questions. Graul responded:

We do not owe the Board any explanation other than our "audit" of the CD in question is incomplete because we have been unable to obtain sufficient evidence to support the existence and ownership of this asset. You could say that we have obtained bits and pieces of evidence[] but are not satisfied with the sufficiency of such evidence to support our opinion on the financial statements. You could also say that because of the unusual circumstances surrounding the evidence provided thus far, we concluded that the Board should undertake a full investigation of the matter.

49. Later that day, Hambleton replied to Graul's email, asking whether they "should go into detail of the issues in the letter." Graul responded to Hambleton: "Short of saying we think there is fraud, the point is we have been looking for support for months and don't have anything satisfactory to support a final opinion. If we give a list of questions, we'll get answers to those questions and still not know what is really going on. An independent investigation is the only way to get to the bottom of this. The list doesn't look like it would get us there."

50. Also on December 21, 2009, BDO partners Henaghan, Rainis, and Gerace questioned Associate-1 about the assignment agreement and Huff's involvement with GEE, River Falls Financial, and River Falls Investments. According to summary notes of the call, Associate-1's explanation for why River Falls Financial, purportedly owned by Pence, wired payments of $300,000 each to GEE on four days (December 2, 3, 4, and 9), was that the funds were "initially inadvertently transferred to the [River Falls Financial] account rather than the GEE account." Associate-1 also informed them that Huff's wife was the original 100% owner of River Falls Financial and that Pence acquired the company in 2009. The notes also reflect that Associate-1 conveyed that through a trust Huff has an ownership interest in River Falls Investments. Associate-1 further told them that he was familiar with Park Avenue Insurance and he believes it "is insolvent at this point."

51. Ultimately it was determined that the detailed letter would be sent and, early on December 22, 2009, Henaghan sent GEE's AC Chair a five-page letter, dated December 21, 2009, in substantially the same form as Henaghan had internally circulated earlier. Henaghan's letter identified a number of inconsistencies in the audit evidence BDO had received regarding the purported CD:

- BDO had not received "sufficient audit evidence" to support the existence of a CD investment as of September 30, 2009. The questions raised in regards to the CD at both the November and December audit committee meetings remained unaddressed.

- BDO had not received an adequate explanation from PAB as to the whereabouts of the $2.3 million after July 23, 2009, because the Bank claimed to have no record of a CD in its system. PAB never "repaid the CD proceeds or provided an adequate explanation regarding the status of the CD."

- BDO had "requested (but not been granted) an opportunity to speak directly with [PAB] regarding this matter."[7]

- The July 2009 PAB statement "indicates the amount was transferred to Park Avenue Insurance. We would like to understand why it appears that the funds were transferred to Park Avenue Insurance and were not invested into a CD. . . . [M]anagement has provided no explanation for this. The documentation also appears to indicate that prior to September 2009, [Associate-1] was an authorized signor on the Company's operating account."

- Heineman's statements to BDO: (1) claiming on November 23 that "the issue would be resolved and the funds deposited in the Company's bank account within a few days"—which did not happen; (2) stating on November 25 that the money would not be "paid back in installments"—which did happen; (3) claiming GEE would have the proceeds by November 30—which did not happen; (4) asserting on December 8 that he negotiated the assignment with Associate-1—but "during [BDO's] earlier discussions with Mr. Heineman he had represented that he was not involved in the process of resolving the issues related to the CD."

- BDO received conflicting reports regarding the return of the CD funds: (1) the AC Member stated on December 4 that "the bank continues to put money against the CD they owe the Company and it should be fully repaid"; (2) Pence and Heineman referred BDO to the AC Member; and (3) "In all discussions leading up to December 7, 2009, no one ever indicated that the CD had been assigned to [Associate-1]."

- "At the December 9, 2009 audit committee meeting, general counsel and one audit committee member requested that BDO not be present for the discussion regarding the CD matter."

- BDO had not received a clear explanation as to why River Falls Investments would purchase the CD that the Bank has said does not exist, why River Falls Investments would transfer funds to GEE before an assignment agreement had been executed, and whether Associate-1's intent to sell companies to GEE was related to his agreement to purchase the CD.

- "Approximately $900,000 of the proceeds recovered by the Company was received from River Falls Financial Services. [BDO] had previously been informed that River Falls Financial Services was 100% owned by Steve Pence. However, in a December 18, 2009 telephone conversation with Steve Pence, he was unable to explain why these amounts were transferred from River Falls Financial Services (as the proceeds were for [Associate-1's] purchase of the CD)."

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[7] BDO never contacted PAB or spoke to anyone from PAB after learning that PAB failed to repay the CD proceeds.

52. Henaghan's letter indicated that he included specific facts in the letter "to illustrate that it appears that management has not been forthcoming with information surrounding this matter. This fact pattern has caused us to raise the level of scrutiny surrounding this issue."

53. At the end of his letter, Henaghan stated that BDO did not have sufficient audit evidence at that time to formally conclude the audit and demanded an independent investigation:

> While BDO recognizes that the issue related to the CD may be the result of potential administrative or other errors at [PAB], we do not believe we have been provided sufficient audit evidence to formally conclude on this matter at this point. As a result of the fact that almost one month has passed since the first audit committee meeting discussing this matter, that it appears management has not been fully forthcoming on how it was resolving the issue, and certain question remain unanswered, we will <u>require</u> the audit committee to commission a full investigation of this matter prior to the completion of our audit for the year ended September 30, 2009. This investigation should be conducted by an independent firm that is acceptable to our firm and should address the following unexplained matters:
>
> - Why would the Company maintain $2.3 million at Park Avenue Bank in direct violation of its own investment policy?
> - Why was [Associate-1] an authorized signor on the Company's account at Park Avenue Bank?
> - What happened to the CD? We would like an explanation for all of the facts noted above surrounding the situation.
> - Why did the Company not pursue legal action against the bank and report the situation to the FDIC when the bank failed to reimburse the Company when the CD matured?
> - Why would Mr. Heineman & Mr. Pence represent they were unaware of the status of the CD resolution and why funds were being received from entities other than Park Avenue Bank when it appears they were aware of the assignment agreement with [Associate-1]?
> - Why would [Associate-1] be willing to purchase an asset whose value is in question when he has no relationship to the Company?
> - Why did River Falls Financial Services reimburse the Company for the CD if they did not have any relationship with [Associate-1] and were not a party to the assignment agreement?
> - We would like a clear understanding of the relationships between [Associate-1], Mr. Pence and Mr. Heineman and any entities where they may have joint ownership?
> - What is the relationship between [Associate-1], Mr. Pence, Mr. Heineman and Park Avenue Bank?
>
> Please note that the issues listed above represent[] some of the areas of concern based on our current understanding of the facts. The above items should not be

considered an all-inclusive list and the investigation should not be limited to the above identified items. We may identify additional questions and require additional audit evidence based on the results of the investigation. BDO recommends that this investigation be commissioned as soon as possible.

54. On the evening of December 22, 2009, Respondents learned that the audit committee meeting that was scheduled for the following day had been cancelled, Zizza, an advisor to Pence who had attended GEE board meetings through the fall of 2009, would be taking over as CEO, and that Pence and Associate-1 intended to prepare written responses to each of the issues identified in the December 21 letter. In email exchanges that evening and the following morning regarding these events, Henaghan, Gerace, Hambleton, and the BDO Midwest Leader agreed that BDO should communicate to GEE in writing that BDO "will continue to require an independent investigation."

55. Following Zizza's appointment as GEE's new CEO, BDO partners Henaghan, Rainis, Gerace, and the BDO Midwest Leader spoke to Zizza and the AC Chair on December 24, 2009. A senior partner in BDO's New York office (the "NY Partner") also attended the call because he handled some of Zizza's other business relationships with BDO, including audit or tax work for Zizza's private company and three public companies for which Zizza served as a board member. Henaghan later wrote a memo describing the December 24 call, stating that Zizza "requested that BDO conclude the audit without the need for an independent investigation" because of "the change in management and the fact that the Company had recovered full control of the $2.3 million in question" and that the AC Chair agreed. The memo also indicates that both Zizza and the AC Chair "acknowledged that some inappropriate actions were taken within the Company and that it was likely that even more inappropriate actions were taken at the Bank" and that both "felt that with [Heineman's] removal from the management team, the inappropriate actions within the Company would stop."

56. Also on December 24, BDO partners Henaghan, Rainis, and Gerace had a telephone conversation with Pence, Zizza, and the AC Chair. According to a memo Henaghan later wrote describing this call, Pence indicated he asked GEE to move its business to PAB because of his prior working relationship as an attorney for Antonucci, PAB's then-President, and Associate-1's association with PAB as a customer. The memo also indicates that Pence had told BDO that the reason he represented he was unaware of the status of the CD resolution and why funds were being received from entities other than PAB was because "he was unaware of the assignment agreement until after the funds were returned to the Company." The memo further noted that Associate-1's explanation for why River Falls Financial transferred funds to GEE was because River Falls Financial "also has an operating account" at the same bank and "[t]he funds were transferred from one of his companies to [River Falls Financial] in error," and as such, River Falls Financial "then had to transfer the funds to GEE."

57. After these calls with Zizza, Pence, and the AC Chair, Henaghan sent Rainis, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel an email on December 24, 2009, asking for their availability for a call and stating he was drafting a

memo summarizing current facts. Graul responded: "Unless there is something new that hasn't been discussed in the last few calls, what's the purpose?" The NY Partner replied: "The purpose is to try to salvage an account where they made [] changes in the management because of the alleged wrongdoing." Graul responded: "Did they change the guy that can't support the $2 million that supposedly was put into company? What about the two audit committee members that stalled the investigation and the lawyer that wouldn't let us participate in a board meeting to preserve privilege. There's something funny going on here." The NY Partner replied that he had no disagreement with Graul on the last point.

58. BDO's 2009 Assurance Manual required Henaghan to consult with Graul, Hambleton, and Gerace in the circumstances presented here. The Manual required the engagement partner seeking consultation to prepare a memorandum concerning all consultations, which should, among other things, define the issues; "identify client source documents/evidence reviewed"; summarize the proper accounting treatment; summarize the impact on the financial statement presentation and disclosure; and describe any alternative solutions considered and why they were rejected. Finally, BDO's 2009 Assurance Manual required the memorandum to be sent to all consultants, who "should acknowledge their agreement with the memorandum."

59. Early in the morning on December 28, Henaghan sent a draft memo to Rainis, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel. The memo summarized BDO's calls with Zizza, the AC Chair, Pence, and Associate-1, and attempted to answer the questions posed in Henaghan's letter to the AC Chair dated December 21, 2009. The memo concluded: "the engagement team believes it is appropriate to reconsider the need for an independent investigation and as such is requesting a consultation on this matter."

60. That same day, Henaghan, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel discussed GEE for approximately one hour. Despite the existence of multiple, unanswered questions, they ultimately agreed to drop the demand for an independent investigation if GEE agreed to include commentary on two material weaknesses in internal controls, including certain circumstances surrounding the purported CD, in a Form 8-K and that Associate-1 would not become part of management, among other things. A memo later written by Henaghan to document the discussion notes as considerations, among other things, that Zizza—whom BDO trusted—had replaced Heineman as CEO and that the AC Chair, who had initially supported the independent investigation, no longer believed that it was required.

61. Following their call, the NY Partner spoke to Zizza and Henaghan spoke to the AC Chair about the statements BDO wanted made in the Form 8-K and Associate-1's contemplated role with GEE. Henaghan emailed an update to Rainis, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel, stating that the AC Chair indicated that GEE was contemplating an acquisition that would make Associate-1 an approximate 20% shareholder of GEE, but not an officer, director, or part of management. Graul responded: "I don't like it but won't object provided [that Associate-1] is not a board member and has no managerial responsibilities, even with respect to the business he is selling. Please make it perfectly clear that this is the last accommodation that I am willing to make from a risk management perspective."

62. Also following their December 28 call, Hambleton sent an email to the other BDO partners asking whether they were comfortable with the classification of the $2.3 million as cash at September 30. Henaghan responded: "we have a confirmation from Park Ave Bank & the subsequent execution and funding of the assignment agreement as evidence of the existence of the CD at 9/30." Henaghan did not mention any of the inconsistent evidence that he identified in his letter to the AC Chair dated December 21, 2009, and that indicated that no such CD or other cash equivalent existed as of September 30, 2009. Neither Hambleton nor any of the other BDO partners responded or commented on these omissions.

63. BDO provided a draft Form 8-K disclosure to GEE, and reviewed and agreed to the language ultimately included in GEE's Form 8-K filed on December 30, 2009. The Form 8-K disclosed Heineman's resignation, Zizza's appointment as CEO, and the fact that Zizza was paid $20,000 per month since March 2009 to consult for Pence. The Form 8-K also stated:

> In July 2009, the Registrant purchased a $2.3 million certificate of deposit ("CD") at a New York bank. When the CD matured in October 2009, the bank did not timely credit the proceeds of the CD to the Registrant's account. Although the Registrant has made a formal inquiry of the bank, to date the Company has not received an adequate explanation for the bank's non-performance relating to the CD. In December 2009, the Registrant was reimbursed in full through a non-recourse assignment of the CD for face value to an unrelated party, who has other business interests with the bank. The purchaser of the CD is neither an employee nor a director of the Registrant.

64. The Form 8-K also disclosed two material weaknesses: (1) "the size of the New York bank from which the CD was purchased did not meet the minimum requirements of [GEE]'s investment policy"; and (2) the Company "authorized an individual that was neither an employer nor a director as an authorized signor on the Registrant's bank account." The Form 8-K did not indicate that Associate-1 was both the authorized signatory and the purportedly "unrelated party" who purchased the purported CD.

65. On January 4, 2010, Henaghan sent an email to Rainis, Graul, Gerace, Hambleton, the BDO Midwest Leader, and BDO's general counsel attaching the Form 8-K, the December 21, 2009, letter to the AC Chair demanding an independent investigation, Heineman's resignation email, and a final memo discussing BDO's calls with the AC Chair, Pence, Zizza, and Associate-1 and concluding that BDO should issue its opinion on GEE's financial statements. The final memo noted that Zizza and the AC Chair "acknowledged that some inappropriate actions were taken within the Company and that it was likely that even more inappropriate actions were taken at the Bank.... Both men also acknowledged that they felt that with [Heineman's] removal from the management team, the inappropriate actions within the Company would stop." The memo noted that "without the cooperation of [Heineman] and the Bank – neither of which anyone was likely to obtain, it was highly unlikely that the motivations or even all of the actions would ever be learned." BDO did not attempt to contact Heineman following his resignation nor did BDO attempt to contact PAB at any time after this issue arose.

66. The memo also stated that Zizza "represented to BDO that [Associate-1] will not become an employee or director of the Company" and concluded: "To the extent any new adverse information related to the transaction comes to our attention we will again consult with BDO's risk management and National SEC groups in regards to continued client retention." Rainis, Graul, Gerace, and Hambleton each reviewed the memo and concurred with the decision to drop the demand for an independent investigation. BDO's general counsel also agreed with the approach outlined in the memo.

67. On January 5, 2010, after Respondents had already decided that GEE's Form 8-K disclosure concerning the purported CD was adequate and informed GEE that BDO would withdraw its demand for an investigation and issue an unqualified audit opinion, Hambleton asked BDO's general counsel, Henaghan, Rainis, Graul, Gerace, and the NY Partner: "I want to make sure we believe the company's response is a sufficient response to a potential illegal act. Although we didn't specifically say we thought there was a potential illegal act in the [December 21] letter, we did include enough issues that would lead someone to that view as does the memo's statement about some 'inappropriate actions.'" BDO's general counsel responded: "I do believe the company's response was appropriate under the circumstances."

68. On January 8, 2010, GEE filed its Form 10-K, which classified the $2.3 million purported CD as a cash equivalent and stated in footnote disclosure to the financial statements:

> In July 2009, the Company purchased a $2,300,000 certificate of deposit ("CD") at a New York bank. When the CD matured in October 2009, the bank did not timely credit the proceeds of the CD to the Company's account. Although the Company has made a formal inquiry of the bank, to date the Company has not received an adequate explanation for the bank's non-performance relating to the CD. In December 2009, the Company was reimbursed in full through a non-recourse assignment of the CD for face value to an unrelated party, who has other business interests with the bank. The purchaser of the CD is neither an employee nor a director of the Company.

69. GEE's Form 10-K filed on January 8, 2010 contained an audit report from BDO that stated BDO's audits were conducted "in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that GEE's financial statements presented fairly, in all material respects, the company's position and results at September 30, 2009, in conformity with GAAP.

G. IN 2010, BDO LEARNED OF FACTUAL ALLEGATIONS IN A CRIMINAL COMPLAINT AGAINST THE PAB PRESIDENT ALLEGING THAT THE PURPORTED CD DID NOT EXIST

70. On January 19, 2010, just days after BDO issued its unqualified opinion and GEE filed its 2009 Form 10-K, Henaghan sent an email to Rainis, Graul, Gerace, Hambleton, the BDO Midwest Leader, and NY Partner attaching a January 12, 2010, Grand Jury Subpoena, issued to the

AC Chair seeking his appearance and production of "any and all documents relating to any account maintained at Park Avenue Bank."

71. On March 13, 2010, the United States of America filed a 44-page criminal Complaint against former PAB president Antonucci (the "Antonucci Complaint"), alleging a scheme and conspiracy involving a $6.5 million round-trip transaction in which GEE's $2.3 million was diverted as part of the conspiracy. Huff, Heineman, and Pence are referred to and identifiable as designated "co-conspirator[s] not named herein" in certain aspects of that conspiracy. The allegations in the Antonucci Complaint contained several details that indicated that GEE did not have a CD with PAB, that River Falls Financial, River Falls Investments, Oxygen, SDH, and PSQ were related parties, and that Heineman had authorized the money to be transferred to Park Avenue Insurance as part of the conspiracy, and not to purchase a CD:

- "To hide the improper diversion of GEE's funds from GEE's auditors and Board of Directors, [Antonucci] and others created a counterfeit certificate of deposit [], falsely representing that GEE's $2.3 million had been invested in a 90-day certificate of deposit at the Bank. In fact, and as [Antonucci] well knew, there was no $2.3 million CD."

- GEE's $2.3 million had been transferred to Park Avenue Insurance, which was controlled by Antonucci. According to the Bank records, Heineman authorized this transfer.

- Antonucci fraudulently signed the BDO confirmation of the $2.3 million CD, when Antonucci knew it did not exist.

The Antonucci Complaint further identified several "Oxygen-related entities" as participants in the conspiracy, including, River Falls Financial (which Pence said he owned), PSQ (Pence's entity that purchased the majority stake in GEE), and Oxygen and SDH—two companies that paid GEE purportedly under the assignment agreement with River Falls Investments (which Associate-1 said he and a Huff family trust owned). It further alleged that a group of five associates (including Huff and Pence) were listed on some of the accounts of the Oxygen-related entities, which shared a common address in Louisville, Kentucky.

72. On April 27, 2010, Henaghan sent an email attaching the Antonucci Complaint to Rainis, Graul, Gerace, Hambleton, the BDO Midwest Leader, and BDO's general counsel. Henaghan's email also attached a March 10, 2010 Grand Jury Subpoena issued to GEE, requesting (i) documents relating to Huff, Pence, Heineman, the purported CD, SDH, Oxygen, O2HR, and River Falls Financial and (ii) documents reflecting any payments to Heineman, Pence, Associate-1, or the AC Member. Henaghan further attached a client retention memo addressed to Graul, Hambleton, Gerace, the BDO Midwest Leader, and BDO's general counsel. The memo stated: "As I believe everyone is aware, in March 2010, Charles Antonucci, the president of Park Avenue Bank was arrested related to allegations of criminal acts in his role as bank president, including signing a counterfeit CD and our confirmation when he had in fact diverted the funds for his own personal use." The memo also noted that Pence was an unnamed co-conspirator. The memo concluded that the engagement team recommended that BDO continue its relationship with GEE because, among other factors, "Pence has not been formally charged yet with any criminal wrong-

doing." However, the memo did not address what impact the Antonucci Complaint's allegations might have on the representations contained in GEE's financial statements (issued two months before the complaint) concerning the purported CD.

73. On April 28, 2010, Graul responded to Henaghan's email requesting that he obtain additional information concerning certain allegations in connection with client retention concerns. Specifically, Graul indicated that Gerace had confirmed to him that "[w]hen the missing company funds were 'dribbling' in from other sources" those sources included entities linked to the conspiracy alleged in the Antonucci Complaint. Graul asked Henaghan to determine (i) whether any related party transactions might involve the entities mentioned in the complaint; (ii) who authorized the funds to be paid to GEE from the "Oxygen-related entities" River Falls Financial, SDH, and Oxygen; and (iii) whether the AC Chair and Zizza are comfortable working with Pence because "the preponderance of the accusations seem pretty bad for Mr. Pence." Hambleton responded to all, stating: "I agree with [Graul]. It seems there are more potential connections here." However, neither Graul, Hambleton, Gerace, nor Rainis ever followed up with Henaghan to learn whether he had identified those "potential connections." Nevertheless, Graul and Gerace subsequently approved the retention of GEE as a client.

74. In a May 25, 2010, email, Henaghan told Zizza that he would like to discuss certain issues regarding the Antonucci Complaint. Henaghan wrote that he wanted to discuss the allegations that "Pence purchased a 25% interest in Bedford Consulting from Antonucci for $6.5 million in what the complaint describes as an 'artifice designed to cover up the true source of the $6.5 million.'" Henaghan also wrote: "The Complaint indicates that River Falls is owned by Pence, [Associate-1], and Heineman. All previous information disclosed to us by Heineman and Pence indicated that Pence owned 100% of River Falls." He further noted that the Complaint indicated that PSQ borrowed money from River Falls to buy the GEE shares. Henaghan's email to Zizza did not address the allegations in the Antonucci Complaint denying the existence of the purported CD or indicating related party issues concerning the funds received by the "Oxygen-related entities."

75. On June 1, 2010, in connection with the allegations contained in the Antonucci Complaint, an Assistant United States Attorney for the Southern District of New York interviewed Henaghan in detail about BDO's 2009 audit, including the information BDO received about the ownership structures of River Falls Financial, River Falls Investments, WTS, On-Site, Oxygen, and AIR.

76. Other than Henaghan's single discussion with Pence (who denied the allegations) and further communications with Zizza (who stated that he still trusted Pence), BDO did not perform any additional procedures specific to the allegations in the Antonucci Complaint concerning GEE, its chairman and former CEO, or the purported CD. BDO's workpapers do not include any information about what BDO did to investigate the allegation that PAB records indicated that Heineman authorized the transfer of $2.3 million to Park Avenue Insurance. BDO's workpapers also do not include any analysis of the impact on GEE's financial statements if Heineman had conspired with Antonucci to steal GEE's $2.3 million, by authorizing the transfer of

the money to Antonucci's company, Park Avenue Insurance, as alleged in the Antonucci Complaint. The workpapers do not include an analysis of whether the assignment agreement with River Falls Investments, in which GEE received $2.3 million from SDH, Oxygen, or River Falls Financial, was a related party transaction. In fact, Henaghan did not document any answers he received pursuant to his discussions with Pence or Zizza. Moreover, the client retention memo approved by Graul and Gerace and "matters for reviewer concern" memo reviewed by Henaghan and Rainis, which were retained in the workpapers for the 2010 audit, make no reference to the Antonucci Complaint or guilty plea.

77. In October 2010, Antonucci pled guilty to multiple criminal charges in a criminal information, including securities fraud, bank bribery, and embezzlement of bank funds. As part of his guilty plea, Antonucci admitted that he and his co-conspirators caused GEE to use $2.3 million of its funds to make PAB whole on a loan PAB made to a company controlled by his co-conspirators that had gone bankrupt, that the purported CD had never existed, and that he had signed a false confirmation that the bank had issued a CD to GEE that he then sent to BDO. BDO learned of this guilty plea shortly thereafter.

78. Henaghan, Rainis, and Gerace learned, through GEE's November 2010 Form 8-K filing and publicly available information, that Pence purportedly sold PSQ to a person associated with Huff ("Associate-2"). After Associate-2 became the majority owner of GEE, a BDO senior manager on the GEE audit noted that Google showed that Associate-2 was connected to O2HR, Huff, and Associate-1. According to the Form 8-K, Associate-2 paid nothing for PSQ; he just assumed promissory notes issued by Pence to AIR for approximately $3 million, which funded PSQ's purchase of the majority of GEE shares in July 2009. Associate-1 had previously informed Henaghan in a December 21, 2009 email that AIR had "investments received and invested in" River Falls Investments, the entity that purchased the purported CD from GEE.

79. Despite all of these additional indications of affiliation among AIR, River Falls Investments, River Falls Financial, Pence, Associate-1, and Huff, BDO did not perform additional audit procedures in 2010 to determine whether the purported purchase by River Falls Investments of the purported CD from GEE (i) was fairly characterized in GEE's financial statements or (ii) should have been identified as a related party transaction in GEE's financial statements. Instead, Henaghan and Rainis relied on GEE management and director representations that there were no undisclosed related party transactions. BDO also relied on Associate-1's representations although, as Graul acknowledged to Gerace and Henaghan on August 10, 2010: "Anything and everything that involves [Associate-1] should be scrutinized carefully . . . [Associate-1] is not to be trusted and everyone on the engagement should be made aware of this." Nevertheless, Henaghan, as engagement partner, Rainis, as concurring partner, and Gerace, as the assigned regional technical director, each agreed in those capacities that BDO could issue an unqualified audit opinion.

80. GEE's Form 10-K filed on December 28, 2010, for its fiscal year ended September 30, 2010, classified the $2.3 million CD as a cash equivalent as of September 30, 2009, included a similar disclosure as the disclosure in the Form 10-K filed in January 2010:

> In November 2009, the Company discovered that it did not receive the proceeds from a bank for a $2,300,000 certificate of deposit that was scheduled to mature in October 2009. Although the Company made a formal inquiry of the bank, it did not receive an adequate explanation for the bank's non-performance related to the deposit. In December 2009, the Company entered into an agreement to assign its interests in the certificate of deposit, without recourse, to an unrelated party that has other business interests with the bank, and the Company was reimbursed for the face value of the deposit.

81. GEE's Form 10-K filed on December 28, 2010, as amended on April 15, 2011, contained an audit report from BDO that stated BDO's audits were conducted in accordance with PCAOB standards and that GEE's financial statements presented fairly, in all material respects, the company's position and results at September 30, 2010 and 2009, in conformity with GAAP.

H. VIOLATIONS

RULE 102(e) AND SECTION 4C OF THE EXCHANGE ACT

82. BDO's 2009 and 2010 audits were deficient and not performed in accordance with PCAOB standards.[8] Section 4C(b) and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to practice as accountants. Pursuant to these provisions, "improper professional conduct" includes two types of negligent conduct: (1) a single instance of highly unreasonable conduct that results in a violation of professional standards in circumstances in which heightened scrutiny is warranted; or (2) repeated instances of unreasonable conduct, each resulting in violations of professional standards, that indicate a lack of competence.

Failed to exercise due professional care and an attitude of professional skepticism (AU § 230)

83. PCAOB standards require auditors to exercise due professional care in the planning and performance of the audit and the preparation of the report. (AU § 230.01) Auditors must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence." (AU § 230.07) In addition, the auditor should "consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit

[8] References to auditing standards in this Order are to PCAOB standards in effect at the time the audit work was performed.

process." (AU § 230.08) The Commission and courts have held that related party transactions require heightened scrutiny.[9]

84. As set forth above, Henaghan, Rainis, Graul, and Gerace knew or should have known facts that cast substantial doubt on the existence of the purported CD given, among other things, (1) significant integrity issues with Heineman, the person who claimed to have authorized the investment, and Associate-1, the person with whom Heineman purportedly "negotiated" the assignment agreement; (2) PAB had told GEE that it had no record of the purported CD; and (3) PAB had provided GEE and BDO with documentation showing the $2.3 million actually had been transferred to Park Avenue Insurance on July 23, 2009.

85. Henaghan, Rainis, Graul, and Gerace also knew or should have known that the circumstances presented by the purported $2.3 million CD that was not honored by PAB, the subsequent receipt by GEE of $2.3 million from River Falls Financial, SDH, and Oxygen, and the purported assignment agreement with River Falls Investments warranted heightened scrutiny. Notwithstanding the many red flags concerning the purported CD and the assignment agreement discussed above, BDO issued audit reports in both 2009 and 2010 containing unqualified opinions that were filed with GEE's financial statements in the Form 10-Ks. In those reports, BDO inaccurately stated that the audit had been conducted in accordance with PCAOB standards and that GEE's financial statements presented fairly, in all material respects, the company's position and results in conformity with GAAP.

86. As a result of their above-described conduct, Henaghan, Rainis, Graul, and Gerace failed to exercise due professional care and an attitude of professional skepticism in BDO's 2009 and 2010 audits of GEE.

Failed to obtain sufficient competent evidential matter concerning the purported CD (AU §§ 326 and 333)

87. PCAOB standards require auditors to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under audit. To be "competent," evidence "must be both valid and relevant." (AU § 326.21) "The amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his or her professional judgment after a careful study of the circumstance in the particular case." (AU § 326.22) This includes evaluating the reliability of the evidence,[10] and weighing all of the evidence obtained. The validity and sufficiency of required evidence depends on the circumstances and the auditors' judgment, but should be "persuasive" though it need not be "convincing." (AU § 326.22)

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[9] *See McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005) (citing *Howard v. SEC*, 376 F.3d 1136, 1149 (D.C. Cir. 2004)) (noting that related party transactions "are viewed with extreme skepticism in all areas of finance").

[10] AU § 330.33: "the auditor should consider (a) the reliability of the confirmations…."

88. PCAOB standards also provide that management representations "are not a substitute for the application of th[e] auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit," that "the auditor obtains written representations from management to complement other auditing procedures," and that "[i]n exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." (AU §§ 333.02, 333.03, 230.09)[11]

89. As a result of his above-described conduct, Henaghan failed to obtain sufficient evidence supporting assertions in GEE's 2009 and 2010 Form 10-K financial statements that the purported CD existed and was a cash equivalent as of September 30, 2009, and that GEE entered into an assignment agreement with an unrelated party.[12]

Failed to determine whether fraud or potential illegal acts may have impacted GEE's fiscal year 2009 and 2010 financial statements (AU §§ 316, 317)

90. Under AU § 316.01, an auditor must plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. The auditors must brainstorm "how and where they believe the entity's financial statements might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated." (AU § 316.14) AU § 316.06 states that there are "[t]wo types of misstatements relevant to the auditor's consideration of fraud—misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets." It explains that financial reporting may be accomplished by falsification of supporting documentation, or misrepresentations of events, transactions, or other significant information. It further instructs that fraudulent financial reporting "need not be the result of a grand plan or conspiracy" and may instead "be that management representatives rationalize the appropriateness of a material misstatement ... as a temporary misstatement of financial statement ... expected to be corrected later." It instructs that that misappropriation of assets may be accompanied by "false or misleading records or documents, possibly created by circumventing controls." AU § 316.09 also notes that management engaged in fraud will take steps to conceal the fraud from auditors. AU § 316.10 further states that fraud may be concealed through collusion among management and third parties. For these reasons, AU § 316.13 requires auditors to exercise professional skepticism when considering the risk of material misstatement due to fraud.

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[11] AU § 508.20 also provided that "[c]ertain circumstances may require a qualified opinion ... [when] "[t]here is a lack of sufficient competent evidential matter or there are restrictions on the scope of the audit that have led the auditor to conclude that he or she cannot express an unqualified opinion...."

[12] In addition, AS § 3.12 required BDO to "document significant audit findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached." Henaghan failed to comply with this documentation requirement with respect to each of the major auditing issues encountered during the 2009 and 2010 audits.

91. AU § 316.68 lists conditions that may be identified during the fieldwork that are indicators of potential fraud, including (i) unsupported or unauthorized balances or transactions; (ii) missing documents; (iii) unusual discrepancies between the entity's records and confirmation replies; (iv) inconsistent, vague or implausible responses from management or employees; and (v) denial of access to records, facilities, certain employees, customers, vendors or others from whom audit evidence might be sought.

92. AU § 317.10 notes that auditors may become aware of possible illegal acts during the course of their audit: "When the auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstances in which it occurred and sufficient other information to evaluate the effect on the financial statements."

93. As a result of his above-described conduct, Henaghan failed to adhere to these PCAOB standards during BDO's 2009 or 2010 audits of GEE.

Failed to obtain sufficient audit evidence to determine whether the assignment agreement was a related party transaction (AU §§ 326 and 334)

94. PCAOB standards require that "[an] auditor should view related party transactions within the framework of existing [accounting] pronouncements, placing primary emphasis on the adequacy of disclosure. In addition, the auditor should be aware that the substance of a particular transaction could be significantly different from its form and that the financial statements should recognize the substance of particular transactions rather than merely their legal form." (AU § 334.02)

95. PCAOB standards require an auditor to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under audit. (AU § 326.01) In selecting particular substantive tests to achieve the audit objectives, an auditor considers, among other things, the risk of material misstatement of the financial statements. (AU § 326.11) With respect to related party transactions, PCAOB standards require that after an auditor identifies related party transactions, he or she should apply the procedures considered necessary to obtain satisfaction concerning their purpose, nature, and extent and their effect on the financial statements. (AU § 334.09) For each related party transaction for which disclosure is required, PCAOB standards require that the auditor satisfy himself that the transaction is adequately disclosed in the financial statements. (AU § 334.11)

96. The failure to disclose the assignment agreement as a related party transaction caused the financial statements to be misleading. Financial Accounting Standards Board Accounting Standards Codification ("ASC") Topic 850, *Related Party Disclosures* required that the following must be disclosed concerning related party transactions: (a) the nature of the relationship involved; (b) a description of the transaction; (c) the dollar amount of the transaction; and (d) amounts due from or to related parties and, if not otherwise apparent, the terms and manner of settlement. Related party transactions cannot be presumed to have been conducted at arm's-length. GAAP requires these disclosures so the reader can be alerted to their existence, so as to

help the reader of the financial statements detect and explain possible differences in financial statements of a company that engaged in related party transactions to those that did not.[13] Such disclosure helps the reader evaluate the substance of the related party transaction.

97. As a result of his above-described conduct, Henaghan failed to exercise the requisite level of care, failed to perform sufficient procedures to identify related party transactions, failed to obtain sufficient audit evidence to determine whether the assignment agreement was a related party transaction during BDO's 2009 or 2010 audits of GEE, and failed to follow up on evidence indicating that assertions regarding the purported CD and assignment agreement were unsubstantiated. Respondents also failed to ensure the issuance of an accurate audit report in 2009 and 2010, which misrepresented that GEE's financial statements were presented fairly, in all material respects, in accordance with GAAP.

Failed to Investigate Newly Discovered Facts in 2010 (AU § 561)

98. AU § 561.04 states that when an auditor becomes aware of information that he would have investigated if it had come to his attention during the course of the audit, he must determine if the information is reliable and whether the facts existed at the date of his report. If the information is reliable and existed at the date of the report, the auditor must determine if his report would have been affected and people relying on the financial statements would find it important. (AU § 561.05.)

99. As a result of his above-described conduct, Henaghan failed to adhere to this PCAOB Standard after learning of, among other things, the Antonucci Complaint in March 2010 and subsequent guilty plea in October 2010, as it concerned GEE's 2009 financial statements.

Rainis's Failure to Comply with Concurring Review Standard

100. The concurring partner reviewer's responsibility is to perform an objective review of significant auditing, accounting, and financial reporting matters and to conclude, based on all the relevant facts and circumstances of which the concurring partner reviewer has knowledge, that no matters that have come to his or her attention would cause the concurring partner reviewer to believe that the client's financial statements covered by the firm's audit report are not in conformity with generally accepted accounting principles in all material respects or that the audit was not performed in accordance with generally accepted auditing standards. SEC Practice Section §1000.39 (Appendix E).

101. As a result of his above-described conduct, Rainis failed to adhere to this standard during BDO's 2009 or 2010 audits of GEE.

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[13] ASC 850-10-05-2.

Finding

102. As a result of the conduct described above, the Commission finds that Henaghan, Rainis, Graul, and Gerace engaged in improper professional conduct within the meaning of Sections 4C(a)(2), 4C(b)(2)(A), and 4C(b)(2)(B) of the Exchange Act and Rules 102(e)(1)(ii), 102(e)(1)(iv)(B)(1), and 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice. The conduct by Henaghan, Rainis, Graul, and Gerace in the 2009 and 2010 audits of GEE involved repeated instances of unreasonable conduct, each resulting in violations of PCAOB standards and indicating a lack of competence, and also satisfies the standard of highly unreasonable conduct resulting in violations of PCAOB standards in circumstances in which heightened scrutiny was warranted.

CAUSING VIOLATIONS OF SECTION 10A OF THE EXCHANGE ACT

103. Section 10A(a)(1) of the Exchange Act requires each audit conducted of an issuer by a registered public accounting firm to include "procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts." Section 10A(a)(2) of the Exchange Act requires each audit conducted of an issuer by a registered public accounting firm to include "procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein." Section 10A(b)(1) requires a registered public accounting firm to, in accordance with PCAOB standards, "determine whether it is likely that an illegal act has occurred" if the firm "detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred." No showing of scienter is necessary to establish a violation of Section 10A. *See SEC v. Solucorp Indus., Ltd.*, 197 F. Supp. 2d. 4, 10-11 (S.D.N.Y. 2002).

104. In connection with the 2009 and 2010 GEE audits, BDO violated Section 10A(a)(1) of the Exchange Act by failing to plan, design, and carry out audit procedures to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statements amounts. As a result of Respondents' conduct described above, Respondents were each a cause of BDO's violations in circumstances in which each knew or should have known that their respective acts and omissions would contribute to BDO's violations.

105. In connection with the 2009 and 2010 GEE audits, BDO violated Section 10A(a)(2) of the Exchange Act by failing to plan, design, and carry out audit procedures to identify GEE's material related party transactions that required disclosure in the financial statements. As a result of Respondents' conduct described above, Respondents were each a cause of BDO's violations in circumstances in which each knew or should have known that their respective acts and omissions would contribute to BDO's violations.

106. In connection with the 2009 and 2010 GEE audits, BDO violated Section 10A(b)(1) of the Exchange Act by failing to determine whether it was likely that an illegal act had occurred after BDO was made aware of information indicating that an illegal act may have

occurred. As a result of Respondents' conduct described above, Respondents were each a cause of BDO's violations in circumstances in which each knew or should have known that their respective acts and omissions would contribute to BDO's violations.

107. As a result of the conduct described above, the Commission finds that Respondents were each a cause of BDO's violations of Sections 10A(a)(1), (a)(2), and (b)(1) of the Exchange Act.

CAUSING VIOLATIONS OF SECTION 13(a) OF
THE EXCHANGE ACT AND RULE 13a-1 THEREUNDER

108. Section 13(a) of the Exchange Act and Rule 13a-1 thereunder require that every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission annual reports (i.e., Form 10-K) as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading. The obligation to file such reports embodies the requirement that they be true and correct.

109. GEE's annual reports on Form 10-K for fiscal years 2009 and 2010 included audit reports from BDO that stated BDO's audits were conducted "in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that GEE's financial statements presented fairly, in all material respects, the company's position and results. These statements were materially misleading. As a result of Respondents' above-described conduct, BDO's 2009 and 2010 audits were not conducted in accordance with PCAOB standards and the financial statements included in GEE's 2009 and 2010 Form 10-Ks were materially misstated because, among other things, they incorrectly represented GEE had a $2.3 million CD and classified it as a cash equivalent as of September 30, 2009, and did not disclose the assignment agreement as a related party transaction, contrary to GAAP. At a minimum, each of the Respondents knew or should have known that their acts or omissions would contribute to GEE's filing of inaccurate 2009 and 2010 Form 10-Ks.

110. As a result of the conduct described above, the Commission finds that Respondents were a cause of GEE's violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.

IV.

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

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

A. Pursuant to Section 21C of the Exchange Act, Henaghan, Rainis, Graul, Gerace, and Hambleton shall cease and desist from committing or causing any violations and any future violations and any future violations of Sections 10A and 13(a) of the Exchange Act and Rule 13a-1 thereunder.

B. Henaghan is denied the privilege of appearing or practicing before the Commission as an accountant.

1. After three years from the date of this Order, Henaghan 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:

a. 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 Henaghan'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

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

(1) Henaghan, 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;

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

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

(4) Henaghan acknowledges his responsibility, as long as Henaghan appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, engagement quality review, and quality control standards.

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

C. Rainis is denied the privilege of appearing or practicing before the Commission as an accountant.

1. After two years from the date of this Order, Rainis 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:

a. 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 Rainis'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

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

(1) Rainis, 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;

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

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

(4) Rainis acknowledges his responsibility, as long as Rainis appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, engagement quality review, and quality control standards.

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

D. Gerace is denied the privilege of appearing or practicing before the Commission as an accountant.

1. After one year from the date of this Order, Gerace 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:

a. 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 Gerace'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

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

(1) Gerace, 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;

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

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

(4) Gerace acknowledges his responsibility, as long as Gerace appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB,

including, but not limited to, all requirements relating to registration, inspections, engagement quality review, and quality control standards.

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

E. Graul is denied the privilege of appearing or practicing before the Commission as an accountant.

1. After one year from the date of this Order, Graul 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:

a. 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 Graul'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

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

(1) Graul, 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;

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

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

(4) Graul acknowledges his responsibility, as long as Graul appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, engagement quality review, and quality control standards.

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

F. Respondents shall each, within 14 days of the entry of this Order, pay the civil money penalties indicated below:

(i) $30,000 for Henaghan;
(ii) $15,000 for Rainis;
(iii) $10,000 for Gerace;
(iv) $10,000 for Graul; and
(v) $10,000 for Hambleton.

to the 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. Payments ordered in this paragraph 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 Henaghan, Rainis, Graul, Gerace, or Hambleton 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, New York Regional Office, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281-1022.

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 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

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. 75860 / September 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3690 / September 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16798

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

I.

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

A. SUMMARY

1. These proceedings concern materially misleading statements and omissions made by Heineman, the chief executive officer ("CEO") of General Employment Enterprises, Inc. ("GEE" or the "Company") in 2009, to the Company's auditors after substantially all of the Company's cash—$2.3 million—was unaccounted for.

B. RESPONDENT

2. **Heineman**, age 57 and a resident of Cincinnati, Ohio, served as the CEO of GEE from July 1, 2009 through December 23, 2009. Heineman also served as manager of River Falls Financial Services, LLC from as early as January 2009 through April 29, 2011.

C. RELEVANT ENTITIES AND INDIVIDUALS

3. **GEE** is an Illinois corporation headquartered in Oakbrook Terrace, Illinois that provides professional placement services and temporary staffing services in certain industries. GEE's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NYSE MKT stock exchange. GEE files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

4. **River Falls Financial Services, LLC** ("River Falls Financial"), **River Falls Investments, LLC f/k/a Oxygen Unlimited II, LLC** ("River Falls Investments"), **River Falls Holdings, LLC** ("RFH"), **Accredited Investor Resources, LLC f/k/a Oxygen Investment Partners, LLC** ("AIR"), **Oxygen Unlimited, LLC** ("Oxygen"), **O2HR, LLC** ("O2HR"), **SDH Realty, LLC** ("SDH"), **WTS Acquisition LLC** ("WTS"), **H2H Holdings, LLC** ("H2H"), and **PSQ, LLC** ("PSQ") (collectively, the "Affiliated Entities") are purported holding, investment, employment-related, and insurance companies. River Falls Financial, AIR's administrative member, purportedly owned at least 99% of AIR's common units and millions of dollars of AIR's preferred units. AIR was purportedly an investment company designed to make investments in River Falls Investments and certain other of the Affiliated Entities. River Falls Investments was a purported holding company of Oxygen, which was a purported holding company of O2HR, a professional employer organization. RFH was the purported holding company of River Falls Investments. PSQ was a purported holding company whose sole asset was GEE shares representing a controlling stake in the Company acquired as of July 1, 2009.

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

5. During at least 2009 and 2010, **Wilbur Anthony Huff** ("Huff")[2] exercised substantial financial and management control during at least 2009 and 2010 over numerous entities, including, among others, the Affiliated Entities and their holdings. As a convicted felon, Huff faced legal and practical barriers to operating business entities in his own name, particularly business in regulated industries, including employment-related, insurance, and banking companies. Huff installed other business partners, including Heineman, to perform day-to-day operational functions and/or serve as the listed owners, directors, or managers. From as early as May 2008 through at least November 2009, Huff paid Heineman as much as $15,000 per month through the Affiliated Entities, mostly through River Falls Investments. In exchange, Heineman agreed to serve as the listed officer, director, or manager for GEE, River Falls Financial, and many of the Affiliated Entities and also purportedly advised Huff on various matters.

6. **Park Avenue Bank** ("PAB" or "the Bank") was a New York State chartered bank until it was closed by the New York State Banking Department on March 12, 2010, and the Federal Deposit Insurance Corporation was named Receiver. The Affiliated Entities primarily conducted their banking business through PAB. **Charles J. Antonucci, Sr.** ("Antonucci") served as the president and CEO of PAB from June 2004 until October 2009. In October 2010, Antonucci pled guilty to multiple criminal charges, including securities fraud, bank bribery, embezzlement, and providing a false confirmation to BDO of GEE's purported CD at PAB. Separately, **Park Avenue Insurance** was a private insurance company owned by Antonucci that was not affiliated with PAB.

7. **BDO USA, LLP** ("BDO"), formerly known as BDO Seidman, LLP, is a Delaware limited liability partnership and a PCAOB-registered public accounting firm with its headquarters in Chicago, Illinois. BDO served as GEE's independent auditor from 2004 through 2012.

8. **Stephen B. Pence** ("Pence"), age 60 and a resident of Louisville, Kentucky. As of July 1, 2009, Pence became a beneficial owner of a majority of GEE's common stock through a holding company, PSQ, LLC ("PSQ"), with the right to appoint three directors, including himself as chairman of the board, and to designate a CEO, a position he assigned to Heineman. Pence served as the chairman of the board of GEE until November 17, 2010. Pence formerly served as

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[2] Huff pled guilty to federal mail fraud charges for obtaining insurance premium finance loans under false pretenses in the Western District of Kentucky in 2003. In 2008, the Commission filed charges against Huff related to a scheme to misappropriate assets from and to record fake letters of credit at Certified Services, Inc. ("Certified"). *SEC v. Huff*, 08-CV-60315 (S.D. Fla.). On October 22, 2010, the Court entered judgment for the Commission against Huff requiring him to pay more than $13 million, among other relief. Separately, after an October 2012 indictment against him, Huff pled guilty on December 23, 2014 to an information, which alleged, among other things, that: (1) Huff controlled GEE, in whole or in part, by installing other individuals; (2) Huff participated with Antonucci in a conspiracy in which they stole $2.3 million from GEE and Huff later returned the $2.3 million to GEE from three companies he controlled; and (3) a large portion of the $2.3 million received by GEE were funds entrusted to Oxygen by its clients for payment of the clients' employment tax and other obligations. *U.S. v. Huff*, 12-CR-750 (S.D.N.Y.).

the lieutenant governor of Kentucky from 2003 to 2007 and the United States Attorney for the Western District of Kentucky from 2001 to 2003.

9. **Salvatore J. Zizza** ("Zizza") served as CEO of GEE from December 23, 2009, the day that Heineman resigned as CEO, through December 2012. Prior to his appointment as CEO, Zizza received monthly payments of $20,000 from PSQ, which were funded by several of the Affiliated Entities, for purported consulting services, and Zizza frequently attended GEE board meetings as an "invited guest." In 2009, businesses owned or operated by Zizza received loans in excess of $1 million that Huff directed from certain of the Affiliated Entities.

10. **Associate-1** was another of Huff's business partners and was listed or served at various times as a manager of River Falls Investments, Oxygen, and O2HR, and as co-manager of River Falls Financial with Heineman. Associate-1 was also involved in PSQ's acquisition of a controlling stake in GEE and attended several GEE board meetings in 2009. In addition, from July 2009 until September 2009, Associate-1 was a signatory on GEE's bank account at PAB despite the fact that Associate-1 was not an official employee, officer, or director of the Company. Associate-1 also purported to be the owner of WTS (another of the Affiliated Entities), a holding company of **On-Site Services, Inc.** ("On-Site") and **Ameritemps, Inc.** ("Ameritemps"), which WTS had acquired in January 2009 with funding from other Affiliated Entities. Almost immediately after PSQ's acquisition of a controlling stake in GEE, Heineman began presenting proposals to GEE's board for GEE to acquire these companies. For example, at a GEE board meeting on August 10, 2009, attended by Pence and Zizza, the board authorized Heineman to enter into a letter of intent with WTS to acquire On-Site, and Heineman reported that he would present another acquisition candidate, Ameritemps, at the September board meeting.

D. BACKGROUND

11. GEE's May 18, 2009, definitive proxy statement disclosed that in January 2009, GEE began discussions with representatives of River Falls Financial concerning the possibility of a tender offer and direct cash investment in GEE. The River Falls Financial representatives included Heineman and Pence, and Huff was present for one of the relevant meetings. The proxy statement further disclosed that, on February 11, 2009, River Falls Financial and PSQ, a special purpose vehicle purportedly formed by Pence, entered into a non-binding letter of intent with GEE for a purchase and tender offer agreement to obtain a controlling stake in GEE.

12. According to GEE's May 18, 2009, definitive proxy statement, on March 30, 2009, after negotiations continued following the February 2009 non-binding letter of intent, Pence signed on behalf of PSQ a definitive securities purchase and tender offer agreement (the "Purchase Agreement"). The Purchase Agreement provided that, subject to shareholder approval, PSQ would acquire a controlling stake in GEE by (1) purchasing 7,700,000 newly-issued shares of GEE common stock in a private placement transaction at a purchase price of $0.25 per share for a total purchase price of $1,925,000; (2) commencing a cash tender offer to purchase from the Company's shareholders up to 2,500,000 shares of common stock at a purchase price of $0.60 per share; (3) appointing three directors to a five-member board of directors, including Pence becoming the chairman of the board; and (4) designating Heineman GEE's CEO. On June 22, 2009, a GEE press released announced shareholders approved the Purchase Agreement and the closing of the

Purchase Agreement was announced on July 1, 2009. As a result, PSQ acquired more than 65% ownership of the Company, Pence became GEE's chairman and appointed two other directors, and Heineman became GEE's CEO.

13. Although Pence purported to be sole member and owner of PSQ, as Heineman knew, PSQ was one of the Affiliated Entities over which Huff exercised substantial financial and management control. Virtually all of the funds deposited in PSQ's bank accounts during 2009 were deposits made directly from several of the Affiliated Entities, including AIR, Oxygen, River Falls Financial, and RFH, typically at the direction of Huff. Specifically, in almost every instance in which PSQ needed to make a payment, PSQ received the necessary funds from one of the Affiliated Entities and immediately paid the obligation with the deposited funds. For example, to fund PSQ's obligations under the Purchase Agreement, AIR transferred $1,925,000 to PSQ, and to cover PSQ's tender offer obligations, AIR transferred $850,000 and Oxygen transferred $372,000 (a total of $1,222,000) to PSQ. In exchange, Huff required Pence to sign two purported promissory notes to AIR in his personal capacity for these amounts ($1,925,000 and $1,222,000), even though $372,000 had been provided by Oxygen. Although the two promissory notes required Pence to pay annual interest of 5%, Huff did not actually require Pence to make any interest payments to AIR and no payments were made.

14. In late June 2009, Pence arranged for Associate-1 to become a signatory on GEE's bank account at PAB and Associate-1 remained a signatory from July 2009 until September 2009. In addition, Associate-1 negotiated certain employment and other agreements on behalf of GEE, and Associate-1 attended several GEE board meetings in 2009. At the same time, Huff and Associate-1 controlled WTS, which owned a number of companies that Huff and Associate-1 intended to sell to GEE. Because Huff and Associate-1 controlled WTS, Pence did not appoint Associate-1 to be an officer, director, or employee of GEE, which avoided scrutiny of this clear conflict of interest.

15. Huff and his business partners—including Pence, Heineman, and Associate-1—created a number of oral and written side agreements regarding ownership, profit sharing, and management of the Affiliated Entities. For example, at the time AIR purportedly loaned Pence the funds for PSQ's transaction with GEE, Pence had no ability to repay the loans without fully liquidating the GEE shares purchased by PSQ. Thus, in consideration for AIR's purported loans to Pence, Pence and Huff orally agreed that if GEE's stock price increased Pence would compensate AIR with GEE shares in addition to repaying the amounts of the promissory notes. As a result, Huff and AIR had a beneficial ownership interest in the GEE shares held by PSQ, which was not disclosed.

16. From March 2009 through at least April 2010, in connection with PSQ's majority ownership of GEE, PSQ paid Zizza $20,000 per month purportedly for consulting work. Huff funded PSQ's payments to Zizza through the Affiliated Entities. For example, Pence notified Huff on January 2, 2010 that PSQ needed to pay Zizza for consulting and specifically asked Huff and Huff's assistant to deposit money into PSQ's account so PSQ could pay Zizza. Huff's assistant sent PSQ a check from a River Falls Financial account on January 4, 2010, and Pence sent Zizza a check from PSQ's account for $20,000 on the same date. Zizza advised Pence and Huff on several acquisitions that GEE was considering in 2009. Huff and Pence also promised Zizza that if GEE's

stock price increased, they would compensate Zizza with at least 500,000 GEE shares. Zizza became the CEO of GEE on December 23, 2009.

17. As part of his arrangement with Huff, Heineman served in various roles at several of the Affiliated Entities and signed numerous agreements involving the Affiliated Entities, including:

- Heineman signed a December 2008 agreement on behalf of WTS in which WTS purchased the Ohio assets of Ameritemps, Inc., which later became two companies that GEE purchased in 2010, RFFG of Cleveland, LLC and DMCC Staffing, LLC.

- At Huff's direction, Heineman personally guaranteed a loan of $1.5 million made by PAB to a Affiliated Entity called Aviation Solutions, LLC.

- Heineman served as an authorized signer on several bank accounts that certain Affiliated Entities had with PAB.

- At Huff's direction, Heineman signed a November 2010 agreement, as manager of River Falls Financial and on behalf of AIR, in which AIR agreed that PSQ would assume Pence's $3 million promissory notes issued to AIR.

18. Huff covertly exercised influence and control over GEE operations through Pence and Heineman as a result of his control over AIR, which financed PSQ's investment in GEE. Huff also sent substantial monthly payments to Pence ($25,000), Zizza ($20,000), and Heineman ($15,000) from various Affiliated Entities in an attempt to ensure his control over, and ability to influence, GEE operations.

19. Huff exerted control over GEE by, among other things, causing GEE to acquire several entities owned by WTS, which Huff and Associate-1 controlled. For example, at an August 10, 2009, GEE board meeting, attended by Pence and Zizza (as Pence's guest), Heineman convinced the GEE board of directors to authorize him to enter into a letter of intent with WTS to acquire its subsidiary On-Site, which was publicly announced on September 6, 2009. In June 2010, while Zizza was GEE's CEO, GEE acquired On-Site, resulting in a financial benefit to Huff. In November 2010, GEE acquired additional assets of WTS doing business as Ameritemps, RFFG of Cleveland, LLC and DMCC Staffing, LLC, again resulting in a financial benefit to Huff. During 2010, Zizza had numerous discussions with Huff concerning these acquisitions.

E. HEINEMAN KNEW OR SHOULD HAVE KNOWN THAT THE PURPORTED $2.3 MILLION CD ASSIGNMENT WAS FRAUDULENT

20. As part of the July 2009 closing of PSQ's Purchase Agreement with GEE, GEE opened a checking account at PAB into which PSQ's escrowed $1,925,000 would be deposited upon the closing. In June 2009, Associate-1 coordinated with GEE's chief financial officer (the "GEE CFO") to have the GEE checking account opened at PAB and the authorized signatories on the account were the GEE CFO, Pence, and Associate-1. The GEE CFO, Pence, and Associate-1 remained the only authorized signatories on the account until September 2009, at which time

Associate-1 was removed and Heineman was added. Following the closing, Heineman directed the GEE CFO to transfer an additional $750,000 from GEE's accounts at other banks to the GEE PAB checking account. The approximately $2.6 million deposited in the GEE PAB checking account constituted substantially all of GEE's cash and half of its assets. Heineman understood that GEE opened the bank account with PAB because of Huff's business relationship with Antonucci, PAB's president. Heineman also knew or should have known that the Affiliated Entities primarily maintained their bank accounts at PAB and that Huff and the Affiliated Entities had other business dealings with Antonucci.

21. In approximately July 2009, Huff discussed with Pence the possibility of GEE investing money in Park Avenue Insurance to achieve greater returns on GEE's cash. Pence told Heineman about Huff's idea and involved Heineman in exploring the terms for GEE's potential investment. Heineman knew or should have known that Park Avenue Insurance was privately owned by Antonucci and that Pence had served as Park Avenue Insurance's president during part of 2009.

22. On July 14, 2009, Heineman received a draft promissory note from Huff's attorney that proposed that GEE make a one-year loan to Park Avenue Insurance in the amount of $2.4 million with four percent interest. Heineman responded that the promissory note should be changed to $2.7 million. No promissory note between GEE and Park Avenue Insurance appears to have been actually executed.

23. However, in August 2009, the GEE CFO reviewed the July 2009 PAB monthly statement indicating that $2.3 million had been withdrawn from the GEE PAB operating account on July 23, 2009, without his knowledge. When asked about the missing funds, Heineman claimed that he had authorized GEE to invest $2.3 million into a certificate of deposit account at PAB. Although the GEE CFO repeatedly requested that Heineman provide documentation concerning the purported CD, such as a written authorization, account agreement, and account statements—and cited the lack of documentation as a control deficiency—Heineman only provided the GEE CFO with a one-page PDF of a typewritten "Certificate of Deposit Receipt" for $2.3 million with a single maturity date of October 21, 2009, and interest rate of two percent.

24. GEE's fiscal year ended on September 30, 2009. On October 19, 2009, the GEE CFO provided to audit committee members and BDO a report of the evaluation of internal control for fiscal year 2009, which noted the purported PAB CD as an identified control deficiency. The report noted that "[t]he transaction was not executed by the office of the Treasurer, and no written approval or account agreement was provided to the accounting department" and that "it did not conform to the company's investment guidelines" because it did not provide sufficient diversification and PAB did not meet GEE's size requirement. However, the report concluded that the control deficiency did not constitute a material weakness. BDO concurred with this assessment. In response, Heineman did not provide any additional information or documentation to the GEE CFO.

25. In early November 2009, the GEE CFO noticed that PAB had not remitted the proceeds of the purported CD of $2.3 million plus interest into GEE's checking account upon the maturity date, October 21, 2009. When the GEE CFO contacted PAB, a PAB representative stated

that the Bank had no record of the purported CD in its system. The GEE CFO then pressed both Heineman and Pence for an explanation. On November 9, 2009, Pence asked Heineman for information about the purported CD; Heineman responded that Huff would contact PAB on GEE's behalf.

26. According to the minutes of a November 23, 2009, audit committee meeting, attended by BDO, the GEE CFO reported his concerns that GEE had little documentation supporting the purported CD, including no written authorization from an account signatory and no deposit agreement. According to the minutes, Heineman claimed that he authorized the purported CD at Pence's direction, and claimed the lack of documentation was due to "the rapid pace of the transactions in which he had been involved, coupled with reorganization and personnel changes at Park Avenue Bank." Heineman next stated that he had anticipated that the CD would be maintained on a continuing renewal basis but he had asked Pence to liquidate the purported CD and have the funds transferred into the PAB checking account by the end of the week. The minutes also state that the BDO engagement partner "said that the audit was substantially completed, pending resolution of the missing funds issue, receipt of legal letters from counsel, and the executed management representation letter" and that BDO "would be issuing an unqualified opinion on the consolidated financial statements."

27. On November 24, 2009, the BDO engagement partner emailed the GEE audit committee chairman (the "AC Chair"), stating that the GEE CFO had "indicated there was an update on the CD and that the funds would be returned in installments. I am not sure if you can provide any further clarity on why this would be. I wanted to check with you before I had another discussion with [Heineman]." The AC Chair replied that he "[could] not provide any clarity" and expressed concern that one of the audit committee members (the "AC Member") "seems to be tied in with this group." The AC Member had been appointed by Pence in connection with the PSQ transaction in July.

28. The BDO engagement partner replied to the AC Chair the following day, November 25, 2009, that he had spoken to Heineman that morning and Heineman indicated that Pence and the AC Member "were taking the lead on this as they have a previous working relationship with the bank." BDO's engagement partner also noted that Heineman, however, had "disagreed with the fact that the CD would be 'paid back in installments'" and had "indicated that the proceeds of the CD would be in the Company's bank account by Monday."

29. On November 24, 25, and 27, 2009, Huff directed and caused a total of $900,000 to be transferred to GEE's bank accounts in installment payments of $300,000 on each such date from the bank accounts of two of the Affiliated Entities: SDH and Oxygen.

30. On November 30, 2009, GEE's CFO asked Heineman if he knew anything concerning two $300,000 wire transfers that GEE had unexpectedly received from SDH and Oxygen. Heineman claimed that he did not know why those transfers had occurred. Heineman's statement was materially misleading.

31. Also on November 30, 2009, Pence, Zizza, and Heineman attended a GEE board of directors meeting. Zizza, who had no formal role at GEE at this time, attended as an "invited

guest." The board minutes indicate that the AC Chair explained that the Company's Form 10-K had not yet been filed because BDO's "final" opinion was predicated on the satisfactory accounting for the PAB CD and an explanation for where GEE's funds had been since the CD matured on October 21. During this November 30, 2009, board meeting, the AC Member stated he believed that the situation occurred as a result of administrative errors on the part of the Bank, and Pence said that the AC Member had agreed to pursue the matter with PAB. Neither Pence nor Heineman (or anyone else) mentioned anything about GEE selling or assigning the purported CD to a third party.

32. On December 4, 2009, the BDO engagement partner on the GEE audit sent an email to the AC Chair, Heineman, and Pence, among others, summarizing the open items requiring resolution prior to the issuance of BDO's audit report. The email begins by noting that after the CD had matured in October 2009, when the GEE CFO had contacted the Bank, a PAB representative informed the GEE CFO that there was no record of the purported CD and that after some investigation by the AC Member, "in late November it was determined that the funds would be returned to GEE in installments." The email then notes that GEE had received the following wire transfers: (i) November 24: $300,000 wire transfer from SDH; (ii) November 25: $300,000 wire transfer from Oxygen; (iii) November 27: $300,000 wire transfer from SDH; and (iv) December 1: $100,000 wire transfer from Oxygen. It then stated that the BDO engagement partner had discussed the matter with Heineman and Pence, who both referred him to the AC Member who was working directly with PAB on the matter, and that the AC Member left him a voicemail "indicating the bank continues to put money against the CD they owe [GEE] and it should be fully repaid by the close of business on Monday, Dec. 7" and that the Bank would provide a short apology note.

33. Shortly after receiving it, the AC Chair forwarded the December 4, 2009, email from the BDO engagement partner to Heineman, Pence, the AC Member, the GEE CFO, and GEE's board, noting: "Multiple representatives of BDO have told me that they will not sign off on the GEE Audit . . . until they have sufficient documentation of what has transpired. [BDO's] position is that the Liabilities associated with a sign-off far exceed any past or potential future Audit Fees that [they] have received or will receive. The high level message is that a letter of apology from Park Avenue Bank will not be sufficient." The BDO engagement partner received a copy of this email and replied to all: "To clarify, [our] primary concern is getting an understanding of exactly what has occurred in order to allow us to complete our audit procedures. As I am sure everyone would agree, what has transpired over the last few weeks with the funds at [PAB] has been highly unusual. I know everyone has been working to resolve the issue. However, time continues to pass and [GEE's] filing deadline will be here before we know it. As such, I wanted to clarify the importance of appropriately addressing the issue as quickly as possible to allow us to complete the audit."

34. Later in the day on December 4, the AC Chair sent an email to the BDO engagement partner and concurring partner summarizing his call with the AC Member, stating that when he spoke with the AC Member "he told me that [PAB] had reported these transaction [sic] to the FDIC and that the money sent to the various entities that are now sending GEE the money are sending us the banks money rather than sending it back to the bank." The AC Chair continued: "This makes absolutely no sense. It looks like [PAB] is on the verge of failing. The FDIC and a

bankruptcy estate are going to require [PAB] to collect every cent they can under loans or other arrangements to settle with the creditors of the bank before they send money to third parties."

35. The following day, on December 5, 2009, the AC Chair emailed GEE's board (including Pence) and Heineman calling for a special audit committee meeting on December 9 because of "several unanswered questions related to $2.3 million of the Company's cash which supposedly was invested in a Certificate of Deposit ('CD') at Park Avenue Bank which will need to be answered before BDO will complete their Audit Report for the Company's fiscal year ended September 30, 2009." The AC Chair's email noted several issues, including that (i) there was no account agreement with PAB or regular reporting on the CD; (ii) PAB did not remit the proceeds of the CD into GEE's operating account when it reached its maturity date on October 21, 2009; (iii) PAB provided no explanation to the GEE CFO when he attempted to investigate; and (iv) the AC Member who took the lead on this matter with PAB "was informed on or about November 21, 2009, that the funds would be returned to [GEE] in a series of deposits." The email also provided a chart of seven wire transfers totaling $1.7 million, which included the four noted in Henaghan's December 4 email plus a December 2, 2009, wire transfer from Oxygen for $100,000, a December 2, 2009, wire transfer from River Falls Financial of $300,000, and a December 3, 2009, wire transfer from River Falls Financial also for $300,000. The address listed for both SDH and River Falls Financial on each of their wire transfers in the chart was 11921 Brinley Ave, Louisville, KY.

36. On December 4 and December 9, 2009, GEE received two additional wire transfers from River Falls Financial for $300,000 each, bringing the total amount received by GEE from River Falls Financial to $1.2 million and the total of the nine wire transfers to $2.3 million, the same amount that Heineman had purported to invest in a CD. Heineman knew or should have known that Huff, in conjunction with Associate-1, directed the transfers from SDH, Oxygen, and River Falls Financial to return the missing funds to GEE.

37. On December 8, the AC Chair emailed the BDO engagement partner, providing some links he suggested the BDO engagement partner review before he had a conversation with the AC Member and any representatives of PAB, "particularly the Anthony Huff links" and explained that he "met Anthony Huff when we went to New York" to negotiate PSQ's acquisition. The email included links to a press release announcing the Commission's lawsuit against Huff, a link to Huff's website noting the address 11921 Brinley Avenue, Louisville, KY in the text of the email, and a link to the website for Oxygen noting the identical address. This is the same address that appeared in the wires sent to GEE by River Falls Financial and SDH, as noted in the AC Chair's December 5 email described in paragraph 36, above. Also, Huff's website at the time contained references to River Falls Investments, SDH, Oxygen, and O2HR.

38. Also on December 8, 2009, the day before the special audit committee meeting, the AC Chair received an email from Heineman to the audit committee with several attachments. Heineman's email purported to offer a new explanation for why GEE had received $2.3 million from the three entities rather than PAB. Heineman claimed that he had negotiated an assignment agreement with the manager of River Falls Investments (Associate-1), who "offered to purchase" the purported CD from GEE at face value. Heineman also attached to his email an unsigned, draft assignment agreement and a letter from Heineman to PAB, dated July 21, 2009, that purportedly authorized the $2.3 million CD investment. Heineman's email also attached a July 2009 monthly

statement for GEE's operating account at PAB, which included the description of the $2.3 million withdrawal as a debit on July 23 with a debit memo stating in handwriting: "To: Park Avenue Insurance, See Attachment Approval, $2,300,000.00." Park Avenue Insurance was a private insurance company separately owned by Antonucci that was not affiliated with PAB.

39. The AC Chair responded to Heineman's email that day, stating: "Given the chain of event[s] you described below, why was GEE not informed immediately when River Falls Investments purchased the CD and why are we just now learning that a law firm has been engaged to document the assignment of the CD? We have been asking questions about the CD now for nearly a month."

40. The BDO engagement partner also exchanged emails with the AC Chair later that day, noting his agreement with the AC Chair's questions to Heineman and that "the sale of the CD would constitute a related party transaction which typically should be approved by the board." The AC Chair replied to the BDO engagement partner that he had just spoken to Heineman and Heineman "claims that RFI (River Falls Investment) is 100% owned by [Associate-1] and is not related to River Falls Financial [] or any of the other entities." The BDO engagement partner replied, "That is consistent with what [] Pence told me in my conversation with him. The common names are a little strange though."

41. Heineman's aforementioned statements to BDO around December 2009 were materially misleading because, among other things, Heineman knew or should have known that:

a. he did not negotiate an assignment agreement with Associate-1 (or anyone else);

b. Huff controlled River Falls Investments, which was a related party; indeed, River Falls Investments had been making substantial monthly payments to Heineman since May 2008;

c. Huff had directed the three Affiliated Entities to transfer funds to GEE in late November and early December to preserve the financial viability of GEE for the benefit of Huff and PSQ;

d. his assignment agreement story had falsely explained why GEE had received those payments from the Affiliated Entities;

e. Pence did not actually own or control River Falls Financial, Huff did; and

f. Pence, Huff, Associate-1, and Heineman had an unwritten agreement to divide amongst themselves any financial windfalls associated with the market performance of GEE's stock.

42. Along with his December 8, 2009, email to the audit committee, Heineman attached a letter, dated July 21, 2009, signed by him and addressed to the president of PAB, stating: "Please transfer $2,300,000 from the GEE checking account to a 90-day automatic renewal Certificate of Deposit." Heineman had drafted this July 2009 letter in late 2009 and

presented it to GEE's audit committee to convince everyone that he had authorized the purchase of the purported CD in light of the increased scrutiny concerning GEE's missing funds.

43. According to the minutes of GEE's audit committee meeting on December 9, 2009:

- The BDO engagement partner expressed concern that BDO still did not have a clear understanding of the purported CD transaction.

- The BDO engagement partner said that BDO needed to understand the nature of the purported administrative errors at PAB that he had been told were responsible for the lack of proper documentation regarding the CD transaction. He also explained that BDO required documentation validating the banking transactions, and an explanation as to why there was no existence of an account agreement with the Bank or no record of the CD being at the bank.

- Another BDO partner, BDO's Midwest Regional Business Line Leader, said he believed members of GEE's senior management appeared hesitant to provide information related to these transactions.

- The BDO engagement partner stated that the assignment agreement did not resolve the outstanding issues as BDO still needed to know what transpired within PAB and make a determination of whether the assignment agreement with River Falls Investments was a related party transaction.

- BDO also advised that although the assignment agreement "may reduce or eliminate the need for going concern disclosure, it would increase the requirement that management provide sufficient disclosure regarding any related party conflicts."

44. On December 14, 2009, GEE's outside counsel sent PAB a formal letter requesting all documentation and information concerning the purported CD. PAB's December 16, 2009, response provided only documents relating to GEE's checking account and did not provide any documents or other information about the purported CD. The checking account documentation, however, indicated that only Associate-1, the GEE CFO, and Pence were authorized signers on GEE's account from July to September 2009—not Heineman—and the checking account statements reflected a debit memo for the transfer of $2.3 million of GEE's cash to Park Avenue Insurance on July 23, 2009.

45. On December 22, 2009, BDO sent the AC Chair a letter stating that BDO did not have sufficient audit evidence to formally conclude the audit and demanded an independent investigation ("BDO's demand letter"). BDO's demand letter identified multiple inconsistencies and problems in the audit evidence BDO had received regarding the purported CD, including that a number of significant questions remained unanswered concerning both the existence of the purported CD (e.g., why bank records provided by PAB showed a transfer of $2.3 million to Park Avenue Insurance) and the manner in which $2.3 million had been transferred to the Company by the Affiliated Entities (e.g., why Associate-1 would pay 100% of the face value of the purported

CD after the maturity date had expired without payment by PAB, why had River Falls Financial—purportedly owned by Pence—transferred approximately $1 million to GEE in connection with the alleged assignment of the purported CD to River Falls Investments, and why Heineman had made inconsistent representations about his involvement in negotiating the alleged assignment with Associate-1). Pence reviewed the letter and told Huff that he was very concerned. Pence also forwarded BDO's demand letter to Zizza and Associate-1, the purported manager of River Falls Investments.

46. On the evening of December 22, 2009, BDO learned that the Audit Committee meeting that was scheduled for the following day had been cancelled, Zizza, an advisor to Pence who had attended GEE board meetings through the fall of 2009, would be taking over as CEO, and that Pence and Associate-1 intended to prepare written responses to each of the issues identified in the December 21 letter. On December 23, 2009, Heineman formally resigned as GEE's CEO and that same day Pence appointed Zizza, who had previously brought new business to BDO in the form of several auditing clients, to be GEE's new CEO.

F. VIOLATIONS

47. Rule 13b2-2 of the Exchange Act prohibits officers and directors from, directly or indirectly, making or causing to be made materially false or misleading statements or omissions to accountants in connection with an audit or preparation of reports to be filed with the Commission.

48. As a result of the conduct described above, Heineman violated Rule 13b2-2 under 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 Exchange Act Rule 13b2-2.

B. Respondent shall pay a civil penalty of $150,000 to the 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 the following installments: (1) $40,000 within 10 days of the entry of this Order; (2) $40,000 within 120 days of the entry of this Order; (3) $40,000 within 240 days of the entry of this Order; and (4) $30,000 within 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 Heineman 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, New York Regional Office, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281-1022.

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. 75861 / September 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3691 / September 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16799

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

I.

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

A. SUMMARY

1. These proceedings concern materially misleading statements and omissions made by Zizza, the chief executive officer ("CEO") of General Employment Enterprises, Inc. ("GEE" or the "Company"), to the Company's auditors concerning the return of $2.3 million from related parties after the money was unaccounted for.

B. RESPONDENT

2. **Zizza**, age 69 and a resident of New York, New York, served as the CEO of GEE from December 23, 2009, through December 2012.

C. RELEVANT ENTITIES AND INDIVIDUALS

3. **GEE** is an Illinois corporation headquartered in Oakbrook Terrace, Illinois that provides professional placement services and temporary staffing services in certain industries. GEE's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NYSE MKT stock exchange. GEE files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

4. **River Falls Financial Services, LLC** ("River Falls Financial"), **River Falls Investments, LLC f/k/a Oxygen Unlimited II, LLC** ("River Falls Investments"), **River Falls Holdings, LLC** ("RFH"), **Accredited Investor Resources, LLC f/k/a Oxygen Investment Partners, LLC** ("AIR"), **Oxygen Unlimited, LLC** ("Oxygen"), **O2HR, LLC** ("O2HR"), **SDH Realty, LLC** ("SDH"), **WTS Acquisition LLC** ("WTS"), **H2H Holdings, LLC** ("H2H"), and **PSQ, LLC** ("PSQ") (collectively, the "Affiliated Entities") are purported holding, investment, employment-related, and insurance companies. River Falls Financial, AIR's administrative member, purportedly owned at least 99% of AIR's common units and millions of dollars of AIR's preferred units. AIR was purportedly an investment company designed to make investments in River Falls Investments and certain other of the Affiliated Entities. River Falls Investments was a purported holding company of Oxygen, which was a purported holding company of O2HR, a professional employer organization. RFH was the purported holding company of River Falls Investments. PSQ was a purported holding company whose sole asset was GEE shares representing a controlling stake in the Company acquired as of July 1, 2009.

5. During at least 2009 and 2010, **Wilbur Anthony Huff** ("Huff")[2] exercised substantial financial and management control over numerous entities, including, among others, the

[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.

Affiliated Entities and their holdings. As a convicted felon, Huff faced legal and practical barriers to operating business entities in his own name, particularly business in regulated industries, including employment-related, insurance, and banking companies. Huff installed other business partners, including Pence, to perform day-to-day operational functions and/or serve as the listed owners, directors, or managers. Zizza first met Huff and Pence in 2008 when Huff asked for Zizza's help raising money for Oxygen and River Falls Investments. Zizza also attended a conference at which Huff discussed various AIR-related investments.

6. **Park Avenue Bank** ("PAB" or "the Bank") was a New York State chartered bank until it was closed by the New York State Banking Department on March 12, 2010, and the Federal Deposit Insurance Corporation was named Receiver. The Affiliated Entities primarily conducted their banking business through PAB. **Charles J. Antonucci, Sr.** ("Antonucci") served as the president and CEO of PAB from June 2004 until October 2009. In October 2010, Antonucci pled guilty to multiple criminal charges, including securities fraud, bank bribery, embezzlement, and providing a false confirmation to BDO of GEE's purported CD at PAB. Separately, **Park Avenue Insurance** was a private insurance company owned by Antonucci that was not affiliated with PAB.

7. **BDO USA, LLP** ("BDO"), formerly known as BDO Seidman, LLP, is a Delaware limited liability partnership and a PCAOB-registered public accounting firm with its headquarters in Chicago, Illinois. BDO served as GEE's independent auditor from 2004 through 2012.

8. **Stephen B. Pence** ("Pence") served as the chairman of the board of GEE from July 1, 2009, through November 17, 2010. Although Pence purported to be the sole member and owner of PSQ, whose sole asset was the GEE shares representing a controlling stake in the Company as of July 1, 2009, PSQ was one of the Affiliated Entities over which Huff exercised substantial financial and management control. PSQ's acquisition of GEE stake was funded by AIR and Oxygen. Pence also represented to BDO that he was the 100% owner of River Falls Financial, another of the Affiliated Entities. Huff directed substantial monthly payments to Pence ($25,000) from several of the Affiliated Entities to ensure his control over, and ability to influence, GEE's operations. Pence formerly served as the lieutenant governor of Kentucky from 2003 to 2007 and the United States Attorney for the Western District of Kentucky from 2001 to 2003.

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[2] Huff pled guilty to federal mail fraud charges for obtaining insurance premium finance loans under false pretenses in the Western District of Kentucky in 2003. In 2008, the Commission filed charges against Huff related to a scheme to misappropriate assets from and to record fake letters of credit at Certified Services, Inc. *SEC v. Huff*, 08-CV-60315 (S.D. Fla.). On October 22, 2010, the Court entered judgment for the Commission against Huff requiring him to pay more than $13 million, among other relief. Separately, after an October 2012 indictment against him, Huff pled guilty on December 23, 2014 to an information, which alleged, among other things, that: (1) Huff controlled GEE, in whole or in part, by installing other individuals; (2) Huff participated with Antonucci in a conspiracy in which they stole $2.3 million from GEE and Huff later returned the $2.3 million to GEE from three companies he controlled; and (3) a large portion of the $2.3 million received by GEE were funds entrusted to Oxygen by its clients for payment of the clients' employment tax and other obligations. *U.S. v. Huff*, 12-CR-750 (S.D.N.Y.).

9. **Ronald E. Heineman** ("Heineman") was appointed as the CEO of GEE on July 1, 2009, in connection with PSQ's acquisition of a controlling stake in GEE. Heineman served as CEO until his resignation on December 23, 2009, in connection with the events described herein. Zizza was appointed as GEE's CEO to replace Heineman on the same day. Huff directed substantial monthly payments to Heineman ($15,000) from the Affiliated Entities during this time period.

10. **Associate-1** was another of Huff's business partners and was listed or served at various times as a manager of River Falls Investments, Oxygen, and O2HR, and as co-manager of River Falls Financial with Heineman. Associate-1 was also involved in PSQ's acquisition of a controlling stake in GEE and attended several GEE board meetings in 2009. In addition, from July 2009 until September 2009, Associate-1 was a signatory on GEE's bank account at PAB despite the fact that Associate-1 was not an official employee, officer, or director of the Company. Associate-1 also purported to be the owner of WTS (another of the Affiliated Entities), a holding company of **On-Site Services, Inc.** ("On-Site") and **Ameritemps, Inc.** ("Ameritemps"), which WTS had acquired in January 2009 with funding from other Affiliated Entities.

D. BACKGROUND

11. Zizza became CEO of GEE on December 23, 2009, after a period of prior business dealings with Huff, Pence, and other entities and individuals associated with them. In December 2009, shortly before and after he became GEE's CEO, Zizza engaged in a series of conversations with the company's auditor, BDO, concerning the circumstances surrounding the return of $2.3 million that GEE had purportedly invested in a CD issued by PAB.

12. GEE's May 18, 2009, definitive proxy statement disclosed that in January 2009, GEE began discussions with representatives of River Falls Financial concerning the possibility of a tender offer and direct cash investment in GEE. The River Falls Financial representatives included Heineman and Pence, and Huff was present for one of the relevant meetings. At all relevant times, Zizza was aware that Huff was a convicted felon. The proxy statement further disclosed that, on February 11, 2009, River Falls Financial and PSQ, a special purpose vehicle purportedly formed by Pence, entered into a non-binding letter of intent with GEE for a purchase and tender offer agreement to obtain a controlling stake in GEE.

13. In 2009, Zizza understood that Pence had a managerial role with certain of the Affiliated Entities, including River Falls Financial and River Falls Investments. In the spring of 2009, Zizza signed a loan commitment term sheet on behalf of Metropolitan Paper Recycling, Inc. ("MPR"), a company 50% owned by Zizza, in which River Falls Investments agreed to provide $3 million in financing to MPR. Zizza signed the agreement as MPR's chairman, and Pence signed as River Falls Investments's manager. While Zizza understood that Pence had a managerial role with River Falls Investments, he also knew or should have known that Huff exercised substantial financial and management control over River Falls Investments. Zizza also knew or should have known that Huff exercised substantial financial and management control over River Falls Financial because on January 4, 2010, MPR received a loan of $200,000 from River Falls Financial at Huff's direction.

14. According to GEE's May 18, 2009, definitive proxy statement, on March 30, 2009, after negotiations continued following the February 2009 non-binding letter of intent, Pence signed on behalf of PSQ a definitive securities purchase and tender offer agreement (the "Purchase Agreement"). The Purchase Agreement provided that, subject to shareholder approval, PSQ would acquire a controlling stake in GEE by (1) purchasing 7,700,000 newly-issued shares of GEE common stock in a private placement transaction at a purchase price of $0.25 per share for a total purchase price of $1,925,000; (2) commencing a cash tender offer to purchase from the Company's shareholders up to 2,500,000 shares of common stock at a purchase price of $0.60 per share; (3) appointing three directors to a five-member board of directors, including Pence becoming the chairman of the board; and (4) designating Heineman GEE's CEO. On June 22, 2009, a GEE press release announced that shareholders approved the Purchase Agreement and the closing of the Purchase Agreement was announced on July 1, 2009. As a result, PSQ acquired more than 65% ownership of the Company, Pence became GEE's chairman and appointed two other directors, and Heineman became GEE's CEO.

15. Although Pence purported to be sole member and owner of PSQ, as Zizza knew or should have known, PSQ was one of the Affiliated Entities over which Huff exercised substantial financial and management control. Virtually all of the funds deposited in PSQ's bank accounts during 2009 were deposits made directly from several of the Affiliated Entities, including AIR, Oxygen, River Falls Financial, and RFH, typically at the direction of Huff. Specifically, in almost every instance in which PSQ needed to make a payment, PSQ received the necessary funds from one of the Affiliated Entities and immediately paid the obligation with the deposited funds. For example, to fund PSQ's obligations under the Purchase Agreement, AIR transferred $1,925,000 to PSQ, and to cover PSQ's tender offer obligations, AIR transferred $850,000 and Oxygen transferred $372,000 (a total of $1,222,000) to PSQ. In exchange, Huff required Pence to sign two purported promissory notes to AIR in his personal capacity for these amounts ($1,925,000 and $1,222,000), even though $372,000 had been provided by Oxygen. Although the two promissory notes required Pence to pay annual interest of 5%, Huff did not actually require Pence to make any interest payments to AIR and no payments were made.

16. In late June 2009, Pence arranged for Associate-1 to become a signatory on GEE's bank account at PAB and Associate-1 remained a signatory from July 2009 until September 2009. In addition, Associate-1 negotiated certain employment and other agreements on behalf of GEE, and Associate-1 attended several GEE board meetings in 2009. At the same time, Huff and Associate-1 controlled WTS, which owned a number of companies that Huff and Associate-1 intended to sell to GEE. Because Huff and Associate-1 controlled WTS, Pence did not appoint Associate-1 to be an officer, director, or employee of GEE, which avoided scrutiny of this clear conflict of interest.

17. Huff and his business partners—including Pence, Heineman, and Associate-1—created a number of oral and written side agreements regarding ownership, profit sharing, and management of the Affiliated Entities. For example, at the time AIR purportedly loaned Pence the funds for PSQ's transaction with GEE, Pence had no ability to repay the loans without fully liquidating the GEE shares purchased by PSQ. Thus, in consideration for AIR's purported loans to Pence, Pence and Huff orally agreed that if GEE's stock price increased Pence would compensate AIR with GEE shares in addition to repaying the amounts of the promissory notes. As a result,

Huff and AIR had a beneficial ownership interest in the GEE shares held by PSQ, which was not disclosed.

18. From March 2009 through at least April 2010, in connection with PSQ's majority ownership of GEE, PSQ paid Zizza $20,000 per month for consulting work. Huff funded PSQ's payments to Zizza through the Affiliated Entities. For example, Pence notified Huff on January 2, 2010 that PSQ needed to pay Zizza for consulting and specifically asked Huff and Huff's assistant to deposit money into PSQ's account so PSQ could pay Zizza. Huff's assistant sent PSQ a check from a River Falls Financial account on January 4, 2010, and Pence sent Zizza a check from PSQ's account for $20,000 on the same date. Zizza advised Pence and Huff on several acquisitions that GEE was considering in 2009. Huff and Pence also promised Zizza that if GEE's stock price increased, they would compensate Zizza with at least 500,000 GEE shares. Zizza learned that AIR had financed PSQ's purchase of the controlling stake in GEE. Zizza subsequently became the CEO of GEE on December 23, 2009.

19. Huff covertly exercised influence and control over GEE operations through Pence and Heineman as a result of his control over AIR, which financed PSQ's investment in GEE. Huff also sent substantial monthly payments to Pence ($25,000), Zizza ($20,000), and Heineman ($15,000) from several of the Affiliated Entities in an attempt to ensure his control over, and ability to influence, GEE operations.

20. Huff exerted control over GEE by, among other things, causing GEE to acquire several entities owned by WTS, which Huff and Associate-1 controlled. For example, at a GEE board meeting on August 10, 2009, attended by Pence and Zizza (as Pence's guest), Heineman convinced the GEE board of directors to authorize him to enter into a letter of intent with WTS to acquire its subsidiary On-Site, which was publicly announced on September 6, 2009. Thereafter, in June 2010, while Zizza was GEE's CEO, GEE acquired On-Site, resulting in a financial benefit to Huff. In November 2010, GEE acquired additional assets of WTS doing business as Ameritemps, RFFG of Cleveland, LLC and DMCC Staffing, LLC, again resulting in a financial benefit to Huff. During 2010, Zizza had numerous discussions with Huff concerning these acquisitions.

E. ZIZZA KNEW OR SHOULD HAVE KNOWN THAT THE PURPORTED $2.3 MILLION CD ASSIGNMENT WAS A RELATED PARTY TRANSACTION

21. As part of the July 2009 closing of PSQ's Purchase Agreement with GEE, GEE opened a checking account at PAB into which PSQ's escrowed $1,925,000 would be deposited upon the closing. In June 2009, Associate-1 coordinated with GEE's chief financial officer (the "GEE CFO") to have the GEE checking account opened at PAB and the authorized signatories on the account were the GEE CFO, Pence, and Associate-1. The GEE CFO, Pence, and Associate-1 remained the only authorized signatories on the account until September 2009, at which time Associate-1 was removed and Heineman was added. Following the closing, in early July 2009, GEE transferred an additional $750,000 from GEE's accounts at other banks to the GEE PAB checking account. The approximately $2.6 million deposited in the GEE PAB checking account constituted substantially all of GEE's cash and half of its assets.

22. In approximately July 2009, in a conversation in which Zizza did not participate, Huff discussed with Pence, GEE's chairman, the possibility of the Company investing money in Park Avenue Insurance to achieve greater returns on GEE's cash. Park Avenue Insurance was a private insurance company owned by Antonucci that was not affiliated with PAB and Pence had served as Park Avenue Insurance's president during part of 2009.

23. GEE's fiscal year ended on September 30, 2009. GEE's CFO identified that $2.3 million had been withdrawn from the GEE PAB operating account on July 23, 2009, without the GEE CFO's knowledge. The GEE CFO reported that when he asked about the withdrawn funds, GEE's CEO Heineman claimed that he had authorized GEE to invest $2.3 million into a CD at PAB. The GEE CFO also reported that, although he had repeatedly requested documentation concerning the purported CD, such as a written approval or account agreement—and cited the lack of documentation as a control deficiency—Heineman only provided the GEE CFO with a one-page PDF of a typewritten "Certificate of Deposit Receipt" for $2.3 million with a single maturity date of October 21, 2009, and interest rate of two percent. This information became known to Zizza before he became GEE's CEO on December 23, 2009.

24. In early November 2009, the GEE CFO noticed that PAB had not remitted the proceeds of the purported CD of $2.3 million plus interest into GEE's operating account upon the maturity date, October 21, 2009. When the GEE CFO contacted PAB, a PAB representative stated that the Bank had no record of the purported CD in its system. The GEE CFO then pressed both Heineman and Pence for an explanation. On November 9, 2009, Pence asked Heineman for information about the purported CD; Heineman responded to Pence that Huff would contact PAB on GEE's behalf.

25. According to the minutes of a November 23, 2009, audit committee meeting, attended by BDO, the GEE CFO reported his concerns that GEE had little documentation supporting the purported CD, including no written authorization from an account signatory and no deposit agreement. According to the minutes, Heineman claimed that he authorized the purported CD at Pence's direction, and claimed the lack of documentation was due to "the rapid pace of the transactions in which he had been involved, coupled with reorganization and personnel changes at Park Avenue Bank." Heineman next stated that he had anticipated that the CD would be maintained on a continuing renewal basis but he had asked Pence to liquidate the purported CD and have the funds transferred into the PAB checking account by the end of the week. The minutes also state that the BDO engagement partner "said that the audit was substantially completed, pending resolution of the missing funds issue, receipt of legal letters from counsel, and the executed management representation letter" and that BDO "would be issuing an unqualified opinion on the consolidated financial statements."

26. On November 24, 25, and 27, 2009, Huff directed and caused a total of $900,000 to be transferred to GEE's bank accounts in installment payments of $300,000 on each such date from the bank accounts of two Affiliated Entities: SDH and Oxygen.

27. On November 28, 2009, Pence emailed Zizza that an audit committee member, whom Pence had appointed in connection with the PSQ transactions in July (the "AC Member"), "is going to handle the issue with the CD" at the GEE board of directors meeting on November 30,

2009. Pence stated: "I would like for you to talk with him before then . . . . I think he has a good idea." Zizza replied: "Ok will do."

28. On November 30, 2009, Pence, Zizza, Heineman, and the AC Member attended a GEE board of directors meeting. Zizza, who had no formal role at GEE at this time, attended as an "invited guest." The board minutes indicate that the audit committee chairman (the "AC Chair") explained that the Company's Form 10-K had not yet been filed because BDO's "final" opinion was predicated on the satisfactory accounting for the PAB CD and an explanation for where GEE's funds had been since the CD matured on October 21. During this November 30, 2009, board meeting, the AC Member stated he believed that the situation occurred as a result of administrative errors on the part of the Bank, and Pence said that the AC Member had agreed to pursue the matter with PAB. Neither Pence nor Heineman (or anyone else) mentioned anything about GEE selling or assigning the purported CD to a third party.

29. On December 4, 2009, the BDO engagement partner on the GEE audit sent an email to the AC Chair, Heineman, and Pence, among others, summarizing the open items requiring resolution prior to the issuance of BDO's audit report. The email begins by noting that after the CD had matured in October 2009, when the GEE CFO had contacted the Bank, a PAB representative informed the GEE CFO that there was no record of the purported CD and that after some investigation by the AC Member, "in late November it was determined that the funds would be returned to GEE in installments." The email then notes that GEE had received the following wire transfers: (i) November 24: \$300,000 wire transfer from SDH; (ii) November 25: \$300,000 wire transfer from Oxygen; (iii) November 27: \$300,000 wire transfer from SDH; and (iv) December 1: \$100,000 wire transfer from Oxygen. It then stated that the BDO engagement partner had discussed the matter with Heineman and Pence, who both referred him to the AC Member who was working directly with PAB on the matter, and that the AC Member left him a voicemail "indicating the bank continues to put money against the CD they owe [GEE] and it should be fully repaid by the close of business on Monday, Dec. 7" and that the Bank would provide a short apology note.

30. Later in the day on December 4, the AC Chair sent an email to the BDO engagement partner and concurring partner summarizing his call with the AC Member, stating that when he spoke with the AC Member "he told me that [PAB] had reported these transaction [sic] to the FDIC and that the money sent to the various entities that are now sending GEE the money are sending us the banks money rather than sending it back to the bank." The AC Chair continued: "This makes absolutely no sense. It looks like [PAB] is on the verge of failing. The FDIC and a bankruptcy estate are going to require [PAB] to collect every cent they can under loans or other arrangements to settle with the creditors of the bank before they send money to third parties."

31. The following day, on December 5, 2009, the AC Chair emailed GEE's board (including Pence) and Heineman calling for a special audit committee meeting on December 9 because of "several unanswered questions related to \$2.3 million of the Company's cash which supposedly was invested in a Certificate of Deposit ('CD') at Park Avenue Bank which will need to be answered before BDO will complete their Audit Report for the Company's fiscal year ended September 30, 2009." The AC Chair's email noted several issues, including that (i) there was no

account agreement with PAB or regular reporting on the CD; (ii) PAB did not remit the proceeds of the CD into GEE's operating account when it reached its maturity date on October 21, 2009; (iii) PAB provided no explanation to the GEE CFO when he attempted to investigate; and (iv) the AC Member who took the lead on this matter with PAB "was informed on or about November 21, 2009, that the funds would be returned to [GEE] in a series of deposits." The email also provided a chart of seven wire transfers totaling $1.7 million, which included the four noted in Henaghan's December 4 email plus a December 2, 2009, wire transfer from Oxygen for $100,000, a December 2, 2009, wire transfer from River Falls Financial of $300,000, and a December 3, 2009, wire transfer from River Falls Financial also for $300,000. The address listed for both SDH and River Falls Financial on each of their wire transfers in the chart was 11921 Brinley Ave, Louisville, KY.

32. On December 4 and December 9, 2009, GEE received two additional wire transfers from River Falls Financial for $300,000 each, bringing the total amount received by GEE from River Falls Financial to $1.2 million and the total of the nine wire transfers to $2.3 million, the same amount that Heineman had purported to invest in a CD. Zizza knew or should have known that Huff, in conjunction with Associate-1, directed the transfers from SDH, Oxygen, and River Falls Financial to return the missing funds to GEE.

33. On December 8, the AC Chair emailed the BDO engagement partner, providing some links he suggested the BDO engagement partner review before he had a conversation with the AC Member and any representatives of PAB, "particularly the Anthony Huff links" and explained that he "met Anthony Huff when we went to New York" to negotiate PSQ's acquisition. The email included links to a press release announcing the Commission's lawsuit against Huff, a link to Huff's website noting the address 11921 Brinley Avenue, Louisville, KY in the text of the email, and a link to the website for Oxygen noting the identical address. This is the same address that appeared in the wires sent to GEE by River Falls Financial and SDH, as noted in the AC Chair's December 5 email described in paragraph 31, above. Also, Huff's website at the time contained references to River Falls Investments, SDH, Oxygen, and O2HR.

34. Also on December 8, 2009, the day before the special audit committee meeting, the AC Chair received an email from Heineman to the audit committee with several attachments. Heineman's email purported to offer a new explanation for why GEE had received $2.3 million from the three entities rather than PAB. Heineman claimed that he had negotiated an assignment agreement with the manager of River Falls Investments (Associate-1), who "offered to purchase" the purported CD from GEE at face value. Heineman also attached to his email an unsigned, draft assignment agreement and a letter from Heineman to PAB, dated July 21, 2009, that purportedly authorized the $2.3 million CD investment. Heineman's email also attached a July 2009 monthly statement for GEE's operating account at PAB, which included the description of the $2.3 million withdrawal as a debit on July 23 with a debit memo stating in handwriting: "To: Park Avenue Insurance, See Attachment Approval, $2,300,000.00." Park Avenue Insurance was a private insurance company separately owned by Antonucci that was not affiliated with PAB.

35. According to the minutes of GEE's audit committee meeting on December 9, 2009:

- The BDO engagement partner expressed concern that BDO still did not have a clear understanding of the purported CD transaction.

- The BDO engagement partner said that BDO needed to understand the nature of the purported administrative errors at PAB that he had been told were responsible for the lack of proper documentation regarding the CD transaction. He also explained that BDO required documentation validating the banking transactions, and an explanation as to why there was no existence of an account agreement with the Bank or no record of the CD being at the bank.

- Another BDO partner, BDO's Midwest Regional Business Line Leader, said he believed members of GEE's senior management appeared hesitant to provide information related to these transactions.

- The BDO engagement partner stated that the assignment agreement did not resolve the outstanding issues as BDO still needed to know what transpired within PAB and make a determination of whether the assignment agreement with River Falls Investments was a related party transaction.

- BDO also advised that although the assignment agreement "may reduce or eliminate the need for going concern disclosure, it would increase the requirement that management provide sufficient disclosure regarding any related party conflicts."

36. On December 14, 2009, GEE's outside counsel sent PAB a formal letter requesting all documentation and information concerning the purported CD. PAB's December 16, 2009, response provided only documents relating to GEE's checking account and did not provide any documents or other information about the purported CD. The checking account documentation, however, indicated that only Associate-1, the GEE CFO, and Pence were authorized signers on GEE's account from July to September 2009—not Heineman—and the checking account statements reflected a debit memo for the transfer of $2.3 million of GEE's cash to Park Avenue Insurance on July 23, 2009. At some point in December 2009, Zizza understood that a debit memo attached to the GEE PAB July 2009 account statement stated that the $2.3 million had been transferred to Park Avenue Insurance, not into a purported CD.

37. On the evening of December 17, 2009, Zizza emailed Pence that BDO's Midwest Regional Business Line Leader "w[ould] take a call from us to resolve the Bank issue and then issue the statement." The following day, Pence emailed Zizza stating, "We need to decide [Heineman's] fate quickly." Zizza spoke to BDO's Midwest Regional Business Line Leader concerning GEE.

38. On December 22, 2009, BDO sent the AC Chair a letter stating that BDO did not have sufficient audit evidence to formally conclude the audit and demanded an independent investigation ("BDO's demand letter"). BDO's demand letter noted identified multiple inconsistencies and problems in the audit evidence BDO had received regarding the purported CD, including that a number of significant questions remained unanswered concerning both the existence of the purported CD (e.g., why bank records provided by PAB showed a transfer of $2.3 million to Park Avenue Insurance) and the manner in which $2.3 million had been transferred to the Company by the Affiliated Entities (e.g., why Associate-1 would pay 100% of the face value of

the purported CD after the maturity date had expired without payment by PAB, why had River Falls Financial—purportedly owned by Pence—transferred approximately $1 million to GEE in connection with the alleged assignment of the purported CD to River Falls Investments, and why Heineman had made inconsistent representations about his involvement in negotiating the alleged assignment with Associate-1). Pence forwarded BDO's demand letter to Zizza and Associate-1, the purported manager of River Falls Investments.

39. On the evening of December 22, 2009, BDO learned that the audit committee meeting that was scheduled for the following day had been cancelled, Zizza, an advisor to Pence who had attended GEE board meetings through the fall of 2009, would be taking over as CEO, and that Pence and Associate-1 intended to prepare written responses to each of the issues identified in the December 21 letter. On December 23, 2009, Heineman formally resigned as GEE's CEO and that same day Pence appointed Zizza to be GEE's new CEO.

40. Zizza, over the course of many years, had brought new business to BDO in the form of several auditing clients. A senior partner in BDO's New York office (the "BDO NY Partner") handled some of Zizza's other business relationships with BDO, including audit or tax work for Zizza's private company and three public companies for which Zizza served as a board member. Thereafter, the NY Partner reached out to auditors in BDO's Chicago and national offices to vouch for Zizza.

41. On December 24, 2009, after reviewing BDO's demand letter, Zizza participated in two calls with BDO, one that included the AC Chair and another that included both the AC Chair and Pence. The BDO NY Partner also participated in the call with Zizza and the AC Chair. During those calls, Zizza requested that BDO conclude the audit without the need for an independent investigation because GEE had full control of the $2.3 million in question and because he had replaced Heineman as CEO. When BDO asked Zizza about the CD and the assignment agreement, Zizza stated that he was comfortable with issuing the financial statements because GEE had control over the $2.3 million that had been missing.

42. Although a number of critical questions raised in BDO's demand letter remained unanswered, shortly after the December 24 telephone conversations with Zizza, BDO issued an audit report containing an unqualified opinion on GEE's 2009 financial statements. Zizza also advised GEE's audit committee that, in his opinion, there was no need to investigate the potential related party issues arising out of the assignment agreement between GEE and River Falls Investments.

43. On January 8, 2010, Zizza signed a representation letter to BDO that stated the following:

> The following, where applicable and material, have been properly recorded or disclosed in the consolidated financial statements: (a) Related-party transactions (e.g., transactions with unconsolidated subsidiaries; affiliates under common control with the Company or that are directly or indirectly controlled by the Company; principal owners of record or known beneficial interest of 10 percent or more of the Company's voting stock, directors, management, and members of

their immediate families), including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties . . .

In July 2009 the Company purchased a $2.3 million certificate of deposit (CD) at Park Avenue Bank. When the CD matured in October 2009 the bank did not refund the proceeds to the Company. To date the Company has not received an adequate explanation for the bank's non-performance relating to the CD. The Company is not aware of why the Company did not receive the proceeds from its Park Avenue Bank certificate of deposit upon its maturity and has provided you all information available to it in regards to this matter. In December 2009 the Company was reimbursed in full through a non-recourse assignment of the CD to an unrelated party, who has a business interest in the viability of bank. There are no side letters, e-mails, or other agreements (oral or written) that materially alter the terms of the assignment agreement.

44. Zizza's representations to BDO in phone calls and in the management representation letter were materially misleading because, among other things, Zizza knew or should have known that:

a. On paper, Pence was an indirect owner of River Falls Investments, the entity that signed the alleged assignment agreement and had signed loan agreements as River Falls Investments's manager;

b. Huff controlled River Falls Investments and River Falls Financial;

c. Huff had directed the Affiliated Entities to transfer $2.3 million to GEE to preserve the financial viability of GEE for the benefit of AIR, Huff, and PSQ; and

d. Pence, Zizza, Huff and Associate-1 had unwritten agreements, as described in paragraphs 17 and 18 above, whereby they would benefit from the rise in GEE's stock price.

45. Among other things, Zizza also knew or should have known that the assignment agreement between GEE and River Falls Investments was a related party transaction given Huff's influence and control—and Pence's control, on paper—over both entities.

46. On January 8, 2010, Zizza signed GEE's Form 10-K, which classified the $2.3 million purported CD as a cash equivalent and stated in a footnote disclosure to the financial statements:

In July 2009, the Company purchased a $2,300,000 certificate of deposit ("CD") at a New York bank. When the CD matured in October 2009, the bank did not timely credit the proceeds of the CD to the Company's account. Although the Company has made a formal inquiry of the bank, to date the Company has not received an adequate explanation for the bank's non-performance relating to the CD. In December 2009, the Company was reimbursed in full through a non-recourse assignment of the CD for face value to an unrelated party, who has other business interests with the bank. The purchaser of the CD is neither an employee nor a director of the Company.

47. GEE's 2009 Form 10-K was materially misstated because, among other things, it incorrectly represented GEE had a $2.3 million CD and classified it as a cash equivalent as of September 30, 2009, and did not disclose the assignment agreement as a related party transaction given Huff's influence and control—and Pence's control, on paper—over both entities.

48. On March 13, 2010, the United States of America filed a 44-page criminal Complaint against former PAB president Antonucci (the "Antonucci Complaint"), alleging a scheme and conspiracy involving a $6.5 million round-trip transaction in which GEE's $2.3 million was diverted as part of the conspiracy. Huff, Heineman, and Pence are referred to and identifiable as designated "co-conspirator[s] not named herein" in certain aspects of that conspiracy. The allegations in the Antonucci Complaint contained several details that indicated that GEE did not have a CD with PAB, that River Falls Financial, River Falls Investments, Oxygen, SDH, and PSQ were related parties, and that Heineman had authorized the money to be transferred to Park Avenue Insurance as part of the conspiracy, and not to purchase a CD:

- "To hide the improper diversion of GEE's funds from GEE's auditors and Board of Directors, [Antonucci] and others created a counterfeit certificate of deposit [], falsely representing that GEE's $2.3 million had been invested in a 90-day certificate of deposit at the Bank. In fact, and as [Antonucci] well knew, there was no $2.3 million CD."

- GEE's $2.3 million had been transferred to Park Avenue Insurance, which was controlled by Antonucci. According to the Bank records, Heineman authorized this transfer.

- Antonucci fraudulently signed the BDO confirmation of the $2.3 million CD, when Antonucci knew it did not exist.

The Antonucci Complaint further identified several "Oxygen-related entities" as participants in the conspiracy, including, River Falls Financial (which Pence said he owned), PSQ (Pence's entity that purchased the majority stake in GEE), and Oxygen and SDH—two companies that paid GEE purportedly under the assignment agreement with River Falls Investments (which [Associate-1] said he and a Huff family trust owned). It further alleged that a group of five associates (including Huff and Pence) were listed on some of the accounts of the Oxygen-related entities, which shared a common address in Louisville, Kentucky.

49. In a May 25, 2010 email, the BDO engagement partner told Zizza that he would like to discuss certain issues regarding the Antonucci Complaint. The BDO engagement partner wrote that he wanted to discuss the allegations that "Pence purchased a 25% interest in Bedford Consulting from Antonucci for $6.5 million in what the complaint describes as an 'artifice designed to cover up the true source of the $6.5 million.'" He also wrote: "The Complaint indicates that River Falls is owned by Pence, [Associate-1], and Heineman. All previous

information disclosed to us by Heineman and Pence indicated that Pence owned 100% of River Falls." He further noted that the Complaint indicated that PSQ borrowed money from River Falls to buy the GEE shares. The email to Zizza did not address the allegations in the Antonucci Complaint denying the existence of the purported CD or indicating related party issues concerning the funds received by the "Oxygen-related entities."

50. During his conversation with BDO, Zizza withheld material information that bore upon the accuracy of GEE's previously-filed 10-K and future filings addressing the purported CD. Specifically, Zizza failed to disclose to BDO the same material facts identified in paragraph 44 of this Order.

51. Later throughout 2010, Zizza failed to disclose to BDO facts that he knew or should have known, including that companies acquired by GEE, including On-Site, RFFG of Cleveland, LLC, and DMCC Staffing, LLC were partially controlled by Huff. Zizza's materially false or misleading statements and omissions were relevant to BDO's audit of GEE for 2010 and the Company's preparation of its Form 10-K.

52. In December 2010, Zizza signed a representation letter that included similar language to the representation letter discussed in paragraph 43 of this Order concerning related parties, the purported CD with PAB, and the assignment agreement. For the same reasons, Zizza's representations in that management representation letter were materially misleading.

53. GEE's Form 10-K filed on December 28, 2010, for its fiscal year ended September 30, 2010, classified the $2.3 million CD as a cash equivalent as of September 30, 2009, included a similar disclosure as the disclosure in the Form 10-K filed in January 2010 and was materially misleading for the same reasons:

> In November 2009, the Company discovered that it did not receive the proceeds from a bank for a $2,300,000 certificate of deposit that was scheduled to mature in October 2009. Although the Company made a formal inquiry of the bank, it did not receive an adequate explanation for the bank's non-performance related to the deposit. In December 2009, the Company entered into an agreement to assign its interests in the certificate of deposit, without recourse, to an unrelated party that has other business interests with the bank, and the Company was reimbursed for the face value of the deposit.

F. VIOLATIONS

54. Rule 13b2-2 of the Exchange Act prohibits officers and directors from, directly or indirectly, making or causing to be made materially false or misleading statements or omissions to accountants in connection with an audit or preparation of reports to be filed with the Commission.

55. As a result of the conduct described above, Zizza violated Rule 13b2-2 under 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 Exchange Act Rule 13b2-2.

B. Respondent shall within 14 days of the entry of this Order, pay a civil money penalty of $150,000 to the Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act 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 Zizza 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, New York Regional Office, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281-1022.

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. 75862 / September 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3692 / September 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16800

In the Matter of **BDO USA, LLP,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice[2] against BDO USA, LLP ("BDO" or "Respondent").

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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 . . . (2) . . . to have engaged in unethical or improper professional conduct.

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

> The Commission may censure a person . . . who is found . . .
>
> * * *
>
> (ii) to have engaged in unethical or improper professional conduct.
>
> * * *

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Respondent admits the facts set forth in Sections III.B., C., and E. through H. below, acknowledges that its conduct violated the federal securities laws, admits the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "Order"), as set forth below.

III.

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

A. SUMMARY

1. This matter involves improper professional conduct by BDO while serving as the auditor for General Employment Enterprises, Inc. ("GEE" or the "Company"), a staffing services company whose stock trades on the NYSE MKT. During BDO's 2009 audit of GEE's financial statements for its fiscal year ended September 30, 2009, BDO learned that $2.3 million (comprising approximately half of GEE's assets and substantially all of its cash) was unaccounted for when GEE's chief financial officer (the "GEE CFO") advised BDO, in November 2009, that (a) GEE's purported 90-day non-renewable certificate of deposit ("CD") at a New York bank had not been repaid by the bank after the stated maturity date in mid-October, (b) GEE was missing documentation supporting the CD, and (c) a bank employee had told GEE's CFO that the bank had no record of a CD. Thereafter, BDO received multiple conflicting stories from GEE management

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> (iv) with respect to persons licensed to practice as accountants, "improper professional conduct" under Rule 102(e)(1)(ii) means:
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> * * *
>
> (B) either of the following two types of negligent conduct:
>
> > (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
> >
> > (2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

[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.

and board members concerning both the status of the CD and a series of transfers totaling $2.3 million made to GEE by three entities unaffiliated with the bank, one of which BDO had been told was owned by GEE's Chairman and majority shareholder. After BDO raised questions about these deposits, GEE's chief executive officer claimed the deposits were the proceeds of an agreement to assign the CD to a purported unrelated party.

2. BDO's engagement and concurring partners consulted with senior BDO partners, including the assigned BDO regional technical director, BDO's national director of accounting, and BDO's national SEC practice director. The consultation resulted in BDO issuing a five-page letter, dated December 21, 2009, in which BDO advised GEE of its belief that BDO had not been provided sufficient audit evidence to formally conclude on the matter and demanded that GEE's audit committee commission a full investigation of the matter by an independent firm. BDO received conflicting information from various sources as to the existence of the CD and never received rational explanations as to why the $2.3 million went missing and why an equivalent amount was later received under suspect circumstances. Only days later, however, after GEE's chief executive officer resigned, BDO agreed to withdraw its demand for an independent investigation and issued an audit report containing an unqualified opinion on GEE's financial statements. Those financial statements, included in GEE's Form 10-K filed on January 8, 2010, represented that GEE had a $2.3 million cash equivalent in the form of CD as of September 30, 2009, and had entered into an assignment agreement to sell the CD for full face value to an unrelated party.

3. Approximately two months after GEE filed its 2009 Form 10-K with BDO's unqualified audit opinion, BDO learned of a criminal complaint against the New York bank president. The criminal complaint alleged, in connection with a wide-ranging conspiracy involving, among others, GEE's then-chief executive officer and GEE's then-majority shareholder and chairman of the board, that (i) GEE's purported $2.3 million CD never existed, (ii) the bank president signed a false confirmation to BDO, (iii) GEE's $2.3 million was used to attempt to conceal a loan default connected to the broader conspiracy, and (iv) the entities that transferred the $2.3 million back to GEE were related to the bank president's co-conspirators, including GEE's then-majority shareholder and chairman of the board. The bank president pled guilty in October 2010. Despite this additional new information, which was conveyed to senior partners in BDO's regional and national offices, BDO failed to perform appropriate audit procedures to determine whether this new information had any impact on GEE's 2009 financial statements or BDO's audit report thereon. In addition, BDO failed to adequately consider this information during its subsequent audit when it provided an audit report containing an unqualified opinion on GEE's financial statements included in the Company's 2010 Form 10-K.

4. Specifically, among other audit failures during the 2009 and 2010 audits of GEE, BDO: (1) failed to adequately plan, design, and perform audit procedures necessary to determine the existence of a disputed asset and the existence of related party transactions; (2) failed to obtain sufficient competent evidential matter; (3) failed to exercise professional skepticism and due professional care; (4) ignored red flags of fraud, potential illegal acts by GEE's agents, and unidentified related party transactions; (5) placed improper reliance on management representations from individuals they did not trust; and (6) failed to appropriately consider the discovery of new facts.

5. BDO issued audit reports containing unqualified opinions on the financial statements in GEE's 2009 and 2010 Form 10-Ks, which incorrectly stated that GEE had a cash equivalent of $2.3 million as of September 30, 2009, and did not disclose that the $2.3 million was returned by entities related to GEE's chairman of the board. BDO's reports, which BDO knew would be filed with GEE's Form 10-Ks, inaccurately stated that the audits had been conducted in accordance with standards adopted by the Public Company Accounting Oversight Board ("PCAOB") and that GEE's financial statements presented fairly, in all material respects, the company's position and results at September 30, 2009, in conformity with generally accepted accounting principles in the United States of America ("GAAP").

B. RESPONDENT

6. **BDO**, formerly known as BDO Seidman, LLP, is a Delaware limited liability partnership and a PCAOB-registered public accounting firm with its headquarters in Chicago, Illinois. BDO served as GEE's independent auditor from 2004 through 2012.

C. RELEVANT BDO PROFESSIONALS

7. **Sean C. Henaghan** ("Henaghan"), age 42, is a Certified Public Accountant ("CPA") licensed to practice in Illinois and was licensed in Florida from 2010 through 2012. Henaghan served as the BDO engagement partner on the 2009 and 2010 audits of GEE and had final responsibility for the audits.

8. **John E. Rainis** ("Rainis"), age 57, is a CPA licensed to practice in Illinois. Rainis served as the BDO concurring reviewer on the 2009 and 2010 audits of GEE.

9. **Leland E. Graul** ("Graul"), age 66, is a CPA licensed to practice in Illinois. Prior to his retirement, Graul served as BDO's national director of accounting and risk management partner when he was consulted during the 2009 and 2010 audits of GEE.

10. **James J. Gerace** ("Gerace"), age 54, is a CPA licensed to practice in Illinois. Gerace served as the regional technical director of BDO when he was consulted during the 2009 and 2010 audits of GEE.

11. **Wendy M. Hambleton** ("Hambleton"), age 53, is a CPA licensed to practice in Illinois. Hambleton served as BDO's national SEC practice director when she was consulted during the 2009 and 2010 audits of GEE.

D. ISSUER AND OTHER RELEVANT ENTITIES AND INDIVIDUALS

12. **GEE** is an Illinois corporation headquartered in Oakbrook Terrace, Illinois that provides professional placement services and temporary staffing services in certain industries. GEE's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NYSE MKT stock exchange. GEE files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

13. **River Falls Financial Services, LLC** ("River Falls Financial"), **River Falls Investments, LLC f/k/a Oxygen Unlimited II, LLC** ("River Falls Investments"), **River Falls Holdings, LLC** ("RFH"), **Accredited Investor Resources, LLC f/k/a Oxygen Investment Partners, LLC** ("AIR"), **Oxygen Unlimited, LLC** ("Oxygen"), **O2HR, LLC** ("O2HR"), **SDH Realty, LLC** ("SDH"), **WTS Acquisition LLC** ("WTS"), **H2H Holdings, LLC** ("H2H"), and **PSQ, LLC** ("PSQ") (collectively, the "Affiliated Entities") are purported holding, investment, employment-related, and insurance companies. During at least 2009 and 2010, **Wilbur Anthony Huff** ("Huff")[4] exercised substantial financial and management control over numerous entities, including, among others, the Affiliated Entities and their holdings. Huff installed other business partners to perform day-to-day operational functions and/or serve as the listed owners, directors, or managers. As a convicted felon, Huff faced legal and practical barriers to operating business entities in his own name, particularly business in regulated industries, including employment-related, insurance, and banking companies.

14. **Park Avenue Bank** ("PAB" or "the Bank") was a New York State chartered bank until it was closed by the New York State Banking Department on March 12, 2010, and the Federal Deposit Insurance Corporation was named Receiver. The Affiliated Entities primarily conducted their banking business through PAB. **Charles J. Antonucci, Sr.** ("Antonucci") served as the president and CEO of PAB from June 2004 until October 2009. In October 2010, Antonucci pled guilty to multiple criminal charges, including securities fraud, bank bribery, embezzlement, and providing a false confirmation to BDO of GEE's purported CD at PAB. Separately, **Park Avenue Insurance** was a private insurance company owned by Antonucci that was not affiliated with PAB.

15. **Stephen B. Pence** ("Pence") served as the chairman of the board of GEE from July 1, 2009, through November 17, 2010. Although Pence purported to be the sole member and owner of PSQ, whose sole asset was the GEE shares representing a controlling stake in the Company as of July 1, 2009, PSQ was one of the Affiliated Entities over which Huff exercised substantial financial and management control. PSQ's acquisition of GEE stake was funded by AIR and Oxygen. Pence also represented to BDO that he was the 100% owner of River Falls Financial, another of the Affiliated Entities. Huff directed substantial monthly payments to Pence ($25,000)

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[4] Huff pled guilty to federal mail fraud charges for obtaining insurance premium finance loans under false pretenses in the Western District of Kentucky in 2003. In 2008, the Commission filed charges against Huff related to a scheme to misappropriate assets from and to record fake letters of credit at Certified Services, Inc. ("Certified"). *SEC v. Huff*, 08-CV-60315 (S.D. Fla.). On October 22, 2010, the Court entered judgment for the Commission against Huff requiring him to pay more than $13 million, among other relief. Separately, after an October 2012 indictment against him, Huff pled guilty on December 23, 2014 to an information, which alleged, among other things, that: (1) Huff controlled GEE, in whole or in part, by installing other individuals; (2) Huff participated with Antonucci in a conspiracy in which they stole $2.3 million from GEE and Huff later returned the $2.3 million to GEE from three companies he controlled; and (3) a large portion of the $2.3 million received by GEE were funds entrusted to Oxygen by its clients for payment of the clients' employment tax and other obligations. *U.S. v. Huff*, 12-CR-750 (S.D.N.Y.).

from several of the Affiliated Entities to ensure his control over, and ability to influence, GEE's operations. Pence formerly served as the lieutenant governor of Kentucky from 2003 to 2007 and the United States Attorney for the Western District of Kentucky from 2001 to 2003.

16. **Ronald E. Heineman** ("Heineman") was appointed as the chief executive officer ("CEO") of GEE on July 1, 2009, in connection with PSQ's acquisition of a controlling stake in GEE. Heineman served as CEO until his resignation on December 23, 2009, in connection with the events described herein. Huff directed substantial monthly payments to Heineman ($15,000) from the Affiliated Entities during this time period.

17. **Salvatore J. Zizza** ("Zizza") served as the CEO of GEE from December 23, 2009, through December 2012. Prior to his appointment as CEO, Zizza received monthly payments of $20,000 from PSQ, which were funded by several of the Affiliated Entities, for purported consulting services, and Zizza frequently attended GEE board meetings as an "invited guest." In 2009, businesses owned or operated by Zizza received loans in excess of $1 million that Huff directed from certain of the Affiliated Entities.

18. **Associate-1** was another of Huff's business partners and was listed or served at various times as a manager of River Falls Investments, Oxygen, and O2HR, and as co-manager of River Falls Financial with Heineman. Associate-1 was also involved in PSQ's acquisition of a controlling stake in GEE and attended several GEE board meetings in 2009. In addition, from July 2009 until September 2009, Associate-1 was a signatory on GEE's bank account at PAB despite the fact that Associate-1 was not an official employee, officer, or director of the Company. Associate-1 also purported to be the owner of WTS (another of the Affiliated Entities), a holding company of **On-Site Services, Inc.** ("On-Site") and **Ameritemps, Inc.** ("Ameritemps"), which WTS had acquired in January 2009 with funding from other Affiliated Entities. Almost immediately after PSQ's acquisition of a controlling stake in GEE, Heineman began presenting proposals to GEE's board for GEE to acquire these companies. For example, at an August 10, 2009, GEE board meeting, attended by Pence and Zizza, the board authorized Heineman to enter into a letter of intent with WTS to acquire On-Site, and Heineman reported that he would present another acquisition candidate, Ameritemps, at the September board meeting.

E. BACKGROUND

19. GEE's May 18, 2009, definitive proxy statement disclosed that, in January 2009, GEE began discussions with representatives of River Falls Financial, including Heineman and Pence, concerning the possibility of a tender offer and direct cash investment in GEE. As BDO learned later in 2009, Huff was also present for one of the relevant meetings. The proxy statement further disclosed that, on February 11, 2009, River Falls Financial and PSQ, a special purpose vehicle purportedly formed by Pence, entered into a non-binding letter of intent with GEE for a purchase and tender offer agreement to obtain a controlling stake in GEE.

20. According to GEE's May 18, 2009, definitive proxy statement, on March 30, 2009, after negotiations continued following the February 2009 non-binding letter of intent, Pence signed on behalf of PSQ a definitive securities purchase and tender offer agreement (the "Purchase Agreement"). The Purchase Agreement provided that, subject to shareholder approval, PSQ would

acquire a controlling stake in GEE by (1) purchasing 7,700,000 newly-issued shares of GEE common stock in a private placement transaction at a purchase price of $0.25 per share for a total purchase price of $1,925,000; (2) commencing a cash tender offer to purchase from the Company's shareholders up to 2,500,000 shares of common stock at a purchase price of $0.60 per share; (3) appointing three directors to a five-member board of directors, including Pence becoming the chairman of the board; and (4) designating Heineman GEE's CEO. On June 22, 2009, a GEE press release announced that shareholders approved the Purchase Agreement and the closing of the Purchase Agreement was announced on July 1, 2009. As a result, PSQ acquired more than 65% ownership of the Company, Pence became GEE's chairman and appointed two other directors, and Heineman became GEE's CEO.

21. As part of the July 2009 closing of PSQ's purchase agreement with GEE, GEE opened a checking account at PAB into which PSQ's escrowed $1,925,000 would be deposited upon the closing. According to PAB records received by BDO in 2009, in June 2009, Associate-1 coordinated with GEE's chief financial officer (the "GEE CFO") to have the GEE checking account opened at PAB and the authorized signatories on the account were the GEE CFO, Pence, and Associate-1. Those PAB records also indicated that the GEE CFO, Pence, and Associate-1 remained the only authorized signatories on the account until September 2009, at which time Associate-1 was removed and Heineman was added. Following the closing in early July 2009, GEE transferred an additional $750,000 from GEE's accounts at other banks to the GEE PAB checking account. The approximately $2.6 million deposited in the GEE PAB checking account constituted substantially all of GEE's cash and half of its assets.

22. According to information received by BDO, GEE's CFO identified that $2.3 million had been withdrawn from the GEE PAB operating account on July 23, 2009, without the GEE CFO's knowledge. The GEE CFO reported to BDO that when he asked about the withdrawn funds, GEE's CEO Heineman claimed that he had authorized GEE to invest $2.3 million into a CD at PAB. The GEE CFO also informed BDO that, although he had repeatedly requested documentation concerning the purported CD, such as a written approval or account agreement—and cited the lack of documentation as a control deficiency—Heineman only provided the GEE CFO with a one-page PDF of a typewritten "Certificate of Deposit Receipt" for $2.3 million with a single maturity date of October 21, 2009 and interest rate of two percent.

F. BDO RECEIVED INCONSISTENT EVIDENCE CONCERNING THE PURPORTED CD AND THE EXISTENCE OF RELATED PARTY TRANSCTIONS

23. GEE's fiscal year ended on September 30, 2009. As part of its audit of GEE, BDO addressed confirmations for GEE's bank accounts, including the purported CD, to a PAB vice president and branch manager. In October, BDO received a confirmation signed by that vice president for the operating account and a confirmation signed by the PAB president Antonucci for the purported CD. BDO concurring partner Rainis noted that it was "unusual" for the PAB president to sign the confirmation.

24. On October 19, 2009, the GEE CFO provided to audit committee members and BDO a report of the evaluation of internal control for fiscal year 2009, which noted the purported

PAB CD as an identified control deficiency. The report noted that"[t]he transaction was not executed by the office of the Treasurer, and no written approval or account agreement was provided to the accounting department" and that "it did not conform to the company's investment guidelines" because it did not provide sufficient diversification and PAB did not meet GEE's size requirement. However, the report concluded that the control deficiency did not constitute a material weakness. BDO concurred with this assessment.

25. In early November 2009, the GEE CFO noticed that PAB had not remitted the proceeds of the purported CD of $2.3 million plus interest into GEE's operating account upon the maturity date, October 21, 2009. When the GEE CFO contacted PAB, a PAB representative stated that the Bank had no record of the purported CD in its system and then refused to investigate the matter any further. On November 18, 2009, the GEE CFO conveyed this information to the BDO engagement partner Henaghan. The GEE CFO also communicated this information to GEE's audit committee chairman (the "AC Chair").

26. Also in November 2009, BDO partners Henaghan, Graul, and Gerace reviewed background check reports of Heineman and Associate-1 that identified potential concerns. As part of BDO's client retention procedures, BDO had procured a background check of Heineman because he was the new CEO of GEE and of Associate-1 because he purportedly owned On-Site, a subsidiary of WTS that GEE intended to acquire and which BDO agreed to audit. Those background checks revealed that:

- A 2009 lawsuit named GEE's CEO Heineman as a defendant and alleged that he received a fraudulent distribution of in excess of $2 million in cash from a bankrupt company he formally ran.

- Associate-1 served as the chief operating officer of a subsidiary of Certified. The Commission had alleged in a 2008 complaint that Huff was an "undisclosed control person" who, with others, stole $30 million from Certified.

- Associate-1 and Heineman were co-managers of River Falls Financial, and participated in negotiating PSQ's acquisition of GEE shares.

- Heineman and Associate-1 had several substantial personal tax liens.

27. At a November 23, 2009, audit committee meeting, attended by BDO engagement partner Henaghan and concurring partner Rainis, the GEE CFO reported his concerns that GEE had little documentation supporting the purported CD, including no written authorization from an account signatory and no deposit agreement. According to the audit committee minutes, Heineman claimed that he authorized the purported CD at Pence's direction, and claimed the lack of documentation was due to "the rapid pace of the transactions in which he had been involved, coupled with reorganization and personnel changes at Park Avenue Bank." Heineman next stated that he had anticipated that the CD would be maintained on a continuing renewal basis but he had asked Pence to liquidate the purported CD and have the funds transferred into the PAB checking account by the end of the week. The minutes also state that Henaghan "said that the audit was substantially completed, pending resolution of the missing funds issue, receipt of legal letters from

counsel, and the executed management representation letter" and that BDO "would be issuing an unqualified opinion on the consolidated financial statements."

28. On November 24, 2009, Henaghan emailed the AC Chair, stating that the GEE CFO had "indicated there was an update on the CD and that the funds would be returned in installments. I am not sure if you can provide any further clarity on why this would be. I wanted to check with you before I had another discussion with [Heineman]." The AC Chair replied that he "[could] not provide any clarity" and expressed concern that one of the audit committee members (the "AC Member") "seems to be tied in with this group." The AC Member had been appointed by Pence in connection with the PSQ transaction in July.

29. Henaghan replied to the AC Chair the following day, November 25, 2009, that he had spoken to Heineman that morning and Heineman indicated that Pence and the AC Member "were taking the lead on this as they have a previous working relationship with the bank." Henaghan also noted that Heineman, however, had "disagreed with the fact that the CD would be 'paid back in installments'" and had "indicated that the proceeds of the CD would be in the Company's bank account by Monday."

30. By the following Monday, November 30, 2009, GEE still had not obtained the $2.3 million in proceeds of the purported CD from PAB. That day, Pence, Heineman, and Zizza attended a GEE board of directors meeting. Zizza, who had no formal role at GEE at this time, attended as an "invited guest." The board minutes indicate that the AC Chair explained that the Company's Form 10-K had not yet been filed because BDO's "final" opinion was predicated on the satisfactory accounting for the PAB CD and an explanation for where GEE's funds had been since the CD matured on October 21. During this November 30, 2009, board meeting, the AC Member stated he believed that the situation occurred as a result of administrative errors on the part of the Bank, and Pence said that the AC Member had agreed to pursue the matter with PAB. Neither Pence nor Heineman mentioned anything about GEE selling or assigning the purported CD to a third party.[5]

31. By December 3, 2009, BDO learned that GEE had received four transfers from SDH and Oxygen totaling $1 million. On December 3, 2009, the AC Member, who had been tasked by Pence with contacting PAB about the purported CD, told the AC Chair and BDO engagement partner Henaghan that PAB was sending GEE the $2.3 million proceeds of the purported CD. The AC Member also told Henaghan that the Bank had made an "administrative error" and would provide a short apology note.

32. After consulting with fellow BDO partners Rainis and Gerace, Henaghan sent GEE's AC Chair an email on December 4, 2009, summarizing the open items requiring resolution prior to the issuance of BDO's audit report: (1) the purported CD; (2) identification of potential

[5] BDO engagement partner Henaghan and concurring partner Rainis confirmed in the workpaper index that they reviewed all of the minutes for the GEE board and audit committee meetings discussing the purported CD issue.

related parties to Pence; and (3) additional subsequent event procedures. The email begins by noting that after the CD had matured in October 2009, when the GEE CFO had contacted the Bank, a PAB representative informed the GEE CFO that there was no record of the purported CD and that after some investigation by the AC Member, "in late November it was determined that the funds would be returned to GEE in installments." The email then notes that GEE had received the following wire transfers: (i) November 24: $300,000 wire transfer from SDH; (ii) November 25: $300,000 wire transfer from Oxygen; (iii) November 27: $300,000 wire transfer from SDH; and (iv) December 1: $100,000 wire transfer from Oxygen. Henaghan's email then noted that he had discussed the matter with Heineman and Pence, who both referred him to the AC Member who was working directly with PAB on the matter, and that the AC Member left him a voicemail "indicating the bank continues to put money against the CD they owe [GEE] and it should be fully repaid by the close of business on Monday, Dec. 7" and that the Bank would provide a short apology note. Henaghan's email continued:

> [G]iven the highly unusual nature of this issue and the significant amount of time it is taking to recover the funds, it is critical that we understand both the nature of the administrative error as well as the underlying cause of this error.... As I have never encountered such an issue with a bank or CD and any reasonable person (including the PCAOB or SEC) would certainly question such an issue, I need to be in a position to fully explain exactly what occurred.... As such, from an audit perspective I will require the following prior to issuance of the fiscal 2009 financial statements:
>
> > -Source documents (bank statements, etc.) showing the flow of funds from the closing of the PSQ transaction through the date the funds are fully transferred to Chase bank in December 2009 (including an understanding of where the CD funds were disbursed upon maturity of the CD in October)
> >
> > -Explanation as to why the funds received in November and December are being wire transferred from entities other than Park Avenue Bank
> >
> > -To corroborate this documentation, we may request to meet with someone at Park Avenue Bank to understand the nature of the administrative error
> >
> > -A written report by management or others to fully explain the circumstances surrounding the matter including steps [GEE] took to gain its understanding of what transpired....
>
> Also, as the $2.3 million is critical to our assessment of the Company's ability to continue as a going concern, it is important for us to understand this situation so as to gain comfort that the funds will remain available to the Company to fund operations as needed.

33. Henaghan's December 4 email also noted as an open item that he had a conversation with Pence that day "to gain an understanding of other investments he has to make sure we have appropriately identified any potential related parties and may have a few follow up

questions regarding that matter." One of the items Henaghan had spoken to Pence about was the ownership of River Falls Financial, of which Pence had indicated he was the 100% owner.

34. Shortly after receiving it, the AC Chair forwarded Henaghan's email to Heineman, Pence, the AC Member, the GEE CFO, and GEE's board, noting: "Multiple representatives of BDO have told me that they will not sign off on the GEE Audit . . . until they have sufficient documentation of what has transpired. [BDO's] position is that the Liabilities associated with a sign-off far exceed any past or potential future Audit Fees that [they] have received or will receive. The high level message is that a letter of apology from Park Avenue Bank will not be sufficient." Henaghan received a copy of this email and replied to all: "To clarify, [our] primary concern is getting an understanding of exactly what has occurred in order to allow us to complete our audit procedures. As I am sure everyone would agree, what has transpired over the last few weeks with the funds at [PAB] has been highly unusual. I know everyone has been working to resolve the issue. However, time continues to pass and [GEE's] filing deadline will be here before we know it. As such, I wanted to clarify the importance of appropriately addressing the issue as quickly as possible to allow us to complete the audit."

35. Later in the day on December 4, the AC Chair sent an email to Henaghan and Rainis summarizing his call with the AC Member, stating that when he spoke with the AC Member "he told me that [PAB] had reported these transaction [sic] to the FDIC and that the money sent to the various entities that are now sending GEE the money are sending us the banks money rather than sending it back to the bank." The AC Chair continued: "This makes absolutely no sense. It looks like [PAB] is on the verge of failing. The FDIC and a bankruptcy estate are going to require [PAB] to collect every cent they can under loans or other arrangements to settle with the creditors of the bank before they send money to third parties."

36. The following day, on December 5, 2009, the AC Chair emailed GEE's board and Heineman calling for a special audit committee meeting on December 9 because of "several unanswered questions related to $2.3 million of the Company's cash which supposedly was invested in a Certificate of Deposit ('CD') at Park Avenue Bank which will need to be answered before BDO will complete their Audit Report for the Company's fiscal year ended September 30, 2009." The AC Chair's email noted several issues, including that (i) there was no account agreement with PAB or regular reporting on the CD; (ii) PAB did not remit the proceeds of the CD into GEE's operating account when it reached its maturity date on October 21, 2009; (iii) PAB provided no explanation to the GEE CFO when he attempted to investigate; and (iv) the AC Member who took the lead on this matter with PAB "was informed on or about November 21, 2009 that the funds would be returned to [GEE] in a series of deposits." The email also provided a chart of seven wire transfers totaling $1.7 million, which included the four noted in Henaghan's December 4 email plus a December 2, 2009, wire transfer from Oxygen for $100,000, a December 2, 2009, wire transfer from River Falls Financial of $300,000, and a December 3, 2009, wire transfer from River Falls Financial also for $300,000. The address listed for both SDH and River Falls Financial on each of their wire transfers in the chart was 11921 Brinley Ave, Louisville, KY. BDO's engagement partner Henaghan received a copy of the AC Chair's December 5 email and forwarded it to Rainis, Gerace, and BDO's general counsel.

37. River Falls Financial was the entity that Henaghan had just been told was 100% owned by Pence. BDO had also learned in conducting background investigations that Associate-1 and Heineman were co-managers of River Falls Financial.

38. On December 4 and December 9, 2009, GEE received two additional wire transfers from River Falls Financial for $300,000 each, bringing the total amount received by GEE from River Falls Financial to $1.2 million and the total of the nine wire transfers to $2.3 million, the same amount that Heineman had purported to invest in a CD.

39. On December 8, the AC Chair emailed Henaghan, providing some links he suggested Henaghan review before Henaghan had a conversation with the AC Member and any representatives of PAB, "particularly the Anthony Huff links" and explained that he "met Anthony Huff when we went to New York" to negotiate PSQ's acquisition. The email included links to a press release announcing the Commission's lawsuit against Huff, a link to Huff's website noting the address 11921 Brinley Avenue, Louisville, KY in the text of the email, and a link to the website for Oxygen noting the identical address. This is the same address that appeared in the wires sent to GEE by River Falls Financial and SDH, as noted in the AC Chair's December 5 email described in paragraph 36, above. Also, Huff's website at the time contained references to River Falls Investments, SDH, Oxygen, and O2HR.

40. In addition to the background checks of Heineman and Associate-1 discussed in paragraph 26, on November 23 and December 21, Henaghan, Rainis, and Gerace participated in phone calls with Associate-1. According to Henaghan's notes of the calls, they discussed Huff's connections to River Falls Financial and River Falls Investments and the Commission's lawsuit against Huff "alleging fraudulent transfer of assets & non-disclosure of related party transactions." Associate-1 told BDO that Huff's wife was the original 100% owner of River Falls Financial before it was sold to Pence. Associate-1 also told BDO that, through a family trust, Huff had a 70% ownership interest in River Falls Investments.

41. Also on December 8, 2009, the day before the special audit committee meeting, the AC Chair received an email from Heineman to the audit committee with several attachments. Heineman's email purported to offer a new explanation for why GEE had received $2.3 million from the three entities rather than PAB. Heineman claimed that he had negotiated an assignment agreement with the manager of River Falls Investments (Associate-1), who "offered to purchase" the purported CD from GEE at face value. Heineman also attached to his email an unsigned, draft assignment agreement and a letter from Heineman to PAB, dated July 21, 2009, that purportedly authorized the $2.3 million CD investment. Heineman's email also attached a July 2009 monthly statement for GEE's operating account at PAB, which included the description of the $2.3 million withdrawal as a debit on July 23 with a debit memo stating in handwriting: "To: Park Avenue Insurance, See Attachment Approval, $2,300,000.00."

42. The AC Chair responded to Heineman's email that day, stating: "Given the chain of event[s] you described below, why was GEE not informed immediately when River Falls Investments purchased the CD and why are we just now learning that a law firm has been engaged to document the assignment of the CD? We have been asking questions about the CD now for

nearly a month." BDO engagement partner Henaghan received a copy of Heineman's email with attachments and the AC Chair's reply email. On a printout of the AC Chair's reply email, BDO engagement partner Henaghan wrote "$ Anthony Huff."

43. Henaghan also exchanged emails with the AC Chair later that day, noting his agreement with the AC Chair's questions to Heineman and that "the sale of the CD would constitute a related party transaction which typically should be approved by the board." The AC Chair replied to Henaghan that he had just spoken to Heineman and Heineman "claims that RFI (River Falls Investment) is 100% owned by [Associate-1] and is not related to River Falls Financial Services or any of the other entities." Henaghan replied, "That is consistent with what [] Pence told me in my conversation with him. The common names are a little strange though."

44. Prior to the December 9, 2009, special audit committee meeting, BDO had learned of several indications of fraud relating to the purported CD. Moreover, during the 2009 audit of GEE, BDO became aware of multiple indications that the purported assignment agreement with River Falls Investments was a related party transaction, including:

- the common names of River Falls Investments (purportedly owned by a Huff family trust and Associate-1) and River Falls Financial (purportedly owned by Pence, GEE's chairman);

- River Falls Financial had sent GEE $1.2 million in four installments in connection with the assignment agreement;

- Heineman and Associate-1 were co-managers of River Falls Financial;

- Associate-1 was a signatory for GEE's operating account at PAB from July to September 2009, when the $2.3 million was purportedly invested in a CD;

- Heineman's email address was rheineman@riverfallsfinancialgroup.com;

- The validity of a business purpose for River Falls Investments to purchase the CD at face value was questionable given that (i) PAB stated that it had no record of the purported CD in its system; and (ii) GEE did not have a binding agreement in its possession concerning its purported purchase of the CD with PAB;

- River Falls Investments was not listed in GEE's banking records as the originator of the wire transfers that were purported to be in connection with the assignment agreement. GEE received the payments from SDH, River Falls Financial, and Oxygen—all of which were made before a binding agreement with River Falls Investments was executed; and

- River Falls Financial, River Falls Investments, SDH, Oxygen, and Huff all shared a common address: 11921 Brinley Avenue in Louisville, KY 40234.

45. Prior to the GEE special audit committee meeting scheduled for December 9, 2009, Henaghan alerted Rainis, Gerace, and BDO's Midwest Regional Business Line Leader (the "BDO

Midwest Leader") of Heineman's new explanation concerning the assignment agreement and each of them attended the meeting. According to the audit committee meeting minutes:

- Henaghan expressed concern that BDO still did not have a clear understanding of the purported CD transaction.

- Henaghan said that BDO needed to understand the nature of the purported administrative errors at PAB that he had been told were responsible for the lack of proper documentation regarding the CD transaction. Henaghan also explained that BDO required documentation validating the banking transactions, and an explanation as to why there was no existence of an account agreement with the Bank or no record of the CD being at the bank.

- The BDO Midwest Leader said he believed members of GEE's senior management appeared hesitant to provide information related to these transactions.

- Henaghan stated that the assignment agreement did not resolve the outstanding issues as BDO still needed to know what transpired within PAB and make a determination of whether the assignment agreement with River Falls Investments was a related party transaction.

- BDO also advised that although the assignment agreement "may reduce or eliminate the need for going concern disclosure, it would increase the requirement that management provide sufficient disclosure regarding any related party conflicts."

46. On December 14, 2009, GEE's outside counsel sent PAB a formal letter requesting all documentation and information concerning the purported CD. BDO received a copy of this letter. PAB's December 16, 2009, response, also received by BDO, provided only documents relating to GEE's checking account and did not provide any documents or other information about the purported CD. The checking account documentation, however, indicated that only Associate-1, the GEE CFO, and Pence were authorized signers on GEE's account from July to September 2009—not Heineman—and the checking account statements reflected a debit memo for the transfer of $2.3 million of GEE's cash to Park Avenue Insurance on July 23, 2009.

47. On Friday, December 18, 2009, BDO received a letter from GEE's general counsel that attached the final assignment agreement, dated December 11, and a letter from Associate-1 claiming that the $2.3 million sent to GEE by SDH, Oxygen, and River Falls Financial originated from River Falls Investments and its "wholly owned subsidiaries or affiliates." The letter concluded: "The entirety, sans interest, used by the Company for the purchase of the CD was received into the Company's Chase bank account.... Since time is certainly of the essence to complete the audit work for the Form 10-K to be filed by the Company no later than December 31, 2009, we believe that any open concerns your firm had with respect to the source of the initial concerns over the CD are now resolved." The letter did not provide any additional information concerning what had happened with the purported CD and why Associate-1 and River Falls Investments would pay face value for the purported CD which PAB had not honored and had no records to support.

48. Following the receipt of the December 18 letter, BDO partners Henaghan, Rainis, and Gerace requested consultation with Graul, BDO's national director of accounting and risk management partner, Hambleton, BDO's national director of SEC practice, and BDO's general counsel. After discussion of the situation, these BDO partners agreed they should inform GEE that the December 18 letter did not fully address the questions BDO had raised and demand that the audit committee commission an independent investigation to determine exactly what happened.

G. BDO DEMANDED AN INDEPENDENT INVESTIGATION AND, SHORTLY THEREAFTER, WITHDREW THE DEMAND

49. On Monday, December 21, 2009, Henaghan sent an email to Graul and Hambleton, copying Rainis and Gerace, stating: "This morning we informed the [AC Chair] that we will require an independent investigation of the CD matter in order to conclude the audit of General Employment (consistent with our discussions with you on Friday.) Attached is our proposed written communication." The five-page draft communication described in detail much of the inconsistent evidence BDO had received concerning the purported CD and the purported assignment agreement with River Falls Investments and also included a number of proposed questions. Graul responded:

> We do not owe the Board any explanation other than our "audit" of the CD in question is incomplete because we have been unable to obtain sufficient evidence to support the existence and ownership of this asset. You could say that we have obtained bits and pieces of evidence[] but are not satisfied with the sufficiency of such evidence to support our opinion on the financial statements. You could also say that because of the unusual circumstances surrounding the evidence provided thus far, we concluded that the Board should undertake a full investigation of the matter.

50. Later that day, Hambleton replied to Graul's email, asking whether they "should go into detail of the issues in the letter." Graul responded to Hambleton: "Short of saying we think there is fraud, the point is we have been looking for support for months and don't have anything satisfactory to support a final opinion. If we give a list of questions, we'll get answers to those questions and still not know what is really going on. An independent investigation is the only way to get to the bottom of this. The list doesn't look like it would get us there."

51. Also on December 21, 2009, BDO partners Henaghan, Rainis, and Gerace questioned Associate-1 about the assignment agreement and Huff's involvement with GEE, River Falls Financial, and River Falls Investments. According to summary notes of the call, Associate-1's explanation for why River Falls Financial, purportedly owned by Pence, wired payments of $300,000 each to GEE on four days (December 2, 3, 4, and 9), was that the funds were "initially inadvertently transferred to the [River Falls Financial] account rather than the GEE account." Associate-1 also informed BDO that Huff's wife was the original 100% owner of River Falls Financial and that Pence acquired the company in 2009. The notes also reflect that Associate-1 conveyed that through a trust Huff has an ownership interest in River Falls Investments. Associate-1 further told BDO that he was familiar with Park Avenue Insurance and he believes it "is insolvent at this point."

52. Ultimately it was determined that the detailed letter would be sent and, early on December 22, 2009, Henaghan sent GEE's AC Chair a five-page letter, dated December 21, 2009, in substantially the same form as Henaghan had internally circulated earlier. Henaghan's letter identified a number of inconsistencies in the audit evidence BDO had received regarding the purported CD:

- BDO had not received "sufficient audit evidence" to support the existence of a CD investment as of September 30, 2009. The questions raised in regards to the CD at both the November and December audit committee meetings remained unaddressed.

- BDO had not received an adequate explanation from PAB as to the whereabouts of the $2.3 million after July 23, 2009, because the Bank claimed to have no record of a CD in its system. PAB never "repaid the CD proceeds or provided an adequate explanation regarding the status of the CD."

- BDO had "requested (but not been granted) an opportunity to speak directly with [PAB] regarding this matter."[6]

- The July 2009 PAB statement "indicates the amount was transferred to Park Avenue Insurance. We would like to understand why it appears that the funds were transferred to Park Avenue Insurance and were not invested into a CD. . . . [M]anagement has provided no explanation for this. The documentation also appears to indicate that prior to September 2009, [Associate-1] was an authorized signor on the Company's operating account."

- Heineman's statements to BDO: (1) claiming on November 23 that "the issue would be resolved and the funds deposited in the Company's bank account within a few days"—which did not happen; (2) stating on November 25 that the money would not be "paid back in installments"—which did happen; (3) claiming GEE would have the proceeds by November 30—which did not happen; (4) asserting on December 8 that he negotiated the assignment with Associate-1—but "during [BDO's] earlier discussions with Mr. Heineman he had represented that he was not involved in the process of resolving the issues related to the CD."

- BDO received conflicting reports regarding the return of the CD funds: (1) the AC Member stated on December 4 that "the bank continues to put money against the CD they owe the Company and it should be fully repaid"; (2) Pence and Heineman referred BDO to the AC Member; and (3) "In all discussions leading up to December 7, 2009, no one ever indicated that the CD had been assigned to [Associate-1]."

- "At the December 9, 2009 audit committee meeting, general counsel and one audit committee member requested that BDO not be present for the discussion regarding the CD matter."

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[6] BDO never contacted PAB or spoke to anyone from PAB after learning that PAB failed to repay the CD proceeds.

- BDO had not received a clear explanation as to why River Falls Investments would purchase the CD that the Bank has said does not exist, why River Falls Investments would transfer funds to GEE before an assignment agreement had been executed, and whether Associate-1's intent to sell companies to GEE was related to his agreement to purchase the CD.

- "Approximately $900,000 of the proceeds recovered by the Company was received from River Falls Financial Services. [BDO] had previously been informed that River Falls Financial Services was 100% owned by Steve Pence. However, in a December 18, 2009 telephone conversation with Steve Pence, he was unable to explain why these amounts were transferred from River Falls Financial Services (as the proceeds were for [Associate-1's] purchase of the CD)."

53. Henaghan's letter indicated that he included specific facts in the letter "to illustrate that it appears that management has not been forthcoming with information surrounding this matter. This fact pattern has caused us to raise the level of scrutiny surrounding this issue."

54. At the end of his letter, Henaghan stated that BDO did not have sufficient audit evidence at that time to formally conclude the audit and demanded an independent investigation:

> While BDO recognizes that the issue related to the CD may be the result of potential administrative or other errors at [PAB], we do not believe we have been provided sufficient audit evidence to formally conclude on this matter at this point. As a result of the fact that almost one month has passed since the first audit committee meeting discussing this matter, that it appears management has not been fully forthcoming on how it was resolving the issue, and certain question remain unanswered, we will require the audit committee to commission a full investigation of this matter prior to the completion of our audit for the year ended September 30, 2009. This investigation should be conducted by an independent firm that is acceptable to our firm and should address the following unexplained matters:
>
> - Why would the Company maintain $2.3 million at Park Avenue Bank in direct violation of its own investment policy?
> - Why was [Associate-1] an authorized signor on the Company's account at Park Avenue Bank?
> - What happened to the CD? We would like an explanation for all of the facts noted above surrounding the situation.
> - Why did the Company not pursue legal action against the bank and report the situation to the FDIC when the bank failed to reimburse the Company when the CD matured?
> - Why would Mr. Heineman & Mr. Pence represent they were unaware of the status of the CD resolution and why funds were being received from entities other than Park Avenue Bank when it appears they were aware of the assignment agreement with [Associate-1]?

- Why would [Associate-1] be willing to purchase an asset whose value is in question when he has no relationship to the Company?
- Why did River Falls Financial Services reimburse the Company for the CD if they did not have any relationship with [Associate-1] and were not a party to the assignment agreement?
- We would like a clear understanding of the relationships between [Associate-1], Mr. Pence and Mr. Heineman and any entities where they may have joint ownership?
- What is the relationship between [Associate-1], Mr. Pence, Mr. Heineman and Park Avenue Bank?

Please note that the issues listed above represent[] some of the areas of concern based on our current understanding of the facts. The above items should not be considered an all-inclusive list and the investigation should not be limited to the above identified items. We may identify additional questions and require additional audit evidence based on the results of the investigation. BDO recommends that this investigation be commissioned as soon as possible.

55. On the evening of December 22, 2009, BDO learned that the audit committee meeting that was scheduled for the following day had been cancelled, Zizza, an advisor to Pence who had attended GEE board meetings through the fall of 2009, would be taking over as CEO, and that Pence and Associate-1 intended to prepare written responses to each of the issues identified in the December 21 letter. In email exchanges that evening and the following morning regarding these events, Henaghan, Gerace, Hambleton, and the BDO Midwest Leader agreed that BDO should communicate to GEE in writing that BDO "will continue to require an independent investigation."

56. Following Zizza's appointment as GEE's new CEO, BDO partners Henaghan, Rainis, Gerace, and the BDO Midwest Leader spoke to Zizza and the AC Chair on December 24, 2009. A senior partner in BDO's New York office (the "NY Partner") also attended the call because he handled some of Zizza's other business relationships with BDO, including audit or tax work for Zizza's private company and three public companies for which Zizza served as a board member. Henaghan later wrote a memo describing the December 24 call, stating that Zizza "requested that BDO conclude the audit without the need for an independent investigation" because of "the change in management and the fact that the Company had recovered full control of the $2.3 million in question" and that the AC Chair agreed. The memo also indicates that both Zizza and the AC Chair "acknowledged that some inappropriate actions were taken within the Company and that it was likely that even more inappropriate actions were taken at the Bank" and that both "felt that with [Heineman's] removal from the management team, the inappropriate actions within the Company would stop."

57. Also on December 24, BDO partners Henaghan, Rainis, and Gerace had a telephone conversation with Pence, Zizza, and the AC Chair. According to a memo Henaghan later wrote describing this call, Pence indicated he asked GEE to move its business to PAB because of his prior working relationship as an attorney for Antonucci, PAB's then-President, and

Associate-1's association with PAB as a customer. The memo also indicates that Pence had told BDO that the reason he represented he was unaware of the status of the CD resolution and why funds were being received from entities other than PAB was because "he was unaware of the assignment agreement until after the funds were returned to the Company." The memo further noted that Associate-1's explanation for why River Falls Financial transferred funds to GEE was because River Falls Financial "also has an operating account" at the same bank and "[t]he funds were transferred from one of his companies to [River Falls Financial] in error," and as such, River Falls Financial "then had to transfer the funds to GEE."

58. After these calls with Zizza, Pence, and the AC Chair, Henaghan sent Rainis, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel an email on December 24, 2009, asking for their availability for a call and stating he was drafting a memo summarizing current facts. Graul responded: "Unless there is something new that hasn't been discussed in the last few calls, what's the purpose?" The NY Partner replied: "The purpose is to try to salvage an account where they made [] changes in the management because of the alleged wrongdoing." Graul responded: "Did they change the guy that can't support the $2 million that supposedly was put into company? What about the two audit committee members that stalled the investigation and the lawyer that wouldn't let us participate in a board meeting to preserve privilege. There's something funny going on here." The NY Partner replied that he had no disagreement with Graul on the last point.

59. BDO's 2009 Assurance Manual required Henaghan to consult with Graul, Hambleton, and Gerace in the circumstances presented here. The Manual required the engagement partner seeking consultation to prepare a memorandum concerning all consultations, which should, among other things, define the issues; "identify client source documents/evidence reviewed"; summarize the proper accounting treatment; summarize the impact on the financial statement presentation and disclosure; and describe any alternative solutions considered and why they were rejected. Finally, BDO's 2009 Assurance Manual required the memorandum to be sent to all consultants, who "should acknowledge their agreement with the memorandum."

60. Early in the morning on December 28, Henaghan sent a draft memo to Rainis, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel. The memo summarized BDO's calls with Zizza, the AC Chair, Pence, and Associate-1, and attempted to answer the questions posed in Henaghan's letter to the AC Chair dated December 21, 2009. The memo concluded: "the engagement team believes it is appropriate to reconsider the need for an independent investigation and as such is requesting a consultation on this matter."

61. That same day, Henaghan, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel discussed GEE for approximately one hour. Despite the existence of multiple, unanswered questions, they ultimately agreed to drop the demand for an independent investigation if GEE agreed to include commentary on two material weaknesses in internal controls, including certain circumstances surrounding the purported CD, in a Form 8-K and that Associate-1 would not become part of management, among other things. A memo later written by Henaghan to document the discussion notes as considerations, among other things, that Zizza—whom BDO trusted—had replaced Heineman as CEO and that the AC Chair, who had initially supported the independent investigation, no longer believed that it was required.

62. Following their call, the NY Partner spoke to Zizza and Henaghan spoke to the AC Chair about the statements BDO wanted made in the Form 8-K and Associate-1's contemplated role with GEE. Henaghan emailed an update to Rainis, Graul, Gerace, Hambleton, the NY Partner, the BDO Midwest Leader, and BDO's general counsel, stating that the AC Chair indicated that GEE was contemplating an acquisition that would make Associate-1 an approximate 20% shareholder of GEE, but not an officer, director, or part of management. Graul responded: "I don't like it but won't object provided [that Associate-1] is not a board member and has no managerial responsibilities, even with respect to the business he is selling. Please make it perfectly clear that this is the last accommodation that I am willing to make from a risk management perspective."

63. Also following their December 28 call, Hambleton sent an email to the other BDO partners asking whether they were comfortable with the classification of the $2.3 million as cash at September 30. Henaghan responded: "we have a confirmation from Park Ave Bank & the subsequent execution and funding of the assignment agreement as evidence of the existence of the CD at 9/30." Henaghan did not mention any of the inconsistent evidence that he identified in his letter to the AC Chair dated December 21, 2009, and that indicated that no such CD or other cash equivalent existed as of September 30, 2009. Neither Hambleton nor any of the other BDO partners responded or commented on these omissions.

64. BDO provided a draft Form 8-K disclosure to GEE, and reviewed and agreed to the language ultimately included in GEE's Form 8-K filed on December 30, 2009. The Form 8-K disclosed Heineman's resignation, Zizza's appointment as CEO, and the fact that Zizza was paid $20,000 per month since March 2009 to consult for Pence. The Form 8-K also stated:

> In July 2009, the Registrant purchased a $2.3 million certificate of deposit ("CD") at a New York bank. When the CD matured in October 2009, the bank did not timely credit the proceeds of the CD to the Registrant's account. Although the Registrant has made a formal inquiry of the bank, to date the Company has not received an adequate explanation for the bank's non-performance relating to the CD. In December 2009, the Registrant was reimbursed in full through a non-recourse assignment of the CD for face value to an unrelated party, who has other business interests with the bank. The purchaser of the CD is neither an employee nor a director of the Registrant.

65. The Form 8-K also disclosed two material weaknesses: (1) "the size of the New York bank from which the CD was purchased did not meet the minimum requirements of [GEE]'s investment policy"; and (2) the Company "authorized an individual that was neither an employer nor a director as an authorized signor on the Registrant's bank account." The Form 8-K did not indicate that Associate-1 was both the authorized signatory and the purportedly "unrelated party" who purchased the purported CD.

66. On January 4, 2010, Henaghan sent an email to the other BDO partners attaching the Form 8-K, the December 21, 2009, letter to the AC Chair demanding an independent investigation, Heineman's resignation email, and a final memo discussing BDO's calls with the AC Chair, Pence, Zizza, and Associate-1 and concluding that BDO should issue its opinion on GEE's financial statements. The final memo noted that Zizza and the AC Chair "acknowledged

that some inappropriate actions were taken within the Company and that it was likely that even more inappropriate actions were taken at the Bank.... Both men also acknowledged that they felt that with [Heineman's] removal from the management team, the inappropriate actions within the Company would stop." The memo noted that "without the cooperation of [Heineman] and the Bank – neither of which anyone was likely to obtain, it was highly unlikely that the motivations or even all of the actions would ever be learned." BDO did not attempt to contact Heineman following his resignation nor did BDO attempt to contact PAB at any time after this issue arose.

67. The memo also stated that Zizza "represented to BDO that [Associate-1] will not become an employee or director of the Company" and concluded: "To the extent any new adverse information related to the transaction comes to our attention we will again consult with BDO's risk management and National SEC groups in regards to continued client retention." Rainis, Graul, Gerace, and Hambleton each reviewed the memo and concurred with the decision to drop the demand for an independent investigation. BDO's general counsel also agreed with the approach outlined in the memo.

68. On January 5, 2010, after BDO had already decided that GEE's Form 8-K disclosure concerning the purported CD was adequate and informed GEE that it would withdraw its demand for an investigation and issue an unqualified audit opinion, Hambleton asked BDO's general counsel, Henaghan, Rainis, Graul, Gerace, and the NY Partner: "I want to make sure we believe the company's response is a sufficient response to a potential illegal act. Although we didn't specifically say we thought there was a potential illegal act in the [December 21] letter, we did include enough issues that would lead someone to that view as does the memo's statement about some 'inappropriate actions.'" BDO's general counsel responded: "I do believe the company's response was appropriate under the circumstances."

69. On January 8, 2010, GEE filed its Form 10-K, which classified the $2.3 million purported CD as a cash equivalent and stated in footnote disclosure to the financial statements:

> In July 2009, the Company purchased a $2,300,000 certificate of deposit ("CD") at a New York bank. When the CD matured in October 2009, the bank did not timely credit the proceeds of the CD to the Company's account. Although the Company has made a formal inquiry of the bank, to date the Company has not received an adequate explanation for the bank's non-performance relating to the CD. In December 2009, the Company was reimbursed in full through a non-recourse assignment of the CD for face value to an unrelated party, who has other business interests with the bank. The purchaser of the CD is neither an employee nor a director of the Company.

70. GEE's Form 10-K filed on January 8, 2010 contained an audit report from BDO that stated BDO's audits were conducted "in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that GEE's financial statements presented fairly, in all material respects, the company's position and results at September 30, 2009, in conformity with GAAP.

H. IN 2010, BDO LEARNED OF FACTUAL ALLEGATIONS IN A CRIMINAL COMPLAINT AGAINST THE PAB PRESIDENT ALLEGING THAT THE PURPORTED CD DID NOT EXIST

71. On January 19, 2010, just days after BDO issued its unqualified opinion and GEE filed its 2009 Form 10-K, Henaghan sent an email to Rainis, Graul, Gerace, Hambleton, the BDO Midwest Leader, and NY Partner attaching a January 12, 2010, Grand Jury Subpoena, issued to the AC Chair seeking his appearance and production of "any and all documents relating to any account maintained at Park Avenue Bank."

72. On March 13, 2010, the United States of America filed a 44-page criminal Complaint against former PAB president Antonucci (the "Antonucci Complaint"), alleging a scheme and conspiracy involving a $6.5 million round-trip transaction in which GEE's $2.3 million was diverted as part of the conspiracy. Huff, Heineman, and Pence are referred to and identifiable as designated "co-conspirator[s] not named herein" in certain aspects of that conspiracy. The allegations in the Antonucci Complaint contained several details that indicated that GEE did not have a CD with PAB, that River Falls Financial, River Falls Investments, Oxygen, SDH, and PSQ were related parties, and that Heineman had authorized the money to be transferred to Park Avenue Insurance as part of the conspiracy, and not to purchase a CD:

- "To hide the improper diversion of GEE's funds from GEE's auditors and Board of Directors, [Antonucci] and others created a counterfeit certificate of deposit [], falsely representing that GEE's $2.3 million had been invested in a 90-day certificate of deposit at the Bank. In fact, and as [Antonucci] well knew, there was no $2.3 million CD."
- GEE's $2.3 million had been transferred to Park Avenue Insurance, which was controlled by Antonucci. According to the Bank records, Heineman authorized this transfer.
- Antonucci fraudulently signed the BDO confirmation of the $2.3 million CD, when Antonucci knew it did not exist.

The Antonucci Complaint further identified several "Oxygen-related entities" as participants in the conspiracy, including, River Falls Financial (which Pence said he owned), PSQ (Pence's entity that purchased the majority stake in GEE), and Oxygen and SDH—two companies that paid GEE purportedly under the assignment agreement with River Falls Investments (which Associate-1 said he and a Huff family trust owned). It further alleged that a group of five associates (including Huff and Pence) were listed on some of the accounts of the Oxygen-related entities, which shared a common address in Louisville, Kentucky.

73. On April 27, 2010, Henaghan sent an email attaching the Antonucci Complaint to Rainis, Graul, Gerace, Hambleton, the BDO Midwest Leader, and BDO's general counsel. Henaghan's email also attached a March 10, 2010 Grand Jury Subpoena issued to GEE, requesting (i) documents relating to Huff, Pence, Heineman, the purported CD, SDH, Oxygen, O2HR, and River Falls Financial and (ii) documents reflecting any payments to Heineman, Pence, Associate-1, or the AC Member. Henaghan further attached a client retention memo addressed to Graul, Hambleton, Gerace, the BDO Midwest Leader, and BDO's general counsel. The memo stated:

"As I believe everyone is aware, in March 2010, Charles Antonucci, the president of Park Avenue Bank was arrested related to allegations of criminal acts in his role as bank president, including signing a counterfeit CD and our confirmation when he had in fact diverted the funds for his own personal use." The memo also noted that Pence was an unnamed co-conspirator. The memo concluded that the engagement team recommended that BDO continue its relationship with GEE because, among other factors, "Pence has not been formally charged yet with any criminal wrong-doing." However, the memo did not address what impact the Antonucci Complaint's allegations might have on the representations contained in GEE's financial statements (issued two months before the complaint) concerning the purported CD.

74. On April 28, 2010, Graul responded to Henaghan's email requesting that he obtain additional information concerning certain allegations in connection with client retention concerns. Specifically, Graul indicated that Gerace had confirmed to him that "[w]hen the missing company funds were 'dribbling' in from other sources" those sources included entities linked to the conspiracy alleged in the Antonucci Complaint. Graul asked Henaghan to determine (i) whether any related party transactions might involve the entities mentioned in the complaint; (ii) who authorized the funds to be paid to GEE from the "Oxygen-related entities" River Falls Financial, SDH, and Oxygen; and (iii) whether the AC Chair and Zizza are comfortable working with Pence because "the preponderance of the accusations seem pretty bad for Mr. Pence." Hambleton responded to all, stating: "I agree with [Graul]. It seems there are more potential connections here." However, neither Graul, Hambleton, Gerace, nor Rainis ever followed up with Henaghan to learn whether he had identified those "potential connections."

75. In a May 25, 2010, email, Henaghan told Zizza that he would like to discuss certain issues regarding the Antonucci Complaint. Henaghan wrote that he wanted to discuss the allegations that "Pence purchased a 25% interest in Bedford Consulting from Antonucci for $6.5 million in what the complaint describes as an 'artifice designed to cover up the true source of the $6.5 million.'" Henaghan also wrote: "The Complaint indicates that River Falls is owned by Pence, [Associate-1], and Heineman. All previous information disclosed to us by Heineman and Pence indicated that Pence owned 100% of River Falls." He further noted that the Complaint indicated that PSQ borrowed money from River Falls to buy the GEE shares. Henaghan's email to Zizza did not address the allegations in the Antonucci Complaint denying the existence of the purported CD or indicating related party issues concerning the funds received by the "Oxygen-related entities."

76. On June 1, 2010, in connection with the allegations contained in the Antonucci Complaint, an Assistant United States Attorney for the Southern District of New York interviewed Henaghan in detail about BDO's 2009 audit, including the information BDO received about the ownership structures of River Falls Financial, River Falls Investments, WTS, On-Site, Oxygen, and AIR.

77. Other than Henaghan's single discussion with Pence (who denied the allegations) and further communications with Zizza (who stated that he still trusted Pence), BDO did not perform any additional procedures specific to the allegations in the Antonucci Complaint concerning GEE, its chairman and former CEO, or the purported CD. BDO's workpapers do not

include any information about what BDO did to investigate the allegation that PAB records indicated that Heineman authorized the transfer of $2.3 million to Park Avenue Insurance. BDO's workpapers also do not include any analysis of the impact on GEE's financial statements if Heineman had conspired with Antonucci to steal GEE's $2.3 million, by authorizing the transfer of the money to Antonucci's company, Park Avenue Insurance, as alleged in the Antonucci Complaint. The workpapers do not include an analysis of whether the assignment agreement with River Falls Investments, in which GEE received $2.3 million from SDH, Oxygen, or River Falls Financial, was a related party transaction. In fact, Henaghan did not document any answers he received pursuant to his discussions with Pence or Zizza. Moreover, the client retention memo and "matters for reviewer concern" memo retained in the workpapers for the 2010 audit make no reference to the Antonucci Complaint or guilty plea.

78. In October 2010, Antonucci pled guilty to multiple criminal charges in a criminal information, including securities fraud, bank bribery, and embezzlement of bank funds. As part of his guilty plea, Antonucci admitted that he and his co-conspirators caused GEE to use $2.3 million of its funds to make PAB whole on a loan PAB made to a company controlled by his co-conspirators that had gone bankrupt, that the purported CD had never existed, and that he had signed a false confirmation that the bank had issued a CD to GEE that he then sent to BDO. BDO learned of this guilty plea shortly thereafter.

79. BDO also learned, through GEE's November 2010 Form 8-K filing and publicly available information, that Pence purportedly sold PSQ to a person associated with Huff ("Associate-2"). After Associate-2 became the majority owner of GEE, a BDO senior manager on the GEE audit noted that Google showed that Associate-2 was connected to O2HR, Huff, and Associate-1. According to the Form 8-K, Associate-2 paid nothing for PSQ; he just assumed promissory notes issued by Pence to AIR for approximately $3 million, which funded PSQ's purchase of the majority of GEE shares in July 2009. Associate-1 had previously informed Henaghan in a December 21, 2009 email that AIR had "investments received and invested in" River Falls Investments, the entity that purchased the purported CD from GEE.

80. Despite all of these additional indications of affiliation among AIR, River Falls Investments, River Falls Financial, Pence, Associate-1, and Huff, BDO did not perform additional audit procedures in 2010 to determine whether the purported purchase by River Falls Investments of the purported CD from GEE (i) was fairly characterized in GEE's financial statements or (ii) should have been identified as a related party transaction in GEE's financial statements. Instead, BDO relied on GEE management and director representations that there were no undisclosed related party transactions. BDO also relied on Associate-1's representations although, as Graul acknowledged to Gerace and Henaghan on August 10, 2010: "Anything and everything that involves [Associate-1] should be scrutinized carefully . . . [Associate-1] is not to be trusted and everyone on the engagement should be made aware of this."

81. GEE's Form 10-K filed on December 28, 2010, for its fiscal year ended September 30, 2010, classified the $2.3 million CD as a cash equivalent as of September 30, 2009, included a similar disclosure as the disclosure in the Form 10-K filed in January 2010:

In November 2009, the Company discovered that it did not receive the proceeds from a bank for a $2,300,000 certificate of deposit that was scheduled to mature in October 2009. Although the Company made a formal inquiry of the bank, it did not receive an adequate explanation for the bank's non-performance related to the deposit. In December 2009, the Company entered into an agreement to assign its interests in the certificate of deposit, without recourse, to an unrelated party that has other business interests with the bank, and the Company was reimbursed for the face value of the deposit.

82. GEE's Form 10-K filed on December 28, 2010, as amended on April 15, 2011, contained an audit report from BDO that stated BDO's audits were conducted in accordance with PCAOB standards and that GEE's financial statements presented fairly, in all material respects, the company's position and results at September 30, 2010 and 2009, in conformity with GAAP.

I. VIOLATIONS

RULE 102(e) AND SECTION 4C OF THE EXCHANGE ACT

83. BDO's 2009 and 2010 audits were deficient and not performed in accordance with PCAOB standards.[7] Section 4C(b) and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to practice as accountants. Pursuant to these provisions, "improper professional conduct" includes two types of negligent conduct: (1) a single instance of highly unreasonable conduct that results in a violation of professional standards in circumstances in which heightened scrutiny is warranted; or (2) repeated instances of unreasonable conduct, each resulting in violations of professional standards, that indicate a lack of competence.

84. As set forth above, BDO knew or should have known facts that cast substantial doubt on the existence of the purported CD given, among other things, (1) significant integrity issues with Heineman, the person who claimed to have authorized the investment, and Associate-1, the person with whom Heineman purportedly "negotiated" the assignment agreement; (2) PAB had told GEE that it had no record of the purported CD; and (3) PAB had provided GEE and BDO with documentation showing the $2.3 million actually had been transferred to Park Avenue Insurance on July 23, 2009.

85. BDO also knew or should have known that the circumstances presented by the purported $2.3 million CD that was not honored by PAB, the subsequent receipt by GEE of $2.3 million from River Falls Financial, SDH, and Oxygen, and the purported assignment agreement with River Falls Investments warranted heightened scrutiny. Notwithstanding the many red flags concerning the purported CD and the assignment agreement discussed above, BDO issued audit reports in both 2009 and 2010 containing unqualified opinions that were filed with GEE's financial

[7] References to auditing standards in this Order are to PCAOB standards in effect at the time the audit work was performed.

statements in the Form 10-Ks. In those reports, BDO inaccurately stated that the audit had been conducted in accordance with PCAOB standards and that GEE's financial statements presented fairly, in all material respects, the company's position and results in conformity with GAAP.

Failed to exercise due professional care and an attitude of professional skepticism (AU § 230)

86. PCAOB standards require auditors to exercise due professional care in the planning and performance of the audit and the preparation of the report. (AU § 230.01) Auditors must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence." (AU § 230.07) In addition, the auditor should "consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process." (AU § 230.08) The Commission and courts have held that related party transactions require heightened scrutiny.[8]

87. As a result of BDO's conduct described above, BDO failed to exercise due professional care and an attitude of professional skepticism in its 2009 and 2010 audits of GEE.

Failed to obtain sufficient competent evidential matter concerning the purported CD (AU §§ 326 and 333)

88. PCAOB standards require auditors to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion with respect to the financial statements under audit. To be "competent," evidence "must be both valid and relevant." (AU § 326.21) "The amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his or her professional judgment after a careful study of the circumstance in the particular case." (AU § 326.22) This includes evaluating the reliability of the evidence,[9] and weighing all of the evidence obtained. The validity and sufficiency of required evidence depends on the circumstances and the auditors' judgment, but should be "persuasive" though it need not be "convincing." (AU § 326.22)

89. PCAOB standards also provide that management representations "are not a substitute for the application of th[e] auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit," that "the auditor obtains written representations from management to complement other auditing procedures," and that "[i]n

[8] *See McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005) (citing *Howard v. SEC*, 376 F.3d 1136, 1149 (D.C. Cir. 2004)) (noting that related party transactions "are viewed with extreme skepticism in all areas of finance").

[9] AU § 330.33: "the auditor should consider (a) the reliability of the confirmations . . ."

exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." (AU §§ 333.02, 333.03, 230.09)[10]

90. As a result of BDO's conduct described above, BDO failed to obtain sufficient evidence supporting assertions in GEE's 2009 and 2010 Form 10-K financial statements that the purported CD existed and was a cash equivalent as of September 30, 2009, and that GEE entered into an assignment agreement with an unrelated party.[11]

Failed to determine whether fraud or potential illegal acts may have impacted GEE's fiscal year 2009 and 2010 financial statements (AU §§ 316, 317)

91. Under AU § 316.01, an auditor must plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. The auditors must brainstorm "how and where they believe the entity's financial statements might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated." (AU § 316.14) AU § 316.06 states that there are "[t]wo types of misstatements relevant to the auditor's consideration of fraud—misstatements arising from fraudulent financial reporting and misstatements arising from misappropriation of assets." It explains that financial reporting may be accomplished by falsification of supporting documentation, or misrepresentations of events, transactions, or other significant information. It further instructs that fraudulent financial reporting "need not be the result of a grand plan or conspiracy" and may instead "be that management representatives rationalize the appropriateness of a material misstatement ... as a temporary misstatement of financial statement ... expected to be corrected later." It instructs that that misappropriation of assets may be accompanied by "false or misleading records or documents, possibly created by circumventing controls." AU § 316.09 also notes that management engaged in fraud will take steps to conceal the fraud from auditors. AU § 316.10 further states that fraud may be concealed through collusion among management and third parties. For these reasons, AU § 316.13 requires auditors to exercise professional skepticism when considering the risk of material misstatement due to fraud.

92. AU § 316.68 lists conditions that may be identified during the fieldwork that are indicators of potential fraud, including (i) unsupported or unauthorized balances or transactions; (ii) missing documents; (iii) unusual discrepancies between the entity's records and confirmation replies; (iv) inconsistent, vague or implausible responses from management or employees; and

[10] AU § 508.20 also provided that "[c]ertain circumstances may require a qualified opinion ... [when] "[t]here is a lack of sufficient competent evidential matter or there are restrictions on the scope of the audit that have led the auditor to conclude that he or she cannot express an unqualified opinion...."

[11] In addition, AS § 3.12 required BDO to "document significant audit findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached." BDO failed to comply with this documentation requirement with respect to each of the major auditing issues encountered during the 2009 and 2010 audits.

(v) denial of access to records, facilities, certain employees, customers, vendors or others from whom audit evidence might be sought.

93. AU § 317.10 notes that auditors may become aware of possible illegal acts during the course of their audit: "When the auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstances in which it occurred and sufficient other information to evaluate the effect on the financial statements."

94. As a result of BDO's conduct described above, BDO failed to adhere to these PCAOB standards during its 2009 or 2010 audits of GEE.

Failed to obtain sufficient audit evidence to determine whether the assignment agreement was a related party transaction (AU §§ 326 and 334)

95. PCAOB standards require that "[an] auditor should view related party transactions within the framework of existing [accounting] pronouncements, placing primary emphasis on the adequacy of disclosure. In addition, the auditor should be aware that the substance of a particular transaction could be significantly different from its form and that the financial statements should recognize the substance of particular transactions rather than merely their legal form." (AU § 334.02)

96. PCAOB standards require an auditor to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements under audit. (AU § 326.01) In selecting particular substantive tests to achieve the audit objectives, an auditor considers, among other things, the risk of material misstatement of the financial statements. (AU § 326.11) With respect to related party transactions, PCAOB standards require that after an auditor identifies related party transactions, he or she should apply the procedures considered necessary to obtain satisfaction concerning their purpose, nature, and extent and their effect on the financial statements. (AU § 334.09) For each related party transaction for which disclosure is required, PCAOB standards require that the auditor satisfy himself that the transaction is adequately disclosed in the financial statements. (AU § 334.11)

97. The failure to disclose the assignment agreement as a related party transaction caused the financial statements to be misleading. Financial Accounting Standards Board Accounting Standards Codification ("ASC") Topic 850, *Related Party Disclosures* required that the following must be disclosed concerning related party transactions: (a) the nature of the relationship involved; (b) a description of the transaction; (c) the dollar amount of the transaction; and (d) amounts due from or to related parties and, if not otherwise apparent, the terms and manner of settlement. Related party transactions cannot be presumed to have been conducted at arm's-length. GAAP requires these disclosures so the reader can be alerted to their existence, so as to help the reader of the financial statements detect and explain possible differences in financial

statements of a company that engaged in related party transactions to those that did not.[12] Such disclosure helps the reader evaluate the substance of the related party transaction.

98. As a result of BDO's above-described conduct, BDO failed to exercise the requisite level of care, failed to perform sufficient procedures to identify related party transactions, failed to obtain sufficient audit evidence to determine whether the assignment agreement was a related party transaction during its 2009 or 2010 audits of GEE, and failed to follow up on evidence indicating that assertions regarding the purported CD and assignment agreement were unsubstantiated. BDO also failed to ensure the issuance of an accurate audit report in 2009 and 2010, which misrepresented that GEE's financial statements were presented fairly, in all material respects, in accordance with GAAP.

Failed to Investigate Newly Discovered Facts in 2010 (AU § 561)

99. AU § 561.04 states that when an auditor becomes aware of information that he would have investigated if it had come to his attention during the course of the audit, he must determine if the information is reliable and whether the facts existed at the date of his report. If the information is reliable and existed at the date of the report, the auditor must determine if his report would have been affected and people relying on the financial statements would find it important. (AU § 561.05.)

100. As a result of BDO's conduct described above, BDO failed to adhere to this PCAOB Standard after learning of, among other things, the Antonucci Complaint in March 2010 and subsequent guilty plea in October 2010, as it concerned GEE's 2009 financial statements.

Finding

101. As a result of the conduct described above, the Commission finds that BDO engaged in improper professional conduct within the meaning of Sections 4C(a)(2), 4C(b)(2)(A), and 4C(b)(2)(B) of the Exchange Act and Rules 102(e)(1)(ii), 102(e)(1)(iv)(B)(1), and 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice. BDO's conduct in the 2009 and 2010 audits of GEE involved repeated instances of unreasonable conduct, each resulting in violations of PCAOB standards and indicating a lack of competence, and also satisfies the standard of highly unreasonable conduct resulting in violations of PCAOB standards in circumstances in which heightened scrutiny was warranted.

BDO VIOLATED SECTION 10A OF THE EXCHANGE ACT

102. Section 10A(a)(1) of the Exchange Act requires each audit conducted of an issuer by a registered public accounting firm to include "procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts." Section 10A(a)(2) of the Exchange Act requires

[12] ASC 850-10-05-2.

each audit conducted of an issuer by a registered public accounting firm to include "procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein." Section 10A(b)(1) requires a registered public accounting firm to, in accordance with PCAOB standards, "determine whether it is likely that an illegal act has occurred" if the firm "detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred." No showing of scienter is necessary to establish a violation of Section 10A. *See SEC v. Solucorp Indus.*, Ltd., 197 F. Supp. 2d. 4, 10-11 (S.D.N.Y. 2002).

103. In connection with the 2009 and 2010 GEE audits, BDO violated Section 10A(a)(1) of the Exchange Act by failing to plan, design, and carry out audit procedures to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statements amounts.

104. In connection with the 2009 and 2010 GEE audits, BDO violated Section 10A(a)(2) of the Exchange Act by failing to plan, design, and carry out audit procedures to identify GEE's material related party transactions that required disclosure in the financial statements.

105. In connection with the 2009 and 2010 GEE audits, BDO violated Section 10A(b)(1) of the Exchange Act by failing to determine whether it was likely that an illegal act had occurred after BDO was made aware of information indicating that an illegal act may have occurred.

106. As a result of the conduct described above, the Commission finds that BDO violated Sections 10A(a)(1), (a)(2), and (b)(1) of the Exchange Act.

BDO WAS A CAUSE OF VIOLATIONS OF SECTION 13(a) OF
THE EXCHANGE ACT AND RULE 13a-1 THEREUNDER

107. Section 13(a) of the Exchange Act and Rule 13a-1 thereunder require that every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission annual reports (i.e., Form 10-K) as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading. The obligation to file such reports embodies the requirement that they be true and correct.

108. GEE's annual reports on Form 10-K for fiscal years 2009 and 2010 included audit reports from BDO that stated BDO's audits were conducted "in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that GEE's financial statements presented fairly, in all material respects, the company's position and results. These statements were materially misleading. As a result of BDO's above-described conduct, BDO's 2009 and 2010 audits were not conducted in accordance with PCAOB standards and the financial statements included in GEE's 2009 and 2010 Form 10-Ks were materially misstated because, among other things, they incorrectly represented GEE had a $2.3 million CD and classified it as a

cash equivalent as of September 30, 2009, and did not disclose the assignment agreement as a related party transaction, contrary to GAAP. At a minimum, BDO knew or should have known that its unreasonable conduct would contribute to GEE's filing of inaccurate 2009 and 2010 Form 10-Ks.

109. As a result of the conduct described above, the Commission finds that BDO was a cause of GEE's violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.

J. UNDERTAKINGS

110. BDO's Review. Within one hundred and twenty days after the entry of this Order, BDO shall perform and complete a review and evaluation ("BDO's Review") of the sufficiency and adequacy of BDO's quality controls set forth in its audit manual, including its policies and procedures set forth therein for audit and interim review procedures, regarding the following (hereinafter referred to as "BDO's Policies"):

(i) client acceptance and retention;

(ii) the exercise of due professional care and professional skepticism (as set forth in AU § 230);

(iii) the identification and consideration of disclosures of related parties and related party transactions (as set forth in Auditing Standard No. 18 and AU § 334);

(iv) fraud detection (as set forth in AU § 316);

(v) compliance with the requirements of AU § 317, including the identification of "illegal acts" as defined in AU § 317.02: "Illegal acts by clients are acts attributable to the entity whose financial statements are under audit or acts by management or employees acting on behalf of the entity. Illegal acts by clients do not include personal misconduct by the entity's personnel unrelated to their business activities";

(vi) compliance with Section 10A of the Securities Exchange Act of 1934, including designing procedures to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts, and to comply with all requirements under the standards of the Commission, the PCAOB, and Section 10A to evaluate and report suspected illegal acts;

(vii) obtaining sufficient appropriate audit evidence (as set forth in Auditing Standard No. 15);

(viii) evaluation of and reliance upon management representations (as set forth in AU § 333);

(ix) third-party confirmations (as set forth in AU § 330), including evaluating the results of the confirmation procedures in accordance with AU § 330.33, "In performing that evaluation, the auditor should consider (a) the reliability of the confirmations and alternative procedures; (b) the nature of any exceptions, including the implications, both quantitative and qualitative, of those exceptions; (c) the evidence provided by other procedures; and (d) whether additional evidence is needed."

(x) consultations with local, regional or national office technical oversight professionals;

(xi) adequate audit documentation, including work paper sign-off, archiving, and dating (as set forth in Auditing Standard No. 3);

(xii) document retention; and

(xiii) the response to the discovery of new facts subsequent to the issuance of audit report (as set forth in AU § 561).

BDO's Review shall assess the forgoing areas to determine whether BDO's Policies are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and PCAOB standards and rules.

111. <u>BDO Report.</u> Within sixty days of completing the BDO Review, BDO shall deliver to the Commission staff a detailed written report ("BDO Report") summarizing its review and changes to BDO's Policies, if any, to provide reasonable assurance of compliance with all relevant Commission regulations and PCAOB standards and rules. The BDO Report 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 BDO agrees to provide such evidence.

112. <u>Independent Consultant's Review.</u> BDO has undertaken to retain, within one hundred and eighty days after the entry of this Order, an independent consultant ("Independent Consultant"), not unacceptable to the Commission staff. BDO shall provide to the Commission staff a copy of the engagement letter detailing the scope of the Independent Consultant's responsibilities. The Independent Consultant's compensation and expenses shall be borne exclusively by BDO. BDO shall deliver to the Independent Consultant the BDO Report at the same time as BDO provides such report to the Commission staff as specified in paragraph 111 above. BDO shall require that the Independent Consultant perform a review (the "IC Review") of BDO's Policies to determine whether BDO's Policies are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and PCAOB standards and rules. BDO shall cooperate fully with the Independent Consultant and shall provide reasonable access to firm personnel, information, and records as the Independent Consultant may reasonably request for the IC Review (including training materials pertaining to the undertaking in paragraph 116), subject to BDO's right to withhold from disclosure any information or records protected by any applicable protection or privilege such as the attorney-client privilege or the attorney work product doctrine.

113. Independent Consultant's Report. After the IC Review is completed, but no later than ninety days after receiving the BDO Report, the Independent Consultant shall issue a detailed written report (the "IC Report") to BDO: (a) summarizing the IC Review; and (b) making recommendations, where appropriate, reasonably designed to ensure that BDO's Policies are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and PCAOB standards and rules. BDO shall require the Independent Consultant to provide a copy of the IC Report to the Commission staff and the PCAOB staff when the IC Report is issued.

114. BDO shall adopt, as soon as practicable, all recommendations of the Independent Consultant in the IC Report. Provided, however, that within thirty days of issuance of the IC Report, BDO may advise the Independent Consultant in writing of any recommendation that it considers to be unnecessary, outside the scope of this Order, unduly burdensome, or impractical. BDO need not adopt any such recommendation at that time, but instead may propose in writing to the Independent Consultant and the Commission staff an alternative policy or procedure designed to achieve the same objective or purpose. BDO and the Independent Consultant shall engage in good-faith negotiations in an effort to reach agreement on any recommendations objected to by BDO. In the event that the Independent Consultant and BDO are unable to agree on an alternative proposal within sixty days, BDO shall abide by the determinations of the Independent Consultant.

115. Certification by BDO's CEO. Within sixty days of issuance of the IC Report, but not sooner than thirty days after a copy of the IC Report is provided to the Commission staff, BDO's chief executive officer ("CEO") must certify to the Commission staff in writing that (i) BDO has adopted and has implemented or will implement all recommendations of the Independent Consultant, if any; and (ii) the Independent Consultant agrees with BDO's adoption and implementation of the recommendations. To the extent that BDO has not implemented all recommendations of the Independent Consultant within sixty days of issuance of the IC Report, BDO's CEO must certify to the Commission staff in writing, thirty days after their implementation, that (i) BDO has adopted and has implemented all recommendations of the Independent Consultant; and (ii) the Independent Consultant agrees that the recommendations have been adequately adopted and implemented by BDO. The certifications by BDO's CEO 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 BDO agrees to provide such evidence.

116. Undertakings Regarding Audit Training. Prior to September 30, 2016, BDO shall require each audit professional serving public company audits to complete successfully:

a. A Minimum of 24 Hours of Audit-Related Training. The audit-related training requirement shall cover the topics specified in paragraph 110(i)-(xiii). A minimum of four hours must be allocated to each of these two topics: (i) potential illegal acts and Section 10A of the Exchange Act, and (ii) identification and disclosure of related party transactions. The audit-related training requirement may be fulfilled by completing course(s) conducted in accordance with the applicable state boards of accountancy.

b. <u>A Minimum of 8 Hours of Fraud-Detection Training</u>. BDO shall ensure that audit professionals assigned to public company engagements undergo fraud detection training. The training shall include techniques in detecting and responding to possible fraud in the course of public company audits by audit clients or by employees, officers or directors of audit clients.

117. To ensure the independence of the Independent Consultant, BDO: (1) shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant, without the prior written approval of the Commission staff; and (2) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

118. BDO shall require the Independent Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with BDO, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement shall also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with BDO, 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.

119. BDO shall not be in, and shall not have an attorney-client relationship with the Independent Consultant and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the Independent Consultant from transmitting any information, reports, or documents to Commission staff.

120. BDO shall inform its audit professionals of the terms of the Order within ten business days after entry of the Order.

121. By December 31, 2016, BDO's CEO shall certify, in writing, compliance with the undertakings set forth in paragraphs 116 and 120. 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 BDO agrees to provide such evidence.

122. <u>Annual Certifications.</u> With respect to each of the calendar year periods 2017 and 2018, BDO's chief compliance officer ("CCO") shall certify that BDO has assessed whether BDO's Policies are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and PCAOB standards and rules by, among other things, testing the firm's implementation of BDO's Policies during the twelve (12) months preceding the certification ("Annual Certification"). The Annual Certification shall describe the nature and

scope of BDO's testing. The Annual Certification shall represent that the CCO has reviewed and evaluated the firm's assessment and testing process and that, based on belief and after reasonable inquiry, the CCO believes that BDO's Policies are adequate and sufficient to provide reasonable assurance of compliance with all relevant Commission regulations and PCAOB standards and rules. If the CCO cannot represent that BDO's Policies are adequate and sufficient, then the CCO shall describe in reasonable detail the reasons for the inability to so certify. The CCO shall provide the Annual Certifications to the Commission's staff within sixty days of the end of the annual period. BDO shall preserve and retain all documentation regarding the CCO's Annual Certification for seven (7) years and will make it available to the staffs of the Commission or the PCAOB upon request.

123. All reports and certifications mentioned in these undertakings shall be submitted to Wendy Tepperman, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281, with a copy to the Office of Chief Counsel of the Enforcement Division.

124. 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.

125. In determining whether to accept BDO's Offer, the Commission has considered these undertakings. BDO agrees that if the Division of Enforcement believes that BDO has not satisfied these undertakings, it may petition the Commission to reopen the matter to determine whether additional sanctions are appropriate.

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 that:

A. Pursuant to Section 21C of the Exchange Act, BDO shall cease and desist from committing or causing any violations and any future violations of Sections 10A and 13(a) of the Exchange Act and Rule 13a-1 thereunder.

B. BDO is censured.

C. BDO shall comply with the undertakings enumerated in Section III.J. above.

D. BDO shall within 14 days of the entry of this Order, pay disgorgement of \$536,000 and prejudgment interest of \$76,000, to the 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 SEC Rule of Practice 600.

E. BDO shall within 14 days of the entry of this Order, pay a civil money penalty of $1,500,000 to the 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.

F. Payments ordered in paragraphs D and E above 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 BDO 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, New York Regional Office, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281-1022.

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. 75868 / September 9, 2015

Admin. Proc. File No. 3-16209

In the Matter of the Application of

WD CLEARING, LLC, a Nevada limited liability company; WDMC TRUST d/t/d SEPTEMBER 18, 2013; WDJJ TRUST d/t/d SEPTEMBER 18, 2013; WDCHUM TRUST d/t/d SEPTEMBER 18, 2013; and WDPOP TRUST d/t/d SEPTEMBER 18, 2013

For Review of Action Taken by

Financial Industry Regulatory Authority

ORDER DISMISSING APPLICATION FOR REVIEW

WD Clearing, LLC, et al. ("WD Clearing")[1] requests that we review the September 17, 2014 decision of FINRA member Wilson-Davis & Co., Inc. ("Wilson-Davis" or the "Firm")[2] to withdraw its continuing membership application ("CMA") requesting approval of the Firm's change in ownership, pursuant to which Wilson-Davis would be owned by WD Clearing. WD Clearing asserts that Wilson-Davis's email withdrawing its CMA was a "*de facto* denial of the CMA" by FINRA because Wilson-Davis's email apparently was precipitated by FINRA's warning to Wilson-Davis of a potential impediment to FINRA's approval of the CMA.

WD Clearing contends that FINRA's actions denied it membership, prohibited or limited its access to FINRA's services, and barred it from associating with a FINRA-member firm within the meaning of Section 19(d) of the Securities Exchange Act of 1934.[3] It also contends that it has standing to challenge FINRA's actions as a "person aggrieved" within the meaning of Exchange

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1 Petitioners include WD Clearing, Inc., WDMC Trust d/t/d September 18, 2013, WDJJ Trust d/t/d September 18, 2013, WDCHUM Trust d/t/d September 18, 2013, and WDPOP Trust d/t/d September 13, 2013.

2 Wilson-Davis became a FINRA member firm in 1968. The Firm is headquartered in Salt Lake City, Utah, and conducts a general securities business.

3 *See* 15 U.S.C. § 78s(d)(1).

Act Section 19(d)(2) because it had entered into a securities purchase agreement with Wilson-Davis to purchase the firm, contingent on FINRA's approval of the CMA.[4] We conclude that we lack jurisdiction to entertain this challenge because Wilson-Davis withdrew its CMA before FINRA issued a final decision on the matter. As a result, there is no FINRA action for us to review. We thus dismiss WD Clearing's application and find it unnecessary to address whether WD Clearing has standing under Section 19(d)(2).

I. Background

A. FINRA rules require a member firm to file an application requesting approval of a change in its ownership or control prior to any such change.

Before a member firm may effect a change in ownership or control, it must file a CMA with FINRA seeking approval of the change.[5] An applicant for a change in ownership or control bears the burden of establishing the merits of its application—specifically, that it and its "Associated Persons" will continue to meet each of the fourteen standards for membership set forth in NASD Rule 1014(a) upon approval of the application.[6] During its review, FINRA may place interim restrictions on the applicant based upon those standards, including an interim restriction that prohibits the deal from closing.[7]

B. Wilson-Davis granted nonmember WD Clearing the right to purchase its outstanding stock in exchange for financing and agreed to seek approval from FINRA of the change in ownership.

In April 2013, to satisfy short-term cash requirements, Wilson-Davis borrowed $4 million from John Hurry, a director of Alpine Securities Corporation and Scottsdale Capital Advisors,[8]

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4 *See id.* § 78s(d)(2).

5 NASD Rule 1017(a).

6 *See id.* (h)(1)(a); *see also* NASD Rule 1014(a).

7 NASD Rule 1017(c)(1); *see also* NASD Membership Application Rules, 2002 WL 1966444, at *4 n.2 (Aug. 15, 2002) ("As with other Rule 1017 applications, Rule 1017(c)(1) allows NASD to place interim restrictions on any asset transfer if NASD believes that the application does not meet Rule 1014 standards. These interim restrictions are meant for the protection of investors and ordinarily would not prevent a transaction from moving forward. However, there may be some instances where the protection of investors will require that interim restrictions will prohibit or delay a transaction from closing."); FINRA, Filing a Change in Membership Application at 3, *available at* http://www.finra.org/sites/default/files/Education/p018711.pdf ("[T]he firm can make the ownership change any time after the 30 days has passed—so long as the firm isn't under an interim restriction that prohibits the deal closing prior to FINRA approval.").

8 The Hurry Family Revocable Trust owns Alpine Securities and Scottsdale Capital, two FINRA member firms.

pursuant to a financing agreement which granted Hurry, or his assignees, the right to purchase the Firm's outstanding stock. On December 2, 2013, Wilson-Davis and Hurry's assignees (known collectively as WD Clearing)[9] entered into an agreement to effectuate the purchase. The securities purchase agreement required Wilson-Davis to seek approval from FINRA of the anticipated change in ownership by submitting a CMA in accordance with NASD Rule 1017.

C. Wilson-Davis filed an application with FINRA requesting approval of its change in ownership, pursuant to which Wilson-Davis would be owned by WD Clearing.

On February 24, 2014, FINRA accepted Wilson-Davis's CMA requesting approval of the Firm's change in ownership.[10] The CMA indicated that Hurry, as manager of WD Clearing, would become associated with Wilson-Davis as an owner. The CMA further stated that Hurry, through the Hurry Family Revocable Trust, was the source of funding for the purchase of Wilson-Davis, and that Hurry could and would provide any additional funding necessary to meet the Firm's net capital requirements.

D. FINRA discovered information indicating Hurry might not be capable of complying with federal securities laws, the rules and regulations thereunder, or NASD Rules.

In a letter dated February 25, 2014, FINRA notified Wilson-Davis that, pursuant to NASD Rule 1017(c), interim restrictions would be placed on the Firm to ensure that investors were protected during the pendency of the CMA review process. The letter provided that "effective immediately," the Firm was prohibited from:

- Effecting any portion of the aforementioned ownership change transaction, including unapproved individuals or entities acting in any capacity that would suggest that they are approved direct and/or indirect owners of the Firm, and
- Permitting any trustee, grantor, or beneficiary of the trusts—including, but not limited to, Mr. Hurry—to act in any principal, supervisory or control capacity.

FINRA attributed the restrictions to its ongoing investigation into whether the Firm would continue to meet the standards in NASD Rule 1014 if the change in ownership was approved. In particular, the letter alerted the Firm that FINRA had "identified an article relating to an investigation involving Scottsdale Capital and Alpine Securities, which are controlled by Mr. Hurry." Accordingly, FINRA explained that it was deepening its review into whether the proposed new owner-trusts affiliated with John Hurry "are capable of complying with the federal

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9 WD Clearing, as defined above (*see supra* note 1), is composed of a series of trusts affiliated with Hurry, and WD Clearing, LLC, a Nevada limited liability company formed for the purpose of holding the Hurry Family Revocable Trust's investment in Wilson-Davis. Hurry, through the Hurry Family Revocable Trust, was the source of capital for WD Clearing, LLC, et al.

10 The firm submitted an initial CMA on January 22, 2014, which FINRA deemed substantially incomplete. After the Firm provided additional information on February 24, 2014, FINRA accepted the CMA as substantially complete.

securities laws, the rules and regulations thereunder, and FINRA Rules, including observing high standards of commercial honor and just and equitable principles of trade"[11] and whether the Firm, under the new ownership proposed, "may circumvent, evade or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, and FINRA Rules."[12]

On September 12, 2014, FINRA notified Hurry and his firm, Scottsdale Capital, through a Wells Notice, that FINRA had preliminarily determined that it would bring disciplinary action against Hurry and Scottsdale Capital. Specifically, FINRA alleged that Hurry and Scottsdale Capital sold securities in potential violation of FINRA Rule 2010 and Section 5 of the Securities Act of 1933, and that Hurry, as an owner of Scottsdale Capital, aided and abetted or caused the alleged violation.

E. Wilson-Davis withdrew its application for change in ownership after learning of potential impediments to approval.

On September 15, 2014, Wilson-Davis, in a conversation with FINRA staff overseeing the Firm's CMA, learned about the Wells Notice that had been sent to Hurry. On September 17, 2014, Wilson-Davis, through counsel, sent an email to FINRA staff withdrawing its CMA. The email stated that the Firm understood that "the issues associated with the Wells [N]otice would ultimately cause FINRA to deny the CMA," and that FINRA staff had "requested that Wilson-Davis withdraw the CMA application."[13] On September 17, 2014, FINRA acknowledged the withdrawal in an email stating: "Thank you for your email. This is to confirm receipt of your request; the CMA is hereby withdrawn."

F. WD Clearing filed applications for review with the Commission.

On October 14, 2014, WD Clearing filed an application with us requesting review. Wilson-Davis did not join the application. In a letter dated October 22, 2014, we stated that the matter was "not ripe for Commission review" and rejected the application because FINRA had not entered a final decision.

On November 10, 2014, WD Clearing submitted a second application for review, which Wilson-Davis likewise did not join. On November 20, 2014, we acknowledged the application for review but stated that acceptance of the application did not "constitute a Commission

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11 *See* NASD Rule 1014(a)(3) ("The Applicant and its Associated Persons are capable of complying with the federal securities laws, the rules and regulations thereunder, and NASD Rules, including observing high standards of commercial honor and just and equitable principles of trade.").

12 *See id.* (a)(13) ("FINRA does not possess any information indicating that the Applicant may circumvent, evade, or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, or NASD Rules.").

13 The details of any discussions between FINRA staff members and Wilson-Davis's counsel are not in the record.

determination as to the proper statutory basis" for the application or "a prejudgment . . . pertaining to the Commission's jurisdiction to consider the matter."[14]

II. Analysis

For the reasons explained below, we conclude that FINRA's actions associated with the withdrawal of Wilson-Davis's CMA do not constitute a reviewable limitation or prohibition of access to services, and we accordingly dismiss WD Clearing's application for review.[15] We thus do not address whether WD Clearing is a person aggrieved with standing to challenge those actions.

A. The Commission lacks jurisdiction to review FINRA's preliminary consideration of Wilson-Davis's CMA.

Action by a self-regulatory organization ("SRO"), such as FINRA, "is not reviewable merely because it adversely affects the applicant."[16] Rather, there must be a statutory basis for us to exercise jurisdiction. Section 19(d) of the Exchange Act authorizes us to review an SRO action only if that action: (1) imposes a final disciplinary sanction; (2) denies membership or participation to any applicant; (3) prohibits or limits any person in respect to access to services offered by such organization or member thereof; or (4) bars any person from becoming associated with a member.[17]

WD Clearing argues that "three of these four statutory bases" provide us with jurisdiction to review FINRA's action in considering Wilson-Davis's application.[18] Because Wilson-Davis voluntarily withdrew its application before FINRA had an opportunity to complete its

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14 Notwithstanding this cautionary language, WD Clearing incorrectly claims in its brief before us that we "agreed to consider the Petition."

15 *See Matthew Brian Proman*, Exchange Act Release No. 57740, 93 SEC 300, 2008 WL 1902072, at *1 (Apr. 30, 2008) ("If we find that we do not have jurisdiction, we must dismiss the proceeding.").

16 *Id.* at *2 (quoting *Sky Capital LLC*, Exchange Act Release No. 55828, 90 SEC 1942, 2007 WL 1559228, at *3 (May 30, 2007)).

17 15 U.S.C. § 78s(d)(1), (2). "The grounds for Commission jurisdiction enumerated in Rule 420(a) are the same as those described in Section 19(d)(1) of the Exchange Act." *Lawrence Gage*, Exchange Act Release No. 54600, 89 SEC 289, 2006 WL 2987058, at *3 (Oct. 13, 2006).

18 WD Clearing contends that FINRA denied it access to membership, limited its access to services, and barred it from associating with a FINRA-member firm. We address these contentions below. WD Clearing does not assert, nor do we find, that FINRA imposed a "final disciplinary sanction" as a basis for jurisdiction under Exchange Act Section 19(d), which occurs when an SRO imposes "a punishment or sanction" following a "determination of wrongdoing," *Morgan Stanley & Co., Inc.*, Exchange Act Release No. 39459, 53 SEC 379, 1997 WL 802072, at *2 (Dec. 17, 1997).

investigation and reach a final decision on the merits, we find that none of FINRA's actions in considering Wilson-Davis's CMA—whether viewed individually or collectively—fall within the categories subject to our review.

1. FINRA did not deny membership or participation to WD Clearing.

FINRA did not take any action regarding Wilson-Davis's CMA that qualifies as a denial of membership or participation under Exchange Act Section 19(d). This jurisdictional basis for review is directed at SRO decisions actually denying applications for membership or imposing restrictions on business activities as a condition of membership.[19] In this case, FINRA did not render any decision on the CMA or render a decision that denied, altered, or otherwise affected membership. Wilson-Davis continues to be a FINRA member, notwithstanding the withdrawal of its CMA; and WD Clearing—which has never applied for FINRA membership—remains a nonmember.[20] Even if Wilson-Davis withdrew its application in response to a request from a FINRA staff member, an informal staff request does not constitute a final decision or an official FINRA action. FINRA staff cannot force an applicant to withdraw a CMA and there is no evidence that it did so in this case. Wilson-Davis was free to decline a request to withdraw and proceed with its application process.

Nor can FINRA's actions in reviewing the CMA pursuant to its authority under NASD Rule 1017—including its imposition of interim restrictions on Wilson-Davis to address specific concerns about whether the Firm, under the proposed change in ownership, would satisfy the membership standards set forth in NASD Rule 1014(a)—be construed as a reviewable condition placed upon Wilson-Davis's membership. As we have previously held, "the requirement that SRO members comply with SRO rules does not constitute a condition on membership providing a basis for jurisdiction."[21]

NASD Rule 1014 sets forth minimum requirements that a firm, and its associated persons, must meet to qualify for FINRA membership. These standards are largely intended to ensure that

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19 *See id.* at *3.

20 In *Beatrice J. Feins*, we addressed our jurisdiction over an appeal from a final decision of the American Stock Exchange ("Amex") prohibiting a member from transferring his Amex membership to his grandmother. Exchange Act Release No. 33374, 51 SEC 918, 1993 WL 538913, at *2 (Dec. 23, 1993). We dismissed the member's appeal for lack of jurisdiction because the member, like Wilson-Davis, had "retained his membership and all the privileges thereto." *Id.* Because "Amex treats a transferee of an existing membership as an applicant for new membership," we found that the grandmother had applied for and was denied SRO membership within the meaning of Exchange Act Section 19(d), and we accepted jurisdiction on that ground. *Id.* In contrast, WD Clearing has neither applied for nor been denied FINRA membership, and WD Clearing does not claim that FINRA treats an application for a change in ownership as a new application for membership.

21 *Gage*, 2006 WL 2987058, at *3 (rejecting argument that PHLX's rule change imposed a condition on membership).

any firm that presents itself to the investing public as a FINRA member can and will comply with the federal securities laws, the rules and regulations thereunder, and NASD Rules, "including observing the high standards of commercial honor and just and equitable principles of trade."[22] NASD Rule 1017 provides that "[i]n rendering a decision on an application for approval of a change in ownership or control, . . . [FINRA] shall determine if the Applicant would continue to meet the standards in Rule 1014(a) upon approval of the application."[23] To that end, the Rule authorizes FINRA to "place new interim restrictions on the member based on the standards in Rule 1014, pending final Department action."[24] The February 25, 2014 letter, which imposed the interim restrictions, identified specific concerns pursuant to NASD Rule 1014 that necessitated the restrictions.[25] This was a proper exercise of FINRA's authority under its rules. WD Clearing's desire for relief from the operation of the rules is not a valid jurisdictional ground for our review.[26]

2. FINRA did not prohibit or limit WD Clearing's access to services.

WD Clearing contends that FINRA "prohibited and limited" WD Clearing "from having access to services offered by FINRA" by imposing the interim restrictions on Wilson-Davis during the pendency of the CMA review process. Specifically, WD Clearing argues that "[b]ut for FINRA's unlawful 'interim restrictions,' ownership of Wilson-Davis would have been transferred to [WD Clearing] on or around April 9, 2014," and WD Clearing, "as the owners of Wilson-Davis,

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22 NASD Rule 1014(a)(3); *see also id.* (a)(10) ("The Applicant has a supervisory system, including written supervisory procedures, internal operating procedures (including operational and internal controls), and compliance procedures designed to prevent and detect, to the extent practicable, violations of the federal securities laws, the rules and regulations thereunder, and NASD Rules."); *id.* (a)(13) ("FINRA does not possess any information indicating that the Applicant may circumvent, evade, or otherwise avoid compliance with the federal securities laws, the rules and regulations thereunder, or NASD Rules."); *id.* (a)(14) ("The application and all supporting documents are consistent with the federal securities laws, the rules and regulations thereunder, and NASD Rules.").

23 NASD Rule 1017(h)(1)(A).

24 *Id.*(c)(1); *see supra* note 7.

25 In general, the standards set forth in Rule 1014(a) are intended to ensure that members under new ownership will continue to be capable of satisfying all relevant regulatory requirements for the protection of the investing public, the securities markets, the firm, and other member firms.

26 *Gage*, 2006 WL 2987058, at *4 ("The operation of [FINRA's] rule[s] did not impose a condition on the firm's membership establishing a basis for jurisdiction because '[t]he membership of every [FINRA] member is conditioned on the member's continued compliance with [FINRA] rules.'" (quoting *Joseph Dillon & Co.*, Exchange Act Release No. 43523, 73 SEC 1662, 2000 WL 1664016, at *3 (Nov. 6, 2000))); *see also Morgan Stanley*, 1997 WL 802072, at *3 ("We conclude that the NASD's action does not constitute a denial of membership. . . . [Petitioner] is seeking relief from the operation of the rule, not from any condition imposed on its membership by the NASD.").

would then have been entitled to access services offered by FINRA, at the very least, until FINRA denied the CMA."[27]

We find that neither the interim restrictions nor any other FINRA action in considering Wilson-Davis's CMA "prohibited" or "limited" WD Clearing or Wilson-Davis within the meaning of Section 19(d).[28] The "interim restrictions" FINRA imposed on Wilson-Davis did not constitute a final disposition but were rather, as the name conveys, temporary and provisional. Those restrictions applied exclusively while the CMA was pending. Indeed, FINRA did not actually deny or reach any final disposition on the CMA because Wilson-Davis voluntarily withdrew its application from FINRA's consideration before it had the opportunity to do so, terminating both the interim restrictions and FINRA's review.[29] Given the information FINRA had discovered about Hurry and Scottsdale Capital, Wilson-Davis may have believed that its pending application would not be granted. But believing that an application will not be granted is not the same as receiving a denial. Nothing in the record suggests that FINRA required Wilson-Davis to withdraw its application. When Wilson-Davis voluntarily decided to withdraw its CMA from consideration—whatever its reasons—FINRA had not yet taken any action to limit or prohibit access to its services.[30]

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27 In other words, WD Clearing argues that Wilson-Davis's CMA automatically entitled it to "at the very least" temporary FINRA membership irrespective of whether it, or its associated persons, could satisfy the membership criteria articulated in Rule 1014(a). Nothing in FINRA's rules entitled WD Clearing to enjoy an unregulated trial period.

28 To determine whether FINRA's actions prohibited or limited access to services under the meaning of Section 19(d), we consider whether FINRA has "denied or limited the applicant's ability to utilize one of the fundamentally important services offered by the SRO," and whether the "services at issue were not merely important to the applicant but were central to the function of the SRO." *Sky Capital*, 2007 WL 1559228, at *4 (quoting *Morgan Stanley*, 1997 WL 802072, at *3); *accord Securities Indus. and Fin. Markets Assn.*, Exchange Act Release No. 72182, 2014 WL 1998525, at *9 (May 16, 2014); *see, e.g.*, *Proman*, 2008 WL 1902072, at *2 (finding that relevant standard was not satisfied when Proman failed to identify any services "'central to the function of the SRO,' such as access to an exchange trading floor or registration as a market maker" to which he had been denied access); *Sky Capital*, 2007 WL 1559228, at *4 (finding that *Morgan Stanley* test was not met when applicant failed to show that NASD "Office of the Ombudsman provide[d] a 'fundamentally important service' that [wa]s central to the function of NASD"); *Morgan Stanley*, 1997 WL 802072, at *3 (finding that application for review did not allege a denial of access where applicant merely sought "relief from the automatic operation of [an SRO] prohibition, which its employee's actions triggered").

29 15 U.S.C. § 78s(d)(1) (applicable only where a "*self-regulatory organization* . . . prohibits or limits any person in respect to access to services offered by such organization or member thereof" (emphasis added)).

30 *Cf. William J. Higgins*, Exchange Act Release No. 24429, 48 SEC 713, 1987 WL 757509, at *1 (May 6, 1987) (finding reviewable SRO action under Section 19(d) where Exchange members "requested the NYSE's permission to install telephones" and "[t]hese requests were

3. FINRA did not bar WD Clearing from associating with all FINRA members.

WD Clearing contends that the interim restrictions in place during the CMA review process "effectively barred" WD Clearing's representatives from association with a FINRA member. But FINRA did not bar WD Clearing or its representatives from associating with Wilson-Davis or any other FINRA-member firm, let alone all FINRA-member firms, as would be required for us to assume jurisdiction on this ground.[31] FINRA did not render a decision on the CMA, and the interim restrictions—which were only *interim* and not final—are no longer in effect. WD Clearing remains free to apply for FINRA membership or encourage Wilson-Davis to file a new CMA requesting the change in ownership. But even if FINRA had barred WD Clearing from associating with Wilson-Davis, we would have no jurisdiction on this ground because WD Clearing and its representatives would still have remained free to associate with other FINRA-member firms.[32] Indeed, as WD Clearing concedes, Hurry is currently associated with at least two FINRA members, Alpine Securities and Scottsdale Capital.

B. We also decline review because Wilson-Davis failed to exhaust FINRA's administrative remedies.

We decline review for the additional reason that Wilson-Davis's decision to withdraw its application foreclosed the possibility of its seeking review by FINRA —a predicate to meaningful Commission review. If we were to assume that FINRA would have rejected Wilson-Davis's application based on the incomplete record before us, we would divest FINRA of its "self-regulatory function" because FINRA did not have the opportunity to decide the issue for itself or review its own decision through its internal appellate process prior to Commission review.[33] Requiring Wilson-Davis to file a CMA, FINRA to address it, and Wilson-Davis to exhaust all internal FINRA appeals[34] helps ensure that there is an actual dispute[35] and a

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denied by the NYSE"), *aff'd*, 380 F.3d 611 (2d Cir. 2004); *Scattered Corp.*, Exchange Act Release No. 37249, 52 SEC 812, 1996 WL 284622, at *2 (May 29, 1996) (finding that the Chicago Stock Exchange, Inc.'s "determination not to process Scattered's application for registration as a market maker limits the firm's access to the CHX's services"). There is no allegation here, nor does the record reflect, that FINRA refused to process an application by Wilson-Davis. Instead, Wilson-Davis withdrew its application from review.

31 *Joseph Dillon*, 2000 WL 1664016, at *3 (rejecting jurisdictional basis because, unlike "NASD actions having the effect of barring an individual from association with all NASD members," petitioner's representatives "remain free to associate with other firms").

32 *Id.*

33 *See MFS Sec. Corp. v. SEC*, 380 F.3d 611, 621 (2d Cir. 2004), *affirming MFS Sec. Corp.*, Exchange Act Release No. 47626, 56 SEC 380, 2003 WL 1751581, at *5-6 (Apr. 3, 2003) (refusing to consider applicant's denial of access to services claim because applicant failed to exhaust NYSE procedures).

34 *Cf. Gerald J. Lodovico*, Exchange Act Release No. 73748, 2014 WL 6808366, at *2 (Dec. 4, 2014) ("[W]e will not consider an application for review if the applicant failed to exhaust [the

fully-developed record for us to review.[36] Because WD Clearing filed its application for review before FINRA entered a final decision on Wilson-Davis's CMA, we lack the end result of a complete review process and the associated record.[37]

Accordingly, for the reasons set forth above, IT IS ORDERED that the application for review filed by WD Clearing is DISMISSED.[38]

By the Commission.

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

SRO's] procedures." (citing *Caryl Trewyn Lenahan*, Exchange Act Release No. 73146, 2014 WL 4656403, at *2 n.5 (Sept. 19, 2014))); *cf. also MFS Sec. Corp.*, 2003 WL 1751581, at *5 & n.29 (emphasizing that it is "clearly proper to require that a statutory right to review be exercised in an orderly fashion, and to specify procedural steps which must be observed as a condition to securing review" (quoting *Royal Sec. Corp.*, Exchange Act Release No. 5171, 36 SEC 275, 1955 WL 43159, at *2 (May 20, 1955))).

35 We note that Wilson-Davis took no further action on its application with FINRA following its withdrawal, did not file or join in WD Clearing's application for review, and may lack the economic incentive to consummate the transaction with WD Clearing at this time. *Cf. Texas v. United States*, 523 U.S. 296, 300 (1998) ("A claim is not ripe for adjudication if it rests upon contingent future events that may not occur as anticipated, or indeed may not occur at all." (quotation and citation omitted)). Indeed, the record reveals an underlying dispute between WD Clearing and Wilson-Davis over Wilson-Davis's obligation to consummate the securities purchase agreement. For example, WD Clearing has apparently brought a civil action against Wilson-Davis in Utah for breach of contract. Whatever the nature of this private conflict, we do not have the authority to resolve it.

36 *See MFS Sec. Corp.*, 380 F.3d at 621 (requiring applicant to exhaust administrative remedies "promotes the development of a record in a forum particularly suited to create it, upon which the Commission and, subsequently, the courts can more effectively conduct their review").

37 We note that national securities associations are required to "provide a fair procedure" for denials and limitations. Exchange Act Section 15A(b)(8), 15 U.S.C. § 78o-3(b)(8). They are required to keep a record and to provide notice, an opportunity to be heard, and a "statement setting forth the specific grounds" on which the limitation or prohibition is based. Exchange Act Section 15A(h)(2), 15 U.S.C. § 78o-3(h)(2). This process "also provides SROs with the opportunity to correct their own errors prior to review by the Commission." *MFS Sec. Corp.*, 380 F.3d at 621.

38 We have considered all the arguments advanced by the parties. We need not reach FINRA's arguments for dismissal not addressed above or the parties' preliminary discussion of the merits. We reject or sustain the parties' remaining arguments to the extent that they are inconsistent or in accord with the views expressed herein.

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76057 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16876

In the Matter of **EFIM AKSANOV,** **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 Efim Aksanov ("Aksanov" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>RESPONDENT</u>

1. From in or about 2012 through at least March 2013, Aksanov was a principal of Stock News Info LLC, an entity that purportedly introduced issuers to individuals and entities that provide internet and other electronic promotions. During that time, Aksanov participated in an offering of Face Up Entertainment Group, Inc. ("Face Up") stock, which is a penny stock. Aksanov is 41 years old and resides in Sunny Isles, Florida.

B. RESPONDENT'S CRIMINAL CONVICTION

2. October 21, 2014, Aksanov pled guilty to one count of conspiracy to commit securities fraud in violation of Title 18 United States Code, Section 371 before the United States District Court for the Southern District of New York, in *United States v. Efim Aksanov,* 13 Cr. 410 (NRB). On March 30, 2015, a judgment of conviction was entered against Aksanov. He was sentenced to 21 months imprisonment, three years of supervised release, and was ordered to forfeit $21,750.

3. The count of the indictment to which Aksanov pled guilty alleged, among other things, that from at least in or about 2012 through on or about March 27, 2013, Aksanov and others conspired to commit securities fraud. In connection with his guilty plea, Aksanov admitted, among other things, that he was involved in a scheme to manipulate the price of Face Up stock so the individuals involved in the scheme would profit.

III.

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

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

B. Whether, pursuant to Section 15(b)(6) of the Exchange Act, it is appropriate and in the public interest to bar Aksanov from participating in any offering of penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock; or inducing or attempting to induce the purchase or sale of any penny stock.

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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75894 / September 10, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31818 / September 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15874

In the Matter of MICHAEL H. JOHNSON	ORDER DENYING MOTION TO MODIFY SETTLED BAR ORDER

Michael H. Johnson, the former Senior Vice President of Penson Worldwide, Inc.'s ("PWI") Securities Lending Department, requests that we modify a May 2014 settled bar order to allow him to apply for reentry into the securities industry after one year instead of five years. He claims that "an error in the [Commission] staff's factual analysis of the case and, presumably, in the Commission's analysis of the appropriateness of the terms of [his] settlement" warrants such relief. The Division of Enforcement ("Division") opposes Johnson's motion. For the reasons set forth below, we find that Johnson has not demonstrated "compelling circumstances" that would justify modifying the bar order. Accordingly, the request is denied.

I. Background

A. In May 2014, Johnson consented to a bar based on allegations that he aided and abetted Penson's Regulation SHO violations and failed reasonably to supervise his subordinates.

This proceeding arose out of securities lending practices at PWI's broker-dealer subsidiary, Penson Financial Services, Inc. ("Penson"),[1] that resulted in systematic violations of the close-out requirements of Regulation SHO under the Securities Exchange Act of 1934.[2] On May 19, 2014,

1 PWI and its subsidiaries filed for bankruptcy in 2013 and are no longer in business.

2 17 C.F.R. § 242.204 (requiring broker-dealers and clearing firms to take action to close out a failure to deliver position in an equity security within specified time frames).

42 of 147

we charged Johnson for his role in Penson's violations, and Johnson simultaneously agreed to settle the allegations against him.[3] Pursuant to his offer of settlement, we found, *inter alia*, that from October 2008 to November 2011, Johnson implemented procedures at Penson that he "knew or was reckless in not knowing" did not comply with Regulation SHO, and that he "willfully aided, abetted, and caused" Penson's violations of Regulation SHO.[4] We also found that Johnson failed reasonably to supervise his subordinates and that he "fostered and encouraged their misconduct by participating in it with them."[5] But we did not find that Penson or Johnson profited as a result of the Regulation SHO violations nor did we address Johnson's possible motives for his misconduct. Without admitting or denying our findings, except as to our jurisdiction over him and the subject matter of this proceeding, which were admitted, Johnson consented to be barred from the securities industry with a right to apply for reentry after five years and to pay a $125,000 civil money penalty. Johnson subsequently paid the penalty and left the industry.

B. Less than a year later, Johnson sought modification of the bar based on a factual error in the calculation of Penson's profit from the Regulation SHO violations.

In a letter dated April 3, 2015, Johnson sought modification of the bar based on a factual error in the calculation of Penson's profit from the Regulation SHO violations.[6] Specifically, Johnson pointed to a calculation error by the Division's expert in a separate, litigated proceeding against Penson's former president and chief compliance officer in connection with the Regulation SHO violations.[7] In that proceeding, the Division offered an expert's report and testimony to establish that the profit to Penson from the Regulation SHO violations was approximately $6.2 million, but when the expert testified at the hearing he acknowledged that the $6.2 million figure resulted from a calculation error.[8] The Division subsequently conceded that the total profit to Penson as a result of the Regulation SHO violations was $59,000.[9]

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3 *Michael H. Johnson*, Exchange Act Release No. 72186, 2014 WL 2038878, at *1 (May 19, 2014).

4 *Id.*

5 *Id.* at *6.

6 Johnson did not seek modification of the penalty.

7 *See Thomas R. Delaney II*, Initial Decision No. 755, 2015 WL 1223971, at *1 (Mar. 18, 2015) (finding that Penson's president did not fail reasonably to supervise subordinates but that its chief compliance officer was a cause of Penson's Rule 204 violations and imposing a cease-and-desist order and a $20,000 civil money penalty), *declared final*, Exchange Act Release No. 74843, 2015 WL 1939410 (Apr. 29, 2015). A fourth Penson officer agreed to settle charges that he caused Penson's Regulation SHO violations and consented to a censure and cease-and-desist order. *See Lindsey A. Wetzig*, Exchange Act Release No. 72187, 2014 WL 2038879, at *1 (May 19, 2014).

8 *See Delaney*, 2015 WL 1223971, at *25.

9 *Id.*

According to Johnson, during the Wells process and settlement discussions in his case, Division staff took the position that Penson profited by some $6 million from the Regulation SHO violations, that those violations were the result of intentional conduct by Penson employees, and that Johnson's misconduct was "particularly egregious," given his motive to profit both Penson and himself, and merited significant sanctions. While Johnson maintained throughout the parties' settlement discussions that there was "virtually no profit to Penson and absolutely none to himself" as a result of the Regulation SHO violations, he asserts that he "did not have available to him either the trading data or the resources to analyze it in order to prove to the staff that profit could not have been a motive." Johnson states that, as a result, he could not counter the staff's position and "agreed to settle the matter on the terms demanded by the staff as he was not in the position to litigate the matter."

By order dated May 29, 2015, we construed Johnson's letter as a motion to modify the terms of the bar and directed the parties to file opposing and reply briefs.[10] In its opposition brief, the Division argued that Johnson failed to demonstrate "compelling circumstances" that would support modification of the bar. According to the Division, the erroneous profit calculation had "no bearing" on Johnson's case because that calculation did not exist at the time the Commission issued the settled bar order as to Johnson. The Division and Johnson negotiated the terms of a settlement between August and December 2013, and Johnson submitted an offer of settlement, including a bar with a right to reapply after five years, in December 2013. The Commission accepted Johnson's offer and entered the bar in May 2014. Meanwhile, Penson's successor firm did not begin producing the data necessary for the expert's profit calculation until February 2014—after Johnson had submitted his offer of settlement—and did not finish production until July 2014, after the bar was imposed. The expert did not complete his calculation and provide it to the staff until September 2014. Thus, the Division argued, the expert's profit calculation did not and could not have played any role in the parties' settlement negotiations or the Commission's consideration of an appropriate sanction.

The Division also argued that the settled order contained extensive findings that Johnson engaged in "conscious misbehavior—that is, he knew what he was doing was wrong and did it anyway, irrespective of whether it benefitted him directly." Consequently, proof of motive was not required to establish Johnson's aiding and abetting liability.[11] The Division further argued that Johnson's motive was not "solely limited to potential profits to Penson," but also included a desire to "avoid or reduce the costs of compliance" with Regulation SHO.

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[10] *Michael H. Johnson*, Exchange Act Release No. 75074, 2015 WL 3439151, at *1 (May 29, 2015).

[11] *Cf. Donald L. Koch*, Exchange Act Release No. 72179, 2014 WL 1998524, at *14 (May 16, 2014) (stating that "proof 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"), *petition denied in part and granted in part on other grounds*, 793 F.3d 147 (D.C. Cir. July 14, 2015).

In his reply, Johnson asserted that he "did not intend to start a battle with the Division over the facts found in the settled order, which are not in dispute," and that he "did not, in fact, desire an adversarial process at all." Rather, Johnson asserted, he "asks for nothing more than for the Commission to simply review its records to determine whether it was working with incorrect facts and, if so, determine whether a modification of [the] bar is appropriate."

II. Analysis

We have stated that, in reviewing motions to lift or modify administrative bar orders, we will determine whether, "under all the facts and circumstances presented, it is consistent with the public interest and investor protection to permit the petitioner to function in the industry without the safeguards provided by the bar."[12] Our longstanding approach to administrative bar orders has been that they will "remain in place in the usual case and be removed only in compelling circumstances."[13] "Preserving the status quo ensures that the Commission, in furtherance of the public interest and investor protection, retains its continuing control over such barred individuals' activities."[14]

Consideration of a range of factors guides the public interest and investor protection inquiry. Those factors include the nature of the misconduct at issue in the underlying matter; the time that has passed since issuance of the administrative bar; the compliance record of the petitioner since issuance of the administrative bar; the age and securities industry experience of the petitioner, and the extent to which the Commission has granted prior relief from the administrative bar; whether the petitioner has identified verifiable, unanticipated consequences of the bar; the position and persuasiveness of the Division's response to the request for relief; and whether there exists any other circumstance that would cause the requested relief to be inconsistent with the public interest or the protection of investors.[15] We have indicated that "[n]ot all of these factors will be relevant in determining the appropriateness of relief in a particular case, and no one factor is dispositive."[16]

A. Johnson presents no compelling circumstances that would justify modifying the bar.

Based on our consideration of all the facts and circumstances, we find no compelling circumstances that would justify modifying the bar and eliminating the protections it affords. The

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12 *Ciro Cozzolino*, Exchange Act Release No. 49001, 2003 WL 23094746, at *3 (Dec. 29, 2003).

13 *Id.*

14 *Id.*

15 *Id.*

16 *Kenneth W. Haver, CPA*, Exchange Act Release No. 54824, 2006 WL 3421789, at *3 (Nov. 28, 2006) (denying motion to reopen proceeding or vacate suspension).

settled order found serious violations of the federal securities laws. Only sixteen months have passed since entry of the bar. "That is hardly enough time to conclude that its continuation is no longer required in the public interest."[17] While it appears that Johnson has had no disciplinary record subsequent to the bar, we have said that "a clean disciplinary record is not determinative in our consideration of sanctions."[18] We also have said that "[w]e generally first grant incremental relief in our cases vacating bars."[19] Johnson has not sought prior incremental relief from the bar. As a result, we do not have a sufficient basis for concluding that modification of the bar would be consistent with the public interest. Finally, Johnson has not identified verifiable, unanticipated consequences of the bar or provided additional factors that would support the requested relief from the bar.[20]

Johnson argues that modification of the bar would make his sanction consistent with the sanctions imposed in other Regulation SHO cases.[21] But it is well-established that whether a particular sanction is excessive cannot be determined by comparison with the sanctions imposed on respondents in other cases.[22] Johnson also argues that modification would be appropriate

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17 *William H. Pike*, Investment Company Act Release No. 20417, 1994 WL 389872, at *2 (July 20, 1994) (denying motion to vacate order), *petition denied*, 52 F.3d 1122 (D.C. Cir. 1995) (per curiam).

18 *John Gardner Black*, Advisers Act Release No. 3015, 2010 WL 1474294, at *4 n.17 (Apr. 13, 2010) (denying in part and granting in part petition to set aside bar order), *petition denied*, 462 F. App'x 6 (D.C. Cir. 2013).

19 *Jesse M. Townsley, Jr.*, Exchange Act Release No. 52161, 2005 WL 1963783, at *2 (July 29, 2005) (denying in part petition to vacate bar order) (citing *Salim B. Lewis*, Exchange Act Release No. 51817, 2005 WL 1384087, at *4 (June 10, 2005)).

20 Johnson argues that the bar has placed "unique and severe difficulties" on him and his family. He states that he "was forced out of the industry nearly two years ago as a result of receiving the staff's Wells notice"; that he "sold his home, relocated from St. Louis to Dallas, and moved his family into a smaller, more affordable home"; that he suffers from Parkinson's disease; and that he has "lost his ability to properly care for the medical conditions both he and his wife endure." While we are sympathetic, Johnson's stated difficulties do not render the settled order inequitable. Rather, they are among a range of natural and foreseeable consequences that flow from a bar on employment in the securities industry as a result of the settled order. *See Pike*, 1994 WL 389872, at *2.

21 For support, Johnson cites to settled orders in *Peter J. Bottini*, Exchange Act Release No. 66814, 2012 WL 1264509 (Apr. 16, 2012); *Gary S. Bell*, Exchange Act Release No. 65941, 2011 WL 6184476 (Dec. 13, 2011); *Jeffrey A. Wolfson*, Exchange Act Release No. 67450, 2012 WL 2914902 (July 17, 2012); and *Hazan Capital Mgmt., LLC*, Exchange Act Release No. 60441, 2009 WL 2392842 (Aug. 5, 2009).

22 *See, e.g., Butz v. Glover Lifestock Comm'n Co.*, 411 U.S. 182, 187 (1973) (stating that "[t]he

(continued . . .)

because he "went above and beyond in cooperating with the staff during its investigation," he "acknowledged his mistakes" in connection with Penson's securities lending practices, and he "has learned valuable lessons as a result." We have previously considered and rejected a respondent's assertion that he cooperated with Commission staff when raised in mitigation of the violations or sanctions, and we see no basis for crediting that assertion here.[23] Moreover, even if we were to credit Johnson's assertion of remorse, that assertion does not alter our conclusion that modification would be inconsistent with the public interest and investor protection.

B. Johnson forfeited any claim that the Commission was working with incorrect facts when he consented to the bar.

We have a "strong interest" in the finality of our settlement orders.[24] "Public policy considerations favor the expeditious disposition of litigation, and a respondent cannot be permitted to [follow] one course of action and, upon an unfavorable [result], to try another course of action."[25] "If sanctioned parties easily are able to reopen consent decrees years later, the SEC would have little incentive to enter into such agreements. There would always remain open the possibility of litigation on the merits at some time in the distant future when memories have faded and records have been destroyed."[26]

Moreover, Rule 240 of our Rules of Practice provides that a settling respondent waives all hearings, the filing of proposed findings of fact and conclusions of law, proceedings before and an

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(. . . continued)
employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases"); *Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) (stating that, because "[t]he Commission is not obligated to make its sanctions uniform," court would not compare sanction imposed in case to those imposed in previous cases); *Lewis*, 2005 WL 1384087, at *4 n.42 (rejecting respondent's argument to vacate bar because lesser sanctions were imposed in similar cases and citing *Butz*).

23 *See, e.g.*, *Montford & Co., Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *19 & 20 (May 2, 2014) (rejecting respondent's cooperation with the Division in mitigation of sanctions and according considerable weight to law judge's finding that respondent's expressions of remorse were not credible because they stemmed from "the results to him personally and professionally" and "not from any genuine regret for his wrongdoing"), *petition denied*, 793 F.3d 76 (D.C. Cir. July 10, 2015).

24 *Haver*, 2006 WL 3421789, at *3 (substitutions in original) (quoting *Putnam Inv. Mgmt*, LLC, Exchange Act Release No. 50039, 2004 WL 1619113, at *2 (July 20, 2004)).

25 *Id.* (quoting *David T. Fleischman*, Exchange Act Release No. 8187, 1967 WL 87757, at *3 (Nov. 1, 1967)).

26 *Id.* (quoting *Miller v. SEC*, 998 F.2d 62, 65 (2d Cir. 1993)).

initial decision by a hearing officer, all post-hearing procedures, and judicial review by a court.[27] "The Rule requires each offer of settlement to recite or incorporate as part of the offer the [waiver] provisions of paragraphs (c)(4) and (5)."[28]

Johnson does not dispute that his offer of settlement waived all post-hearing procedures, as required by Rule 240, nor does he suggest that his consent to the bar was "not voluntary, knowing, or informed."[29] Johnson admits that he "elected to settle the matter and did not develop the matter further."[30] Consequently, Johnson "forfeited the opportunity to adduce" evidence of the calculation error,[31] and he "may not now complain that the record is inaccurate or incomplete."[32]

For the foregoing reasons, we find that the public interest and investor protection will not be served if Johnson is permitted to function in the industry without the safeguards provided by the bar order. We therefore decline to modify the settled bar order to allow Johnson to apply for reentry to the securities industry after one year instead of five years.

Accordingly, IT IS ORDERED that the motion of Michael H. Johnson to modify the bar imposed on him on May 19, 2014, be, and it hereby is, DENIED.

By the Commission.

Lynn M. Powalski
By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

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27 17 C.F.R. § 201.240(c)(4).

28 17 C.F.R. § 201.240 (Comment).

29 *Haver*, 2006 WL 3421789, at *3; *cf. Sargent v. Dep't of Health & Human Servs.*, 229 F.3d 1088, 1091 (Fed. Cir. 2000) (stating that "[i]t is well-established that in order to set aside a settlement, an applicant must show that the agreement is unlawful, was involuntary, or was the result of fraud or mutual mistake").

30 *Haver,* 2006 WL 3421789, at *3.

31 *Pike*, 1994 WL 389872, at *2.

32 *Haver*, 2006 WL 3421789, at *3 n.19; *see Edward I. Frankel*, Exchange Act Release No. 38379, 1997 WL 103785, at *2 n.5 (Mar. 10, 1997) (in rejecting petition to vacate bar order where petitioner contended that bar order "relied upon erroneous information," stating that respondent "elected to settle the matter and did not develop the record further" and thus could not "now complain that the record is inaccurate or incomplete").

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75877 / September 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15098

In the Matter of Credit Suisse Securities USA (LLC); DLJ Mortgage Capital, Inc.; Credit Suisse First Boston Mortgage Acceptance Corp.; Credit Suisse First Boston Mortgage Securities Corp.; and Asset Backed Securities Corporation Respondents.	ORDER ESTABLISHING FAIR FUND AND APPROVING PLAN OF DISTRIBUTION FIRST PAYMENT DEFAULT PRACTICE

I.

On November 16, 2012, the Securities and Exchange Commission ("Commission") issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order") against Credit Suisse Securities (USA) LLC ("Credit Suisse Securities"), DLJ Mortgage Capital, Inc., Credit Suisse First Boston Mortgage Acceptance Corp., Credit Suisse First Boston Mortgage Securities Corp., and Asset Backed Securities Corporation (collectively, "Credit Suisse" or "Respondents").[1] In the Order, the Commission found that the Respondents engaged in misconduct including misrepresentations or omissions in the offer or sale of residential mortgage backed securities ("RMBS") relating to

[1] Securities Act Rel. No. 9368 (Nov. 16, 2012), available at http:///sec.gov/litigation/admin/2012/33-9368.pdf.

two undisclosed business practices that violated Sections 17(a)(2) and (3) of the Securities Act of 1933 (the "Securities Act"). 15 U.S.C. § 77q(a)(2) and (3).[2] The Commission ordered the payment of separate monetary sanctions for each set of business practices. The Order indicated that, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the Commission may create two separate Fair Funds, one for each group of investors harmed by the relevant sets of business practices.

This order pertains to one of those practices, the first payment default practice ("FPD Practice"). For the FPD Practice conduct, the Commission ordered Respondents Credit Suisse Securities and Asset Backed Securities Corporation to pay, jointly and severally, a total of $18,256,561 in disgorgement, prejudgment interest and civil money penalties. All payments required by the Order have been made.

As set out in the Order, the Commission's findings with respect to the FPD Practice relate to two RMBS offerings underwritten by Credit Suisse Securities in late 2006. The two RMBS offerings were collateralized by approximately $1.9 billion of subprime mortgages (the "November 2006 securitizations").

Structure of the November 26 Securitizations. The RMBS collateral consisting of residential mortgage loans was acquired by Credit Suisse and deposited into two trusts, one for each offering ("RMBS Trusts"). The trusts then issued numerous classes or "tranches" of debt securities (commonly referred to as "certificates") backed by the RMBS collateral. Credit Suisse marketed and sold these certificates to investors using various offering documents. Each tranche of certificates held different rights to the mortgage payments and other defined funds ("cash

[2] The Commission also found that one respondent, Asset Backed Securities Corp., violated Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d), and Rules 12b-20, 15d-1, and 15d-14(d) thereunder, 17 C.F.R. §§ 240.12b-20, 15d-1, and 15d-14(d), as a result of materially misleading statements in certifications that had been attached to reports filed with the Commission.

flows") going to the RMBS Trust, *e.g.*, to the principal and interest payments made on the underlying mortgages. In broad terms, the "senior tranches" of certificates held the first rights to cash flows to the RMBS Trust, and as a result paid a lower interest rate to investors; the "junior tranches" paid higher interest rates to investors and their cash flow rights were subordinated to the senior tranches. This cash-flow priority structure is commonly referred to as a "waterfall."

The FPD Practice. In the offer and sale of the November 2006 securitizations, Credit Suisse informed potential investors about the protections afforded by a First Payment Default covenant ("FPD covenant") and a First Payment Default backstop ("FPD backstop"). The FPD covenant required the mortgage originator (*i.e.*, the entity from which Credit Suisse purchased the mortgage collateral prior to securitization) to, among other things, repurchase certain delinquent loans held by the RMBS Trust. If the mortgage originator failed to repurchase the delinquent loans, the FPD backstop required Credit Suisse to step into the originator's shoes and repurchase the mortgage from the RMBS Trust.

In marketing materials used in connection with the November 2006 securitizations, Credit Suisse promoted the FPD covenant and backstop provisions, stating that: 1) "all First Payment Default Risk" was removed from the securitizations, 2) it "enforced" the FPD covenant in order to "mitigate the effect" of fraudulent mortgages, and 3) its interests were aligned with investors' interests.

In the Order, the Commission found that the FPD covenant and the FPD backstop were material to investors. The Commission also found that, in breach of the FPD covenant, Credit Suisse failed to put back to the mortgage originator more than 100 delinquent mortgages, and failed to disclose to the RMBS Trusts' trustee or investors that these mortgages remained in the collateral pool for the November 2006 securitizations. The Commission found that Credit Suisse misled investors because, among other things, it should have known at the time of the offering that all loans that breached the FPD covenant would not be put back to the mortgage originator. Credit Suisse further misled investors by representing that its interests were aligned with investors' interests by virtue of the FPD covenant. Credit Suisse was also found to have obtained money from underwriting fees on the November 2006 securitizations, and, on the closing date of the securitizations, through the sales of the mortgages to the trust that would hold the RMBS. The Order also found that Credit Suisse's failure to put back to the mortgage originator the mortgages that were in breach of the FPD covenant caused losses of approximately $10 million to the November 2006 securitizations.[3] These losses reflect an aggregate loss to the RMBS Trusts, which cannot be traced directly to the specific losses, if any, borne by individual investors who held RMBS Trust certificates.[4]

The Order stated that funds paid into each Fair Fund would be distributed pursuant to a distribution plan to be administered in accordance with the Commission's Rules of Practice governing Fair Fund and Disgorgement Plans (the "Commission's Rules"). On August 14, 2014, pursuant to the Order and Rule 1103 of the Commission's Rules, 17 C.F.R. § 201.1103, the Commission proposed the plan[5] ("Proposed FPD Plan" or "Proposed Plan") and issued a notice

[3] The $10 million of losses were calculated by comparing the performance of the FPD mortgages that should have been removed from the collateral pool (the "FPD mortgages") to the performance of the balance of the mortgages held by the RMBS Trusts for the November 2006 securitizations. The FPD mortgages defaulted at a higher rate than the other mortgages held by the RMBS Trust, which contributed to approximately $10 million of losses over the life of the securitizations.

[4] While the losses incurred can be reasonably calculated in the aggregate by comparing the performance of the FPD mortgages to the balance of the mortgages in the collateral pool over a period of months or years, it is impossible to determine in hindsight precisely when a default of an FPD mortgage contributed to a direct loss to an investor, due to, among other things, the lack of regular pricing data for the RMBS certificates.

[5] Available at http://www.sec.gov.litigation/admin/34-72851-ppd-first-payment.pdf.

of the Proposed Plan and opportunity for comment (the "Notice").[6] According to the Proposed Plan, the "purpose of this distribution is to compensate investors in the RMBS Trusts harmed by Credit Suisse's misrepresentations and omissions in its offering materials regarding the FPD Practice." (¶ 4.)[7]

The proposed distribution methodology allocates the Net Fair Fund among the RMBS Trusts based on the proportion of the mortgage collateral in each RMBS Trust that was originated by the Originator. (¶ 54.) The funds for each trust are then allocated[8] to each trust's Eligible Claimants[9] on a *pro rata* basis determined by the Eligible Claimant's investment in the specific trust divided by the sum of all Eligible Claimant's investments in that trust. (¶ 55.)

The Commission received one comment on the Plan. This order addresses that comment.

After careful consideration, the Commission has determined to order a Fair Fund for the amounts paid by Respondents relating to the FPD Practice conduct (the "FPD Fair Fund"), and, for the reasons explained in this order, that the Proposed FPD Plan should be approved with technical modifications (hereinafter the "FPD Plan" or "Plan").[10]

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[6] Exchange Act Rel. No. 72851 (Aug. 14, 2014), available at http://www.sec.gov/litigation/admin/2014/34-72851.pdf. The Notice provided all interested persons thirty days to submit written comments on the Proposed Plan. The Notice advised such persons that they could obtain a copy of the Proposed Plan from the Commission's website or by submitting a written request to the Commission. The notice stated that all persons who desired to comment on the Proposed Plan could submit their comments no later than September 15, 2014.

[7] Paragraph references in this order denoted by the symbol "¶" refer to the numbered paragraphs in the Proposed FPD Plan.

[8] As explained in the Proposed FPD Plan, a preliminary allocation is made and any Eligible Claimant whose preliminary calculation is less than a *de minimis* amount is removed from the pool of Eligible Claimants. (¶ 56.) In the event that a particular Trust is undersubscribed such that a small number of Eligible Claimants would stand to receive disproportionately large recovery, the Fund Administrator, with agreement of the Commission staff, may use discretion in determining the final amount of the recovery. (¶ 58.)

[9] The Proposed Plan defines "Eligible Claimants" as persons (other than Excluded Parties) who purchased Eligible Securities on Eligible Purchase dates. The Proposed Plan also defines the capitalized terms in the definition of Eligible Claimant.

[10] The FPD Plan contains minor technical modifications to its Proposed FPD Plan. The technical modifications are: (i) the last sentence of ¶ 2 has been restated to more accurately reflect the Commission's finding of loss stated in the Order; (ii) in ¶ 58, word changes were made to eliminate an undefined term, "Eligible Claim;" (iii) the modifier

II.

A. **Public Comments on the FPD Plan**

Chris Katopis, Executive Director, Association of Mortgage Investors Letter

Chris Katopis, the Executive Director of the Association of Mortgage Investors ("AMI"), submitted a comment (the "AMI Comment")[11] that stated three concerns with the Proposed Plan: 1) that the Proposed Plan's *pro rata* allocation "improperly override[s] the recognized payment priority or 'waterfall' established by the governing documents of the RMBS trust . . . thereby favoring senior certificate-holders, who may not in fact suffer losses, over more junior classes of certificate-holders"; 2) that the Proposed Plan arbitrarily excludes nearly all subsequent purchasers, potentially undermining the secondary market for RMBS; and 3) that by paying investors directly rather than paying the RMBS trustees, "the Proposed Plan fails to take advantage of [the RMBS waterfall,] a method of distribution that is more efficient, fair, and consistent with investor expectations." The Commission has considered the AMI Comment and, for the reasons discussed below, is approving the Proposed FPD Plan with only technical modifications.[12]

"proposed" is deleted wherever it appeared in the FPD Plan because the Plan when adopted by the Commission is no longer "proposed;" and (iv) ¶ 85 was deleted because the FPD Plan when adopted by the Commission will not be published for further Notice and Comment. These technical modifications are minor. No substantive changes have been made to the methodology for calculating distributions or to the definition or eligibility criteria for Eligible Claimants. Commission staff does not deem these changes to be substantial or to require republication pursuant to Commission Rule 1103. Moreover, under Rule 1104, the Commission has complete discretion when considering whether to republish a plan for notice and comment, and the Commission is not required by Rule 1104 to republish a plan *even if* the Commission substantially modifies it prior to adoption.

[11] The three concerns raised in the AMI Comment have also been raised for the Commission's distribution plan for the previously noted other undisclosed Credit Suisse business practice, the Bulk Settlement practice ("Bulk Settlement Practice"). Although these practices involved different conduct, the portion of this order responding to the AMI Comment and the corresponding portion of the order approving the distribution plan for Bulk Settlement Practice are nearly identical because the analysis of the concerns is the same for both plans.

[12] *See* fn. 10, *supra*.

First, AMI's contention that a *pro rata* allocation overrides the RMBS Trusts' waterfall, thereby favoring senior certificate-holders "who may not in fact [have] suffer[ed] losses," indicates that the harm that is the focus of AMI's concern is limited to the *investment losses* that flowed from the *eventual performance* of certificates held by investors. Subsequent investment performance losses, however, are distinct from the harm to investors addressed in the FPD Plan. A proportionate harm accrued to *all* investors *at the time of the initial offering* when, as a result of the misrepresentations and omissions in the offering documents and marketing materials, investors were deprived of the benefit of their bargain with Credit Suisse. The FPD Plan's purpose and design for addressing investor harm flow directly from the violations at issue in the Order. As noted in the Plan, the "purpose of this distribution is to compensate investors harmed by Credit Suisse's misrepresentations and omissions *in its offering materials* regarding the FPD Practice." (¶ 4, emphasis added.) The Order found that Credit Suisse violated Sections 17(a)(2) and 17(a)(3) of the Securities Act because of material misstatements and omissions "in the offer or sale of securities." The misleading statements and omissions at issue in the Order were made in the securitizations' offering documents and in other materials Credit Suisse used to market the offering to potential investors. In those documents and materials, Credit Suisse misled investors by falsely asserting that 1) its interests were aligned with investors' interests with respect to FPD mortgages, and 2) all FPD mortgages would be removed from the collateral pool. Credit Suisse's misconduct was material to investors' decisions whether to invest in the November 2006 securitizations.

Had Credit Suisse disclosed *to potential initial investors* that its interests were not aligned with theirs, and that at its discretion, some as-yet-indeterminate number of FPD mortgages would remain in the collateral pool, it stands to reason that *all initial* investors would have considered the information in their investment decisions. Investors may have decided to invest in different securities or demanded to be compensated (*e.g.*, to receive a higher interest rate) before assuming the as-yet-unquantifiable FPD-related risks. For that reason, even if there had been no losses from the failure of the mortgages underlying the November 2006 securitizations, there still would have been harm to *all initial* investors caused by the Respondents' conduct. Unlike an investment performance harm, the harm in the offer and sale affected senior and junior certificate-holders alike. It is this harm that the Commission's Plan seeks to address through a *pro rata* distribution. The Plan is reasonably designed to compensate investors for such harm.

The Commission's objective is to distribute the FPD Fair Fund in a fair and reasonable manner, taking into account the relevant facts and circumstances.[13] In light of the factual and legal bases for Respondents' liability, the Commission exercises its discretion to distribute funds *pro rata* to all investors who purchased certificates in the RMBS Trusts' offerings or near the time of the offerings.

Closely related to AMI's first concern is AMI's third concern that the Proposed Plan fails to take advantage of the efficiencies, fairness and consistency with investor expectations associated with the waterfall priority of distributions. AMI's contention, however, that the Commission has "overlook[ed] the possibility that simply distributing proceeds through the trusts to flow through established waterfalls is a more fair and efficient means to compensate investors" is incorrect. The Commission staff carefully considered whether to distribute funds

[13] *See Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 82 (2d Cir. 2006) ("So long as the district court is satisfied that 'in the aggregate, the plan is equitable and reasonable,' the SEC may engage in the 'kind of line-drawing [that] inevitably leaves out some potential claimants'"), citing *SEC v. Wang*, 944 F.2d 80, 88 (2d Cir. 1991).

directly to the trustees for the RMBS Trusts as well as the significance of the RMBS Trusts' waterfalls. There are significant legal and practical barriers to a waterfall distribution, and the proceeds cannot be "simply" distributed through the RMBS Trusts. First, an RMBS Trust's waterfall generally determines the prioritization of defined cash flows from the collateral owned by the Trusts. However, AMI does not contend that the funds held by the Fair Fund - which consist of ill-gotten gains obtained by certain Respondents, civil money penalties, and prejudgment interest - constitute such a defined cash flow. If funds held by the Fair Fund were paid to an RMBS Trust, the Trusts' waterfall would not necessarily determine how such funds would be allocated. Second, assuming that, as noted by AMI, the governing documents of the RMBS trust "provide for the allocation of the losses on a mortgage pool," this fact does not necessarily determine how a Fair Fund payment would be allocated. As noted above, the funds placed in the FPD Fair Fund were ill-gotten gains obtained by certain Respondents, civil money penalties, and prejudgment interest, not payments for investor damages or restitution. Thus, the Commission concludes that, rather than being a "simple solution," distributing funds directly to the RMBS trusts would inject a great deal of uncertainty and complexity regarding how RMBS trustees would allocate funds to current or former investors in the RMBS Trusts due to the complex nature of the trusts and their waterfalls. The Commission's Plan avoids these uncertainties.

AMI's remaining concern is with the Proposed Plan's distribution of funds to investors who purchased securities at or near the time of the initial offerings, rather than investors who purchased certificates on the secondary market long after the initial offerings. This feature of the Proposed Plan is also derived from the factual and legal bases for Respondents' liability. Again, the Commission's Order found that the Respondents' liability stemmed from their conduct in the "*offer or sale of securities*." All initial investors in the RMBS Trusts experienced harm caused by Respondents' material misrepresentations and omissions and other fraudulent acts depriving investors of the benefit of their bargain, including whether to decline to participate in the offering or to negotiate a more favorable purchase price. For that reason, the Proposed Plan distributes the FPD Fair Fund to investors who purchased certificates at or near the time of the initial offering.

The Commission staff is not aware of extant records that would allow the Fund Administrator unambiguously to identify investors who bought directly from Respondents in the offering. In the absence of such records, the Plan treats investors who purchased certificates within 30 days of the offering as "initial investors." The 30-day cutoff reasonably ensures that distributions are made to those investors most likely to have been directly harmed by the conduct at issue in the Order. Investors whose purchases fall outside the 30-day cutoff ("secondary investors") were more likely to have had access to extensive additional information about the RMBS collateral that was unavailable to initial investors at the time of the offering. Beginning approximately 30 days after the offering, and continuing each month thereafter, the RMBS trustee issued reports that provided updated performance data for the RMBS collateral. So, for example, a secondary investor who purchased several months after the offering would have typically had access to multiple trustee reports when making an investment decision. The trustee reports would have shown how the mortgages in the collateral pool performed during that time (*e.g.*, how many mortgages were 30, 60, or 90 days delinquent, how many were in foreclosure, etc.). As a result, relative to an initial investor, a secondary investor was *less dependent* on Credit Suisse's representations in the offering because the secondary investor had access to a larger data set of actual performance history. Therefore, by limiting distributions to initial investors, the Proposed FPD Plan is reasonably designed to distribute funds to those investors whose harm is most closely linked to Respondents' misrepresentations and omissions *in the offering* itself.

B. <u>Establishment of the FPD Fair Fund</u>

The Proposed FPD Plan compensates investors using, in addition to the $12,256,561 in disgorgement and prejudgment interest monies collected from Credit Suisse and Asset Backed Securities Corp., the $6 million penalty also collected for the FPD Practice conduct. Under Section 308(a) of the Sarbanes-Oxley Act, as amended, a penalty ordered in an administrative action "shall, . . . at the direction of the Commission, be added to and become part of a disgorgement fund or other fund established for the benefit of [investor] victims." 15 U.S.C. § 7246(a). The Commission, in its discretion, concludes that the circumstances here justify the addition of the penalty money to other funds collected to create a Fair Fund for the FPD Practice.

Accordingly, IT IS HEREBY ORDERED that:

A. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the FPD Fair Fund is established; and

B. Pursuant to Rule 1104 of the Commission's Rules, 17 C.F.R. § 201.1104, the FPD Plan is approved.

By the Commission.

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75878 / September 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15098

In the Matter of Credit Suisse Securities USA (LLC); DLJ Mortgage Capital, Inc.; Credit Suisse First Boston Mortgage Acceptance Corp.; Credit Suisse First Boston Mortgage Securities Corp.; and Asset Backed Securities Corporation, Respondents.	ORDER ESTABLISHING FAIR FUND AND APPROVING PLAN OF DISTRIBUTION BULK SETTLEMENT PRACTICE

I.

On November 16, 2012, the Securities and Exchange Commission ("Commission") issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order") against Credit Suisse Securities (USA) LLC ("Credit Suisse Securities"), DLJ Mortgage Capital, Inc., Credit Suisse First Boston Mortgage Acceptance Corp., Credit Suisse First Boston Mortgage Securities Corp., and Asset Backed Securities Corporation (collectively, "Credit Suisse" or "Respondents").[1] In the Order, the Commission found that the Respondents engaged in misconduct including misrepresentations or omissions in the offer or sale of residential mortgage backed securities ("RMBS") relating to

[1] Securities Act Rel. No. 9368 (Nov. 16, 2012), available at http:///sec.gov/litigation/admin/2012/33-9368.pdf.

two undisclosed business practices that violated Sections 17(a)(2) and (3) of the Securities Act of 1933 (the "Securities Act"). 15 U.S.C. § 77q(a)(2) and (3)[2]. The Commission ordered the payment of separate monetary sanctions for each set of business practices. The Order indicated that, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the Commission may create two separate Fair Funds, one for each group of investors harmed by the relevant business practices.

This order pertains to one of those practices, the bulk settlement practice ("Bulk Settlement Practice"). For the Bulk Settlement Practice conduct, the Commission ordered Respondents to pay, jointly and severally, a total of $101,747,769 in disgorgement, prejudgment interest, and civil money penalties. All payments required by the Order have been made.

As set out in the Order, the Commission's findings involving the Bulk Settlement Practice relate to 75 RMBS offerings underwritten by Credit Suisse from 2005 to 2007.

Structure of the RMBS Offerings. Each of the 75 RMBS offerings involved the securitization of collateral, consisting of residential mortgage loans, many of which had been previously purchased by Credit Suisse. Credit Suisse created separate trusts for each offering and deposited residential mortgage loans into each trust ("RMBS Trusts"). The RMBS Trusts then issued numerous classes or "tranches" of debt securities (commonly referred to as "certificates") backed by the RMBS collateral. Credit Suisse marketed and sold these certificates to investors using various offering documents. Each tranche of certificates held different rights to the mortgage payments and other defined funds ("cash flows") going to the RMBS Trust, *e.g.*, to the principal and interest payments made on the underlying mortgages. In broad terms, the

[2] The Commission also found that one respondent, Asset Backed Securities Corp., violated Section 15(d) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78o(d), and Rules 12b-20, 15d-1, and 15d-14(d) thereunder, 17 C.F.R. §§ 240.12b-20, 15d-1, and 15d-14(d), as a result of materially misleading statements in certifications that had been attached to reports filed with the Commission.

"senior tranches" of certificates held the first rights to cash flows to the RMBS Trust, and as a result paid a lower interest rate to investors; the "junior tranches" paid higher interest rates to investors, and their cash flow rights were subordinated to the senior tranches. This cash-flow priority structure is commonly referred to as a "waterfall."

The Bulk Settlement Practice. In general, when preparing for an RMBS offering, Credit Suisse purchased mortgage loans from entities that originated the loans ("originators"). The purchase agreements in these transactions typically contained provisions committing the originator to repurchase a loan if the originator breached various representations and warranties or if a borrower missed one of the first three payments due following Credit Suisse's purchase of the loan. The failure to make such a payment is referred to in the Order as an early payment default ("EPD"). When Credit Suisse discovered that a loan suffered an EPD or otherwise breached an originator's representation or warranty, Credit Suisse often demanded that the originator repurchase the loan. If an originator agreed to repurchase such a loan, and Credit Suisse had sold the loan to an RMBS Trust, Credit Suisse repurchased it from the Trust. However, as noted in the Order, Credit Suisse often settled repurchase claims against originators for loans sold to an RMBS Trust by accepting, and keeping for itself, cash payments from the originator in lieu of a repurchase while leaving the EPD loans underlying the settlements in an RMBS Trust. The Order describes such settlements as "bulk settlements" because they often involved cash payments for many different loans. Between 2005 and 2010, Credit Suisse entered into approximately 110 bulk settlements with originators related to loans previously sold to the 75 RMBS Trusts. As a result of its Bulk Settlement Practice, Credit Suisse improperly obtained approximately $55.7 million, including approximately $28.1 million in settlement proceeds and losses avoided of approximately $27.6 million.

In connection with its Bulk Settlement Practice, Credit Suisse made untrue statements of material fact and omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading. As described in the Order, Credit Suisse made various statements in the relevant offering materials about its obligations to repurchase loans from RMBS Trusts that materially breached any representations and warranties to repurchase loans that Credit Suisse made to the RMBS Trusts, and other information relevant to the origination of the loans. For example, Credit Suisse represented that it would repurchase loans from the RMBS Trusts whenever it discovered or was notified of a material breach of one of its representations or warranties to the RMBS Trusts. Additionally, for some RMBS offerings, Credit Suisse expressly represented in offering documents that it would repurchase certain early defaulting loans from the RMBS Trust. Offering documents for all of the 75 RMBS offerings represented that certain Credit Suisse Securities affiliates transferred all "right, title and interest" to the loans, as well as all "proceeds" from the loans, into the trusts. Because Credit Suisse failed to disclose its Bulk Settlement Practice and, for some RMBS offerings failed to comply with offering document provisions that required it to repurchase early defaulting loans, these statements were materially misleading or omitted material information necessary to make the statements not misleading. For example, notwithstanding its representations about when it would repurchase loans from the RMBS Trusts, Credit Suisse did not disclose that at times it also enforced EPD rights without repurchasing loans or that it retained the proceeds from bulk settlements entered into in such situations.

In addition, the Bulk Settlement Practice operated as a fraud or deceit on investors purchasing certificates in the RMBS offerings. The relevant conduct included, but was not limited to: (1) the settling of repurchase claims against originators, and keeping the consideration received, when Credit Suisse had sold the underlying loans to RMBS Trusts; (2) the collection of settlement proceeds for securitizations where Credit Suisse had passed through certain rights to an RMBS Trust or had itself promised to repurchase certain EPD loans; (3) the application of different quality review procedures for loans that Credit Suisse sought to put back to originators and the practice of not repurchasing such loans from trusts unless the originators had agreed to repurchase them; (4) the failure to disclose the bulk settlement practice when answering investor questions about EPDs; and (5) the failure to notify trustees or investors about the benefits Credit Suisse retained related to securitized loans, despite knowing that investors were unaware of the bulk settlement practice.

The Order stated that funds paid into each Fair Fund would be distributed pursuant to a distribution plan to be administered in accordance with the Commission's Rules of Practice governing Fair Fund and Disgorgement Plans (the "Commission's Rules"). On August 14, 2014, pursuant to the Order and Rule 1103 of the Commission's Rules, 17 C.F.R. § 201.1103, the Commission proposed the plan[3] ("Proposed Bulk Settlement Plan" or "Proposed Plan") and issued a notice of the Proposed Plan and opportunity for comment (the "Notice").[4] According to the Proposed Plan, the "purpose of this distribution is to compensate investors harmed by Credit Suisse's misrepresentations and omissions in its offering materials regarding the Bulk Settlement Practice." (¶ 5.)[5]

[3] Available at http://www.sec.gov/litigation/admin/2014/34-72850-ppd.pdf.

[4] Exchange Act Rel. No. 72850 (Aug. 14, 2014), available at https://www.sec.gov/litigation/admin/2014/34-72850.pdf. The Notice provided all interested persons thirty days to submit written comments on the Proposed Plan. The Notice advised such persons that they could obtain a copy of the Proposed Plan from the Commission's website or by submitting a written request to the Commission. The notice stated that all persons who desired to comment on the Proposed Plan could submit their comments no later than September 15, 2014.

[5] Paragraph references in this order denoted by the symbol "¶" refer to the numbered paragraphs in the Proposed Bulk Settlement Plan.

The proposed distribution methodology allocates the Net Fair Fund among the RMBS Trusts based on the proportion of the disgorgement paid by Respondents for each trust relative to the total disgorgement paid by Respondents. (¶ 55.) The funds for each trust are then allocated[6] to each trust's Eligible Claimants[7] on a *pro rata* basis determined by the Eligible Claimant's investment in the specific trust divided by the sum of all Eligible Claimants' investments in that trust. (¶ 56.)

The Commission received two comments on the Proposed Plan. This order addresses those comments.

After careful consideration, the Commission has determined to order a Fair Fund for the amounts paid by Respondents relating to the Bulk Settlement Practice conduct (the "Bulk Settlement Fair Fund"), and, for the reasons explained in this order, that the Proposed Bulk Settlement Plan should be approved with technical modifications (hereinafter the "Bulk Settlement Plan" or "Plan").[8]

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[6] As explained in the Proposed Bulk Settlement Plan, a preliminary allocation is made and any Eligible Claimant whose preliminary calculation is less than a *de minimis* amount is removed from the pool of Eligible Claimants. (¶ 57.) In the event that a particular Trust is undersubscribed such that a small number of Eligible Claimants would stand to receive a disproportionately large recovery, the Fund Administrator, with agreement of the Commission staff, may use discretion in determining the final amount of the recovery. (¶ 59.)

[7] The Proposed Plan defines "Eligible Claimants" as persons (other than Excluded Parties) who purchased Eligible Securities on Eligible Purchase dates. The Proposed Plan also defines the capitalized terms in the definition of Eligible Claimant.

[8] The Bulk Settlement Plan contains minor technical modifications to its Proposed Bulk Settlement Plan. The technical modifications are: (i) in ¶ 59, wording changes were made to eliminate an undefined term, "Eligible Claim;" (ii) the modifier "proposed" is deleted wherever it appeared in the Proposed Bulk Settlement Plan because the Bulk Settlement Plan when adopted by the Commission is no longer "proposed;" and (iii) ¶ 85 is deleted because the Bulk Settlement Plan when adopted will not be published for further Notice and Comment. These technical modifications are minor. No substantive changes have been made to the methodology for calculating distributions or to the definition or eligibility criteria for Eligible Claimants. Commission staff does not deem these changes to be substantial or to require republication pursuant to Commission Rule 1103. Moreover, under Rule 1104, the Commission has complete discretion when considering whether to republish a plan for notice and comment, and the Commission is not required by Rule 1104 to republish a plan *even if* the Commission substantially modifies it prior to adoption.

II.

A. Public Comments on the Bulk Settlement Plan

1. Chris Katopis, Executive Director, Association of Mortgage Investors Letter

Chris Katopis, the Executive Director of the Association of Mortgage Investors ("AMI"), submitted a comment (the "AMI Comment")[9] that stated three concerns with the Proposed Plan: 1) that the Proposed Plan's *pro rata* allocation "improperly override[s] the recognized payment priority or 'waterfall' established by the governing documents of the RMBS trust . . . thereby favoring senior certificate-holders, who may not in fact suffer losses, over more junior classes of certificate-holders"; 2) that the Proposed Plan arbitrarily excludes nearly all subsequent purchasers, potentially undermining the secondary market for RMBS; and 3) that by paying investors directly rather than paying the RMBS trustees, "the Proposed Plan fails to take advantage of [the RMBS waterfall,] a method of distribution that is more efficient, fair, and consistent with investor expectations." The Commission has considered the AMI Comment and, for the reasons discussed below, is approving the Proposed Bulk Settlement Plan with only technical modifications.[10]

First, AMI's contention that a *pro rata* allocation overrides the RMBS Trusts' waterfall, thereby favoring senior certificate-holders "who may not in fact [have] suffer[ed] losses," indicates that the harm that is the focus of AMI's concern is limited to the *investment losses* that flowed from the *eventual performance* of certificates held by investors. Subsequent investment performance losses, however, are distinct from the harm to investors addressed in the

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[9]The three concerns raised in the AMI Comment have also been raised for the Commission's distribution plan for the previously noted other undisclosed Credit Suisse business practice, the first payment default practice ("FPD Practice"). Although these practices involved different conduct, the portion of this order responding to the AMI Comment and the corresponding portion of the order approving the distribution plan for FPD Practice are nearly identical because the analysis of the concerns is the same for both plans.

[10] *See* fn. 7, *supra*.

Bulk Settlement Plan. A proportionate harm accrued to *all* investors *at the time of the initial offering* when, as a result of Credit Suisse's misconduct including its misrepresentations and omissions in the offering documents and marketing materials, investors were deprived of the benefit of their bargain with Credit Suisse. The Bulk Settlement Plan's purpose and design for addressing investor harm flow directly from the violations at issue in the Order. As noted in the Plan, the "purpose of this distribution is to compensate investors in RMBS Trusts harmed by Credit Suisse's misrepresentations and omissions *in its offering materials* regarding the Bulk Settlement Practice." (¶ 5, emphasis added.) The Order found that Credit Suisse violated Sections 17(a)(2) and 17(a)(3) of the Securities Act because of material misstatements and omissions, and other acts that operated as a fraud or deceit on RMBS investors, "in the offer or sale of securities." The misleading statements and omissions at issue in the Order were made in the securitizations' offering documents and in other materials Credit Suisse used to market the offering to potential investors. In those documents and materials, Credit Suisse misled investors through various statements, noted above and in the Order, while failing to disclose the Bulk Settlement Practice, and with respect to certain RMBS transactions, by its failure to comply with offering document provisions that required Credit Suisse to repurchase certain loans. As noted in the Commission's Order, Credit Suisse's Bulk Settlement Practice would have been material to investors' decisions whether to invest with Credit Suisse in these RMBS offerings had investors known about this practice.

Had Credit Suisse disclosed *to potential initial investors* the operation of its Bulk Settlement Practice, it stands to reason that *all initial* investors would have considered the information in their investment decisions. Investors may have decided to invest in different securities or demanded to be compensated (*e.g.*, to receive a higher interest rate) based on their knowledge of the Bulk Settlement Practice. For that reason, even if there had been no losses from the failure of the mortgages underlying the 75 securitizations, there still would have been harm to *all initial* investors caused by the Respondents' conduct. Unlike investment performance harm, the harm in the offer and sale affected senior and junior certificate-holders alike. It is this harm that the Commission's Plan seeks to address through a *pro rata* distribution. The Plan is reasonably designed to compensate investors for such harm.

The Commission's objective is to distribute the Bulk Settlement Practice Fair Fund in a fair and reasonable manner, taking into account the relevant facts and circumstances.[11] In light of the factual and legal bases for Respondents' liability, the Commission exercises its discretion to distribute funds *pro rata* to all investors who purchased certificates in the RMBS Trusts' offerings or near the time of the offerings.

Closely related to AMI's first concern is AMI's third concern that the Proposed Plan fails to take advantage of the efficiencies, fairness and consistency with investor expectations associated with the waterfall priority of distributions. AMI's contention, however, that the Commission has "overlook[ed] the possibility that simply distributing proceeds through the trusts to flow through established waterfalls is a more fair and efficient means to compensate investors" is incorrect. The Commission staff carefully considered whether to distribute funds directly to the trustees for the RMBS Trusts as well as the significance of the RMBS Trusts' waterfalls. There are significant legal and practical barriers to a waterfall distribution, and the proceeds cannot be "simply" distributed through the RMBS Trusts. First, an RMBS Trust's waterfall generally determines the prioritization of defined cash flows from the collateral owned

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[11] *See Official Committee of Unsecured Creditors of WorldCom, Inc. v. SEC*, 467 F.3d 73, 82 (2d Cir. 2006) ("So long as the district court is satisfied that 'in the aggregate, the plan is equitable and reasonable,' the SEC may engage in the 'kind of line-drawing [that] inevitably leaves out some potential claimants'"), citing *SEC v. Wang,* 944 F.2d 80, 88 (2d Cir. 1991).

by the Trusts. However, AMI does not contend that the funds held by the Fair Fund - which consist of ill-gotten gains obtained by certain Respondents, civil money penalties, and prejudgment interest - constitute such a defined cash flow. If funds held by the Fair Fund were paid to an RMBS Trust, the Trust's waterfall would not necessarily determine how such funds would be allocated. Second, assuming that, as noted by AMI, the governing documents of the RMBS Trust "provide for the allocation of the losses on a mortgage pool," this fact does not necessarily determine how a Fair Fund payment would be allocated. As noted above, the funds placed in the Bulk Settlement Practice Fair Fund were ill-gotten gains obtained by certain Respondents, civil money penalties, and prejudgment interest, not payments for investor damages or restitution. Thus, the Commission concludes that, rather than being a "simple solution," distributing funds directly to the RMBS Trusts would inject a great deal of uncertainty and complexity regarding how RMBS trustees would allocate funds to current or former investors in the RMBS Trusts due to the complex nature of the trusts and their waterfalls. The Commission's Plan avoids these uncertainties.

AMI's remaining concern is with the Proposed Plan's distribution of funds to investors who purchased securities at or near the time of the initial offerings, rather than investors who purchased certificates on the secondary market long after the initial offerings. This feature of the Proposed Plan is also derived from the factual and legal bases for Respondents' liability. Again, the Commission's Order found that the Respondents' liability stemmed from their conduct in the "*offer or sale of securities*." All initial investors in the RMBS Trusts experienced harm caused by Respondents' material misrepresentations and omissions and other fraudulent acts depriving investors of the benefit of their bargain, including whether to decline to participate in the offering or to negotiate a more favorable purchase price. For that reason, the Proposed Plan distributes the Bulk Settlement Practice Fair Fund to investors who purchased certificates at or near the time of the initial offering.

The Commission staff is not aware of extant records that would allow the Fund Administrator unambiguously to identify investors who bought directly from Respondents in the offering. In the absence of such records, the Plan treats investors who purchased certificates within 30 days of the offering as "initial investors." The 30-day cutoff reasonably ensures that distributions are made to those investors most likely to have been directly harmed by the conduct at issue in the Order. Investors whose purchases fall outside the 30-day cutoff ("secondary investors") were more likely to have had access to additional information about the RMBS collateral that was unavailable to initial investors at the time of the offering. Beginning approximately 30 days after the offering, and continuing each month thereafter, the RMBS trustee issued reports that provided updated performance data for the RMBS collateral. So, for example, a secondary investor who purchased several months after the offering would have typically had access to multiple trustee reports when making an investment decision. The trustee reports would have shown how the mortgages in the collateral pool performed during that time (*e.g.*, how many mortgages were 30, 60, or 90 days delinquent, how many were in foreclosure, etc.). As a result, relative to an initial investor, a secondary investor was *less dependent* on Credit Suisse's representations in the offerings because the secondary investor had access to a larger data set of actual performance history. Therefore, by limiting distributions to initial investors, the Proposed Bulk Settlement Plan is reasonably designed to distribute funds to those investors whose harm is most closely linked to Respondents' misrepresentations and omissions *in the offering* itself.

2. Erik Haas, Patterson Belknap Webb & Tyler, LLP, Representing MBIA Insurance Corporation

Counsel for MBIA Insurance Corporation ("MBIA") submitted a comment letter ("MBIA Comment") requesting that the Commission revise the Bulk Settlement Plan with respect to one of the 75 RMBS offerings, the Home Equity Mortgage Trust, Series 2007-2 (HEMT 2007-2). Specifically, MBIA requests the Proposed Plan be revised "to clarify MBIA's entitlement to the reimbursement of its claim payments" relating to HEMT 2007-02. In support of its request, MBIA indicates that it has issued an insurance policy to guarantee payments to HEMT 2007-02 to cover amounts due to certificate holders ("Policy") and has made over $390 million in Policy payments to HEMT 2007-02. MBIA claims that as a result of its Policy and its related payments "MBIA owns any claims of certificate holders – including securities law claims – to the extent of the claim payments made" based on the principles of subrogation. In support of its position, MBIA asserts that the Respondents' disgorgement payment pursuant to the Order "represents funds that belong to the Trusts, including HEMT 2007-02." MBIA cites the Order for the proposition that keeping the proceeds of bulk settlements was "contrary to Respondents' obligation to transfer 'right, title and interest' to the loans, and all 'proceeds' from the loans, to the securitization Trusts." As a result, MBIA takes the position that funds to be distributed by the Plan "must be distributed in accordance with the 'waterfall'" which in turn requires, according to MBIA, that "after senior certificate holders are paid their monthly distribution, all remaining funds [be] distributed to MBIA to reimburse it for prior draws on the Policy and for any amounts owed to it under [its] [i]nsurance [a]greement."

The Commission has considered the MBIA Comment and, for the reasons discussed below, declines to substantively modify the Proposed Plan as requested by MBIA and, instead, is approving the Proposed Bulk Settlement Plan with only technical modifications.[12]

MBIA's request that the Proposed Plan be revised to "clarify MBIA's entitlement to reimbursement" would require the Commission to adjudicate a potential claim that MBIA may have based on a contractual insurance arrangement. It is not appropriate for the Commission, in essence, to adjudicate claims unrelated to the federal securities laws in the context of a Fair Fund distribution, such as whether MBIA has a contractual claim or subrogation right against purchasers or holders of HEMT 2007-02 certificates.

Moreover, even if it were appropriate for the Commission to consider such a claim, the findings in the Order cited by MBIA in support of its entitlement claim to Fair Fund proceeds misconstrue those portions of the Order. The statement in the Order that "[o]ffering documents . . . represented that [Credit Suisse] transferred all 'right, title and interest' to the loans, as well as all 'proceeds' from the loans to the trusts" is a finding limited to what *representations* were made to investors in the offering documents. This finding does not establish or purport to establish who owned, or was entitled receive, the bulk settlement proceeds.

Similarly, the Commission's findings related to Credit Suisse's ill-gotten gains and order of disgorgement establish only that Credit Suisse obtained funds causally connected to violations of the federal securities laws and, as a result, that Credit Suisse was not entitled to retain those funds. Contrary to the implication in MBIA's Comment, findings of ill-gotten gain and a

[12] *See* fn. 7, *supra.*

disgorgement order do not address whether any particular third person has or might have a claim for damages for the same amount.[13]

The Bulk Settlement Plan's purpose is to compensate investors harmed by Respondents' misrepresentations and omissions in Credit Suisse's offering materials. The Plan establishes a process for identifying those harmed investors, calculating the amount of individual distributions, and distributing funds. The process of formulating a Fair Fund distribution plan is not the proper time or place to resolve potential claims by third parties to funds proposed to be allocated to investors under the Plan. To the extent that claims exist, they should be asserted in an appropriate forum.

Like AMI's comment, MBIA's comment that Fair Fund funds "must be distributed in accordance with the waterfall" is premised on an assumption that investors were harmed because the bulk settlement funds were owed to the trusts. However, as noted above, harm accrued to *all* investors *at the time of the initial offering* when, as a result of the misrepresentations and omissions in the offering documents and marketing materials, these initial investors were deprived of the benefit of their bargain with Credit Suisse. Moreover, the Commission's Order did not make findings related to the trusts' rights to the proceeds of the Bulk Settlement Practice. The Commission's Order found that Respondents violated Sections 17(a)(2) and 17(a)(3) of the Securities Act based on the impact of the Respondents' undisclosed Bulk Settlement Practice on the relevant offers or sales of securities to investors. For reasons discussed more fully above, the

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[13] *Cf. SEC v. Fischbach Corp.*, 133 F.3d 170 (2d Cir. 1997) ("Although disgorged funds may often go to compensate securities fraud victims for their losses, such compensation is a distinctly secondary goal."); *SEC v. Whitmore*, 659 F.3d 1, 11 n.2 (D.C. Cir. 2001) (stating, in response to an argument about apportioning among wrongdoers, that "this court has emphasized that the purpose of disgorgement is not to compensate for losses but to deprive the wrongdoer of his ill-gotten gain").

Commission finds that a *pro rata* distribution to investors is fair and reasonable in light of the legal and factual bases for Respondents' liability.

B. Establishment of Bulk Settlement Fair Fund

The Proposed Bulk Settlement Plan compensates investors using, in addition to the $68,747,769 in disgorgement and prejudgment interest monies collected from Respondents, the $33 million penalty also collected for the Bulk Settlement Practice conduct. Under Section 308(a) of the Sarbanes-Oxley Act, as amended, a penalty ordered in an administrative action "shall, . . . at the direction of the Commission, be added to and become part of a disgorgement fund or other fund established for the benefit of [investor] victims." 15 U.S.C. § 7246(a). The Commission, in its discretion, concludes that the circumstances here justify the addition of the penalty money to other funds collected to create a Fair Fund for the Bulk Settlement Practice.

Accordingly, IT IS HEREBY ORDERED that:

A. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, the Bulk Settlement Fair Fund is established; and

B. Pursuant to Rule 1104 of the Commission's Rules, 17 C.F.R. § 201.1104, the Bulk Settlement Plan is approved.

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 EXCHANGE ACT OF 1934
Release No. 75879 / September 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16802

In the Matter of **Bala Cynwyd Corp.,** **Digital Lighthouse Corp.,** **Great Idea Corp.,** **Green Carbon Technologies Corp.,** **Riverside Parkway, Inc.,** **Southern Community Bancshares, Inc.,** **SubMicron Technologies, Inc., and** **United eSystems, 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. Bala Cynwyd Corp. ("BLCY") (CIK No. 52813) is a revoked New Jersey corporation located in Bala Cynwyd, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BLCY is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the

[1] In cases where the short form of the issuer's name is in all capital letters, the short form is also its stock symbol.

period ended July 31, 2001. As of April 29, 2015, the common stock of BLCY was not publicly quoted or traded.

2. Digital Lighthouse Corp. ("DGLHQ") (CIK No. 1022191) is a void Delaware corporation located in Englewood, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DGLHQ 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, 2001, which reported a net loss of $4,317,000 for the prior three months.On July 16, 2001 filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Colorado, which was closed on September 27, 2011. As of April 29, 2015, the common stock of DGLHQ was not publicly quoted or traded.

3. Great Idea Corp. ("Great Idea") (CIK No. 1547389) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Great Idea is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form S-1-A on January 30, 2013, which reported a net loss of $11,090 for the period from November 4, 2011 to September 30, 2012. As of April 29, 2015, the common stock of Great Idea was not publicly quoted or traded.

4. Green Carbon Technologies Corp. ("Green Carbon") (CIK No. 1467233) is a revoked Nevada corporation located in Carson City, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Green Carbon is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2011, which reported a net loss of $12,694 for the prior nine months. As of April 29, 2015, the common stock of Green Carbon was not publicly quoted or traded.

5. Riverside Parkway, Inc. ("Riverside") (CIK No. 1024189) is a suspended Oklahoma corporation located in Cleveland, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Riverside is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB on October 15, 1996, which reported a net loss of $95,422 for the six months ended June 30, 1996. As of January 26, 2015, the common stock of Riverside was not publicly quoted or traded.

6. Southern Community Bancshares, Inc. ("SNCBQ") (CIK No. 1171017) is a dissolved Georgia corporation located in Fayetteville, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SNCBQ 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 $9,609,996 for the prior nine months.On September 1, 2009 filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of Georgia, which was closed on October 24, 2013. As of January 26, 2015, the common stock of SNCBQ was not publicly quoted or traded.

7. SubMicron Technologies, Inc. ("SubMicron") (CIK No. 1392486) is a delinquent Colorado corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SubMicron is delinquent in its periodic

filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2011, which reported a net loss of $10,577 for the prior year. As of January 26, 2015, the common stock of SubMicron was not publicly quoted or traded.

8. United eSystems, Inc. ("UESY") (CIK No. 1171357) is a Nevada corporation located in Covington, Louisiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). UESY 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 $660,638 for the prior nine months. As of January 26, 2015, the common stock of UESY was not publicly quoted or traded.

B. DELINQUENT PERIODIC FILINGS

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

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

11. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/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 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
September 10, 2015

Securities Exchange Act of 1934
Release No. 75886 / September 10, 2015

In the Matter of **The Options Clearing Corporation**	)	**Order Discontinuing the Automatic Stay**

This matter comes before the Commission on the Options Clearing Corporation's ("OCC") motion to lift the automatic stay of the approval, through delegated authority, of OCC's plan for raising additional capital ("Capital Plan") to support its function as a systemically important financial market utility. On January 26, 2015, the Commission issued a notice of filing of the proposed rule change regarding the Capital Plan.[1] After consideration of the record in the proposed rule change, the Division of Trading and Markets, for the Commission pursuant to delegated authority, issued an order approving ("Approval Order") the Capital Plan on March 6, 2015.[2]

BATS Global Markets, Inc. ("BATS"), BOX Options Exchange LLC ("BOX"), KCG Holdings, Inc. ("KCG"), Miami International Securities Exchange, LLC ("MIAX"), and Susquehanna International Group, LLP ("SIG") (collectively "Petitioners") each filed petitions for review of the Approval Order, challenging the action taken by delegated authority. The filing of the petitions automatically stayed the Approval Order pursuant to Commission Rule of Practice 431(e).[3] The Commission has entered a separate Order Granting the Petitions for

1 Securities Exchange Act Release No. 74136 (January 26, 2015), 80 FR 5171 (January 30, 2015) (SR-OCC-2015-02).

2 Order Approving Proposed Rule Change Concerning a Proposed Capital Plan for Raising Additional Capital That Would Support the Options Clearing Corporation's Function as a Systemically Important Financial Market Utility, Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058 (March 12, 2015) (SR-OCC-2015-02). The Capital Plan was previously filed as an advance notice pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010. *See* 12 U.S.C. § 5465(e)(1). The Commission issued a notice of no objection to the advance notice on February 26, 2015. *See* Securities Exchange Act Release No. 74387 (February 26, 2015), 80 FR 12215 (March 6, 2015) (SR-OCC-2014-813).

3 17 CFR 201.431(e).

Review and Scheduling Filing of Statements.[4]

In response to the automatic stay imposed by the filing of the petitions to review the Approval Order, OCC filed a Motion to Lift the Stay on April 2, 2015, citing the public policy reasons for implementing the Capital Plan. The Petitioners responded, arguing that continuing the automatic stay is appropriate in light of the important policy and competition issues raised by the Approval Order.

The Commission finds that it is in the public interest to lift the stay during the pendency of the Commission's review. Under the circumstances of this case, the Commission believes, on balance, that strengthening the capitalization of a systemically important clearing agency, such as OCC, is a compelling public interest. The Commission also believes that the concerns raised by the Petitioners regarding potential monetary and competitive harm do not currently justify maintaining the stay during the pendency of the Commission's review. Nor does the Commission believe that lifting the stay precludes meaningful review of the Approval Order.

For the reasons stated above, it is hereby:

ORDERED that the that the automatic stay of delegated action pursuant to Commission Rule of Practice 431(e)[5] is hereby discontinued, and that OCC's Motion to Lift Stay of the staff's action in approving by delegated authority File No. SR-OCC-2015-02[6] is GRANTED.

The order approving such proposed rule change shall remain in effect.

By the Commission.

Robert W. Errett
Deputy Secretary

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4 *See* Order Granting Petitions for Review and Scheduling Filing of Statements, Securities Exchange Act Release No. 75885 (September 10, 2015).

5 *See supra* note 4.

6 *See supra* note 2.

UNITED STATES OF AMERICA

Before the
Securities and Exchange Commission
September 10, 2015

Securities Exchange Act of 1934
Release No. 75885 / September 10, 2015

In the Matter of **BATS Global Markets, Inc.** **BOX Options Exchange LLC** **KCG Holdings, Inc.** **Miami International Securities Exchange, LLC** **Susquehanna International Group, LLP**	**Order Granting Petitions for Review and Scheduling Filing of Statements**

This matter comes before the Commission on petition to review the approval, through delegated authority, of the Options Clearing Corporation's ("OCC") plan for raising additional capital ("Capital Plan") to support its function as a systemically important financial market utility. On January 26, 2015, the Commission issued a notice of filing of the proposed rule change regarding the Capital Plan.[1] After consideration of the record in the proposed rule change, the Division of Trading and Markets, for the Commission pursuant to delegated authority, issued an order approving ("Approval Order") the Capital Plan on March 6, 2015.[2]

BATS Global Markets, Inc. ("BATS"), BOX Options Exchange LLC ("BOX"), KCG Holdings, Inc. ("KCG"), Miami International Securities Exchange, LLC ("MIAX"), and Susquehanna International Group, LLP ("SIG") (collectively "Petitioners") each filed petitions

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1 Securities Exchange Act Release No. 74136 (January 26, 2015), 80 FR 5171 (January 30, 2015) (SR-OCC-2015-02).

2 Order Approving Proposed Rule Change Concerning a Proposed Capital Plan for Raising Additional Capital That Would Support the Options Clearing Corporation's Function as a Systemically Important Financial Market Utility, Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058 (March 12, 2015) (SR-OCC-2015-02). The Capital Plan was previously filed as an advance notice pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010. *See* 12 U.S.C. § 5465(e)(1). The Commission issued a notice of no objection to the advance notice on February 26, 2015. *See* Securities Exchange Act Release No. 74387 (February 26, 2015), 80 FR 12215 (March 6, 2015) (SR-OCC-2014-813).

for review of the Approval Order, challenging the action taken by delegated authority.[3]

The Commission finds that the Petitioners are aggrieved by the Approval Order and pursuant to Rule 431 of the Rules of Practice, the Petitioners' petitions for review of the Approval Order are granted. Further, the Commission hereby establishes that any party or other person may file a written statement in support of or in opposition to the Approval Order on or before October 7, 2015. This will provide an opportunity for the Commission to receive additional comment and information to help it more fully assess the issues raised. The Commission has issued a separate order addressing the automatic stay.[4]

For the reasons stated above, it is hereby:

ORDERED that the petitions of BATS, BOX, KCG, MIAX, and SIG for review of the staff's action in approving by delegated authority File No. SR-OCC-2015-02[5] are GRANTED; and

It is further ORDERED that any party or other person may file a statement in support of or in opposition to the action made pursuant to delegated authority on or before October 7, 2015.

The order approving such proposed rule change shall remain in effect.

By the Commission.

Robert W. Errett
Deputy Secretary

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3 Under Commission Rule of Practice 430 any aggrieved party may seek review of an action made by delegated authority. *See* 17 CFR 201.430.

4 *See* Order Discontinuing the Automatic Stay, Securities Exchange Act Release No. 75886 (September 10, 2015).

5 *See supra* note 2.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75893 / September 10, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4193 / September 10, 2015

Admin. Proc. File No. 3-15850

In the Matter of

MATTHEW D. SAMPLE

OPINION OF THE COMMISSION

APPLICATION FOR CONSENT TO ASSOCIATE

Denial of Rule 193 Application

Applicant, who was barred in a settled follow-on proceeding based on an antifraud injunction, applied for consent to associate with a registered investment adviser. The Director of the Division of Enforcement denied the application pursuant to delegated authority. *Held*, denial of the application is affirmed because Applicant failed to show that the proposed association is consistent with the public interest.

APPEARANCES:

Edwin J. Tomko, of Dykema Cox Smith, for Matthew D. Sample.

Joseph Brenner, Sam Waldon, Kenneth H. Hall, and *Carolyn Morris*, for the Division of Enforcement.

Appeal filed: February 18, 2015
Last brief received: July 7, 2015

Matthew D. Sample, a former associated person of Kingsroad Financial Insurance Services, Inc. ("Kingsroad"), d/b/a Measured Risk Portfolios, a Commission-registered investment adviser, appeals from action taken by the Director of the Division of Enforcement ("Division") pursuant to delegated authority.[1] The Division Director denied his application for consent to associate with Kingsroad and its related broker-dealer, Independent Financial Group, LLC ("IFG"),[2] under Rule 193 of the Commission's Rules of Practice.[3] The Division opposes Sample's appeal. For the reasons set forth below, we conclude that Sample has failed to show that the proposed association would be consistent with the public interest. Accordingly, we affirm the action taken by delegated authority.

I. Background

A. Sample consented to be permanently enjoined from violating antifraud provisions of the federal securities laws.

On April 4, 2014, we filed a complaint against Sample in the United States District Court for the Northern District of Texas, alleging that, from October 2009 to June 2012 ("Relevant Period"), he raised almost $1 million from five investors based on representations that he would use the money to trade on the investors' behalf.[4] Instead, the complaint alleged, Sample fraudulently diverted approximately one-third of the money for his personal use and to make payments to other investors. The complaint further alleged that during the Relevant Period Sample was associated with broker-dealer and investment adviser firms, including Kingsroad.[5]

According to the complaint, Sample raised the money from investors in New Mexico and elsewhere through his unregistered hedge fund, The Lobo Volatility Fund, LLC. Sample told investors he would take a monthly management fee of 1/12 of 1% of the hedge fund's net asset value, 20% of trading profits, and limited expenses. But almost immediately after receiving the investors' funds, Sample diverted significant amounts for his own personal use. When his trading strategy failed, resulting in the loss of all remaining investor funds, Sample provided investors

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1 *See* 17 C.F.R. § 200.30-4(a)(5) (granting the Division Director delegated authority to grant or deny applications made pursuant to Rule 193).

2 IFG is registered with the Commission as a broker-dealer and investment adviser. The exact relationship between Kingsroad and IFG is unclear.

3 17 C.F.R. § 201.193.

4 *SEC v. Sample*, Civil Action No. 3:14-CV-01218-B (N.D. Tex. Apr. 4, 2014), ECF No. 1.

5 Between August 2007 and July 2010, Sample was employed by VTrader Pro, LLC, a registered broker-dealer. Between April 1, 2012 and April 23, 2014, Sample was employed by Kingsroad. Sample represents that the fraudulent activity that overlapped with his employment at Kingsroad involved the preparation and transmittal of a false monthly account statement of one investor.

with false documents that made it look like his trading had been successful. Additionally, Sample raised at least $50,000 from a new investor under false pretenses and then used those funds to make partial payment to prior investors who had demanded a refund.

On April 7, 2014, without admitting or denying the allegations in the complaint, Sample consented to the district court's entry of a final judgment permanently enjoining him from violating 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, and Sections 206(1), 206(2), and 206(4) of the Investment Advisers Act of 1940 and Advisers Act Rule 206(4)-8,[6] and from directly or indirectly soliciting or accepting funds from any person or entity for any unregistered offering of securities.[7]

B. Sample consented to be barred from the securities industry based on the antifraud injunction.

On April 22, 2014, following the entry of the injunction, we instituted and simultaneously settled administrative proceedings against Sample ("Settled Order").[8] In the Settled Order, we found that Sample had been permanently enjoined from violating the aforementioned provisions of the securities laws based on allegations that he managed an unregistered hedge fund that raised $1 million from five investors, misrepresented his intended use of investor funds, misappropriated investor funds for his personal use and to repay prior investors, and intentionally concealed trading losses from investors.[9]

Without admitting or denying the findings therein, except as to the Commission's jurisdiction and the fact that he had been permanently enjoined as a result of the April 7, 2014 judgment, Sample consented to the entry of a bar prohibiting him from associating with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and from participating in a penny stock offering, 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 a penny stock, or inducing or attempting to induce the purchase or sale of a penny stock.[10] The bar from association was unqualified because it did not contain a provision indicating that after the expiration of a

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[6] 15 U.S.C. § 77q(a); 15 U.S.C. § 78j(b) & 17 C.F.R. § 240.10b-5; 15 U.S.C. §§ 80b-6(1), 80b-6(2), 80b-6(4) & 17 C.F.R. § 275.206(4)-8.

[7] *SEC v. Sample*, Civil Action No. 3:14-CV-01218-B (N.D. Tex. Apr. 7, 2014), ECF No. 7. The judgment further provided that, on motion of the Commission, the court would determine the appropriateness of disgorgement and/or a civil penalty. *Id.*

[8] *Matthew D. Sample*, Exchange Act Release No. 71993, 2014 WL 1603591 (Apr. 22, 2014).

[9] *Id.* at *1.

[10] *Id.* at *2.

specified time Sample could apply to re-enter the securities industry.[11]

C. Sample filed a Rule 193 application seeking consent to associate with Kingsroad.

On June 5, 2014, Sample filed a Rule 193 application with the Commission, subsequently supplemented, seeking a "limited lifting" of the bar to permit him to associate with Kingsroad as a wholesaler to "market [the] firm's managed account strategy to financial advisors at broker-dealers with whom [the firm] has [selling] agreements." In the application, Sample asserts that his "primary goal" is to make "full restitution" to defrauded investors. To this end, Sample represents that a friend has offered to lend him $200,000, to be placed in an escrow account for the benefit of defrauded investors and to be repaid from his earnings after he obtains consent to associate. Sample also represents that he will deposit all of his after-tax, annual income in excess of $60,000 into the escrow account for the repayment of defrauded investors, and that he will make defrauded investors the beneficiaries of his $2 million, 15-year term life insurance policy.[12]

Sample further represents that he will be directly supervised by Kingsroad's principals and will have no contact with retail customers or access to investor funds. A written statement dated May 16, 2014, from Kingsroad principal Lawrence Kriesmer[13] describes the proposed supervision to be exercised over Sample:[14]

> [Sample] would be a solicitor of our firm and would call exclusively on other [registered investment advisers] as well as broker dealers and their investment advisor representatives in order to explain our money management strategy and try to secure solicitation or sub-advisory arrangements. [Sample] would work strictly with advisors and not with the general public. Our firm will have other employees who will be able to

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[11] See Letter to: National Association of Securities Dealers, Inc., New York Stock Exchange, Inc., and American Stock Exchange Re: Unqualified Bar Orders, Exchange Act Release No. 34720, 1994 WL 544424, at *1 (Sept. 26, 1994) (stating that unqualified bars "do not contain any proviso for re-application . . . after the expiration of a specified period").

[12] The application represents, without elaboration or support, that if Sample is not permitted to associate with Kingsroad, he "mostly likely" will be prosecuted by the U.S. Attorney's Office in Albuquerque, New Mexico.

[13] The written statement is attached to Sample's brief as "Exhibit 2."

[14] *See* 17 C.F.R. § 201.193(b)(4) (requiring the written statement of the proposed employer to describe: "(i) the terms and conditions of employment and supervision to be exercised over such applicant and, where applicable, by such applicant; (ii) the qualifications, experience, and disciplinary records of the proposed supervisor(s) of the applicant; (iii) the compliance and disciplinary history, during the two years preceding the filing of the application, of the office in which the applicant will be employed; and (iv) the names of any other associated persons in the same office who have previously been barred by the Commission, and whether they are to be supervised by the applicant").

> host or attend events where the general public will be present. [Sample] will not have access to client accounts and will play no role in the day to day operations or trading decisions in our firm. He will be located in our office so that we are able to overhear his conversations with other advisors. His email will be monitored. My business partner or I will periodically make joint visits with [Sample] or follow up calls to outside advisors to insure that [Sample's] communications are consistent with our strategies.

The written statement indicates that Kingsroad has not had any disciplinary events during the past two years, other than the proceedings against Sample discussed above, that no other associated persons are subject to bars, and that Kriesmer has no disciplinary history.

D. The Director of the Division of Enforcement, acting pursuant to delegated authority, denied the Rule 193 application.

On October 23, 2014, the Division's Office of Chief Counsel provided Sample with a formal statement setting forth the reasons for its proposed recommendation that the application be denied, and on November 21, 2014, Sample submitted a response.[15] On February 4, 2015, the Division Director, acting pursuant to delegated authority, denied the application.[16] This appeal followed.

II. Analysis

Rule 193 provides a process by which barred individuals can apply to the Commission for consent to become associated with an entity that is not a member of an SRO, *e.g.*, an investment adviser, an investment company, or a transfer agent.[17] Rule 193 states that applicants "shall make

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[15] *See* 17 C.F.R. § 201.193(e) (requiring applicant to be advised of any adverse recommendation proposed by the staff and provided with a written statement of reasons, after which the applicant has thirty days to submit a written response).

[16] *Matthew D. Sample*, Advisers Act Release No. 4021, 2015 WL 456508, at *3 (Feb. 4, 2015).

[17] 17 C.F.R. § 201.193(a) (providing that an application for consent to associate may be made "where a Commission order bars an individual from association with a registered entity and: (1) [s]uch barred individual seeks to become associated with an entity that is not a member of a self-regulatory organization; or (2) [t]he order contains a proviso that application may be made to the Commission after a specified period of time").

In "Attachment A" to his brief, Sample requests that we "modify" the bar to allow him to associate with Kingsroad. But Rule 193 does not provide for modification of bars, which remain in effect even after consent to associate is granted, *see Applications by Barred Individuals for Consent to Associate with a Registered Broker, Dealer, Municipal Securities Dealer, Investment Adviser or Investment Company*, Exchange Act Release No. 20783, 1984 WL 547096, at *2 (Mar. 16, 1984) (stating that "Commission approval of an application for consent to associate [under the

(continued. . .)

a showing satisfactory to the Commission that the proposed association would be consistent with the public interest."[18] Rule 193 requires an applicant to address the manner and extent of the supervision to be exercised over the applicant and the capacity or position in which the applicant proposes to be associated. The Preliminary Note to the Rule states:

> The nature of the supervision that an applicant will receive or exercise as an associated person with a registered entity is an important matter bearing upon the public interest. In meeting the burden of showing that the proposed association is consistent with the public interest, the application and supporting documentation must demonstrate that the proposed supervision, procedures, or terms and conditions of employment are reasonably designed to prevent a recurrence of the conduct that led to the imposition of the bar.[19]

Rule 193 further requires an applicant to address the passage of time since the imposition of the bar, any restitution or similar action taken to recompense persons injured by the misconduct that resulted in the bar, the applicant's compliance with the order imposing the bar, the applicant's employment following the imposition of the bar, any relevant courses, seminars, or examinations completed after the bar to prepare for a return to the securities business, and any other information material to the application.[20] Finally, the Preliminary Note to Rule 193 states that the Commission "will consider the nature of the findings that resulted in the bar when making its determination as to whether the proposed association is consistent with the public interest."[21]

As discussed below, Sample has not met his burden of demonstrating that the proposed association is consistent with the public interest. He provides no support for his assertion that the proposed supervisory procedures are reasonably designed to prevent a recurrence of the misconduct, and the events that have occurred in the short time since the imposition of the bar do

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(...continued)
predecessor version of Rule 193] . . . does not modify or vacate the Commission order nor does it remove or lift the bar; the order and bar remain in effect"), and Sample's petition is for review of the Division Director's denial of his Rule 193 application. As a result, the request for modification of the bar is not properly before us. *Cf. Victor Teicher*, Exchange Act Release No. 56744, 2007 WL 3254806, at *2 (Nov. 5, 2007) (rejecting request to modify bar order that sought relief under Rule 193 where respondent had not filed a Rule 193 application or complied with its requirements).

18 17 C.F.R. § 201.193(c).

19 *Id.* (Preliminary Note).

20 17 C.F.R. § 201.193(d).

21 *Id.* (Preliminary Note). The Note emphasizes that the Commission "will not consider any application that attempts to reargue or collaterally attack the findings that resulted in the Commission's bar order." In "Attachment 7A" to his brief, Sample states that he is "in no way attempting to reargue or rehash the conditions that led to the bar."

not support his application. Further, the nature of the findings that resulted in the bar does not support his proposed association.

A. Sample has not demonstrated that his proposed supervision, procedures, and terms and conditions of employment are reasonably designed to prevent a recurrence of the conduct that led to the bar.

Sample represents that he will be subject to "enhanced" supervisory procedures,[22] but he fails to demonstrate that the procedures are "reasonably designed to prevent a recurrence" of the misconduct that led to the bar—his outside business activities in managing an unregistered hedge fund and raising money from investors.[23] Sample's failure to make this showing is a deficiency that, standing alone, is a sufficient basis for us to deny his application as inconsistent with the public interest. Moreover, even if Sample, as an outside salesperson, "would be operating in a different area of [Kingsroad's] business and could not repeat the precise violations that led to his bar, [that would be] of little moment. Fraud and other misconduct can be committed in any area."[24]

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22 In "Attachment B" to his brief, Sample sets forth the proposed enhanced procedures, *i.e.*, his contact would be limited to registered investment advisers and registered representatives, he would have no access to the public or to client information, he would be subject to "advanced email and cell phone monitoring," his schedule would be monitored and approved and "all meetings/recap logged weekly," he would be subject to "[r]andom follow up with [his] contacts from prospective advisers, he would be subject to "[c]ompany monitored cell phone with spyware," his correspondence would be subject to approval, his telephone calls would be "recorded and catalogued," and he would be subject to "[w]eekly compliance meetings."

23 Sample argues that, because the bar will remain in place, he will be prohibited from engaging in the misconduct that led to the bar. But the bar does not relieve Sample of his burden under Rule 193 of showing that the supervision to be exercised over him is "reasonably designed" to prevent a recurrence of the misconduct.

24 *Sidney I. Shupak*, Advisers Act Release No. 1061, 1987 WL 757575, at *4 (Mar. 23, 1987) (denying application under former Rule 29, now Rule 193, for consent to associate with registered investment adviser, and stating that applicant, who was barred from associating with any investment adviser based on antifraud, proxy, and other securities law violations, failed to show that such association would be consistent with the public interest in light of his record, including a false statement made in his original application, and the lack of effective supervision to be exercised over him).

B. The relatively short time since the bar was imposed and events that have occurred in the meantime do not support Sample's application or the public interest in the proposed association.

Sample filed his application less than two months after the imposition of the bar, and it has been approximately 16 months since the bar was imposed.[25] In *Stephanie J. Hibler*,[26] we reviewed an application by NASD, now FINRA, for an order granting consent for Hibler, a person subject to statutory disqualification based on a criminal conviction and unqualified bar, to associate with two NASD member firms. Fourteen months after we imposed the bar, NASD notified us that it had proposed to permit the association.[27] On review, we found that we were unable to conclude that the proposed association would be in the public interest given the seriousness of Hibler's prior misconduct and sanction and the short period of time that had passed since imposition of the bar.[28] In so finding, we stated that "[w] are concerned that this application does not accord sufficient deference to the sanction imposed on Hibler by our previous decision."[29] Similarly, here, the bar is relatively recent.[30] To permit Sample to associate so soon after the imposition of the bar would be inconsistent with our determination to exclude him from the securities industry and would run counter to the remedial goals of deterrence.[31]

Sample asserts that he has complied with the bar order, is no longer associated with Kingsroad, and is "currently unemployed."[32] He has taken no action to recompense defrauded

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25 Sample's application and supporting documentation acknowledge that "very little time has passed since the imposition of the bar."

26 Exchange Act Release No. 22067, 1985 WL 548465 (May 23, 1985).

27 *Id.* at *1 & n.3.

28 *Id.* at *2.

29 *Id.*

30 *See also*, *e.g.*, *William H. Pike*, Investment Company Act Release No. 20417, 1994 WL 389872, at *2 (July 20, 1994) (denying motion to vacate settled order entered "a little more than two years" before the motion; stating that this time period "is hardly enough time to conclude that its continuation is no longer required in the public interest"), *petition denied*, 52 F.3d 1122 (D.C. Cir. 1995) (per curiam).

31 *See*, *e.g.*, *Mark S. Parnass*, Exchange Act Release No. 65261, 2011 WL 4101087, at *3 (Sept. 2, 2011) (denying in part petition to vacate bar and stating that the function of a bar "is not limited to merely preventing future identical violations, but is more broadly designed to achieve the goals of deterrence, both specific and general, to address the risks of allowing a respondent to remain in the industry, to serve as a 'legitimate prophylactic remedy consistent with [our] statutory obligations,' and, above all, to 'protect[] investors and the integrity of the markets'") (quoting *Don Warner Reinhard*, Exchange Act Release No. 63720, 2011 WL 121451, at *8 (Jan. 14, 2011)).

32 Sample argues that the opportunity to earn the amount of money needed to repay defrauded investors "is not likely in an alternative field where I have no background. My entire career has

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investors; nor has he completed any courses, seminars, or examinations subsequent to the imposition of the bar to prepare for his return to the securities business.[33] His submissions from friends and family attesting to his good character and employment performance highlight his laudable efforts to better himself and others, but they "do not negate the serious misconduct engaged in by [Sample] or provide any justification for permitting [his] re-entry into the securities industry so soon after" the bar.[34]

C. The proposed association is inconsistent with the public interest in light of the nature of the findings that resulted in the bar.

The nature of the findings that resulted in Sample's bar also lead us to conclude that the proposed association would be inconsistent with the public interest. Sample engaged in serious misconduct when he violated antifraud provisions of the securities laws.[35] The fraud, which occurred over a three-year period, resulted in significant financial loss to investors and evidenced a high degree of scienter. Sample compounded the fraud by providing false documents to investors to make it appear as if the trading had been successful, and by raising additional funds from a new investor under false pretenses and using those funds to reimburse prior investors. For this misconduct, we imposed an unqualified bar—a particularly severe sanction reserved for egregious cases.[36]

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been spent in the financial services sector and it is the only job which I am qualified for." While we are not unsympathetic to his plight, Sample has no "absolute right" to engage in the securities industry. *Nicholas S. Savva*, Exchange Act Release No. 72485, 2014 WL 2887272, at *15 & n.90 (June 26, 2014).

33 Sample represents that he has "investigated and will take FINRA courses on Ethics."

34 *Hibler*, 1985 WL 548465, at *2.

35 *See, e.g., Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *6 (Dec. 12, 2013) (reiterating that "conduct that violates the antifraud provisions of the securities laws is especially serious and subject to the severest of sanctions") (internal quotations and citation omitted), *petition denied*, 773 F.3d 89 (D.C. Cir. 2014). In "Attachment A" to his brief, Sample acknowledges that his misconduct was "serious" and involved the "improper taking" of investor funds.

36 *Unqualified Bar Orders*, 1994 WL 544424, at *1 (stating that "[a]n unqualified bar is a particularly severe sanction and is reserved for egregious cases"). Sample argues that his misconduct "should be evaluated by comparison to the behavior of other offenders and not based upon the sanctions to which he consented." But Rule 193 does not require that we draw such comparisons in considering an application for consent to associate. And, in any event, we conclude—as we did when we imposed the bar order—that the unqualified bar is an appropriate remedial sanction for his egregious misconduct.

Sample argues that his misconduct was not so egregious because he was not required to make admissions as a condition of his settlement and his fraud involved only five investors. But whether an admission is required as part of a settlement is a matter within our discretion.[37] And the fact that he defrauded five investors and not more does not lessen the egregiousness of his misconduct.[38]

In light of Sample's failure to show that the proposed supervisory procedures would prevent a recurrence of the misconduct, the relative recency of the bar, and the findings that led to the bar, we conclude that Sample has not demonstrated that the proposed association would be consistent with the public interest.

D. Sample presents no "extraordinary circumstances" that would render the proposed association consistent with the public interest.

We have said, in the analogous context of a request to modify a bar order, that "when an unqualified bar has been imposed, . . . this 'evidences [our] conclusion that the public interest is served by *permanently* excluding the barred person from the securities industry, . . . [and that] absent extraordinary circumstances, a person subject to an unqualified bar will be unable to establish that it is in the public interest to permit reentry to the securities industry."[39] Sample argues that this case presents "exceptional circumstances" which establish that his return to the securities industry is consistent with the public interest, including that: (1) he misunderstood the scope of the bar order; (2) he has a standing offer of employment; (3) he has an offer of a loan from a friend to repay investors; (4) two of the five defrauded investors support his application; and (5) he will be unable to make restitution if he is denied consent to associate. We find that none of these arguments demonstrates "extraordinary circumstances" that would render the proposed association consistent with the public interest.[40]

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37 *Cf. Shawmut Ass'n v. SEC*, 146 F.2d 791, 796 (1st Cir. 1945) (stating that Commission has "wide discretion in the choice of what 'terms' it shall impose for the protection of investors, and ordinarily a court should not undertake to substitute its judgment of what would be appropriate terms for the administrative judgment").

38 *See Michael J. Fee*, Exchange Act Release No. 31070, 1992 WL 213847, at *3 (Aug. 24, 1992) (rejecting respondent's argument that his sanctions should not be increased because only two customers testified against him, and stating that "[h]is conduct cannot be condoned because he only defrauded a small number of investors"), *aff'd*, 998 F.2d 1002 (3d Cir. 1993) (Table).

39 *Victor Teicher*, Exchange Act Release No. 58789, 2008 WL 4587535, at *2 (Oct. 15, 2008) (quoting *Unqualified Bar Orders*, 1994 WL 544424, at *1 (emphasis in original)).

40 *Accord Hibler*, 1985 WL 548465, at *2 (stating that "the record in this case does not disclose any extraordinary or changed circumstances which might justify permitting a person who was barred, unqualifiedly, from the securities industry based on serious misconduct in violation of the federal securities laws to re-enter the business as a salesperson so soon after the imposition of that bar").

First, Sample argues that he misunderstood the scope of the bar order and believed that he would be able to continue working for Kingsroad as an independent contractor. In Sample's view, it was a "radical change of circumstances" when counsel for Kingsroad's related broker-dealer IFG told him that he would not be able to keep his job. Sample argues that, had he known that the bar would preclude his continued association at Kingsroad, he would have negotiated for a more limited bar. But Sample, who at all times was represented by counsel, acknowledges that his consent to the bar (and antifraud injunction) was voluntary. As a result, we find that Sample has waived any claim of errors or inaccuracies in the bar order.[41]

Second, Sample argues that he has a standing offer of employment from Kingsroad. The offer letter states, in relevant part, that, "[w]ith stipulations, we are willing to offer you a position" at the firm.[42] It continues:

> As you are aware, we have significant hurdles to overcome before the offer will become valid. Namely: a. The SEC must agree to grant your return to our industry in such terms that allow us to offer a reasonable explanation for your rehire to our current solicitors and clients. b. In our current role as a branch office of Independent Financial Group, LLC, they retain the final say in allowing us to operate as an outside business activity. Therefore, IFG must approve your rehire.

Kingsroad's offer is predicated on a series of events that may or may not occur, and, as discussed above, Sample has not demonstrated that the proposed supervisory procedures that would be in place during his employment with Kingsroad are reasonably designed to prevent a recurrence of the misconduct. As a result, Sample has not shown that the offer constitutes "extraordinary circumstances" affecting his application.

Third, Sample argues that a friend has offered to loan him money to repay defrauded investors. As an initial matter, we note that the loan amount—$200,000 in two installments of $100,000 each—is less than the $1 million that Sample raised from investors. In addition, the loan offer, like the employment offer, depends on Sample satisfying several conditions, all of which make it highly unlikely that he would be able to obtain the loan.[43] And there are other

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41 *Edward I. Frankel*, Exchange Act Release No. 38379, 1997 WL 103785, at *2 n.5 (Mar. 10, 1997) (stating that Respondent "elected to settle the matter [bar order] and did not develop the record further" and therefore "cannot now complain that the record is inaccurate or incomplete"). Moreover, we note that Sample has offered no basis for his belief that the bar would have limited application. There is nothing in the language of the order, which broadly prohibits Sample "from association . . . with any investment advisor," that could be read as consistent with that belief.

42 The letter is attached as "Exhibit 3" to Sample's brief.

43 A November 19, 2014 letter from the putative lender, attached to Sample's brief as "Exhibit 5," sets forth four conditions: "(1) The SEC modifying the bar to allow his limited reassociation; (2) Upon successful rehire by Kingsroad Financial and its B-D Independent Financial Group; (3) Upon successful negotiation of a non-prosecution or deferred prosecution agreement with the U.S.

(continued. . .)

uncertainties associated with the loan, such as the amount of interest to be paid, the time frame for repayment, and, above all, whether Sample stands a realistic chance of acquiring the ability to repay defrauded investors, the loan, and any future judgment requiring disgorgement of ill-gotten gains or a civil penalty.[44]

Fourth, Sample argues that two of five defrauded investors have submitted letters in support of the application. But the number of victims who support his application is irrelevant. When assessing the public interest, we "evaluate the 'welfare of investors as a class' and not the interests of a particular set of investors."[45] Moreover, the letters hardly give Sample an unqualified endorsement. Rather, the letters indicate that the investors support the application because it is their only hope of recovering their losses and being made whole.[46]

Fifth, Sample argues that he will be unable to repay defrauded investors if he is not granted consent to associate. But even assuming Sample would be more likely to be in a position to repay the investors he defrauded if his application were granted, we conclude for the reasons discussed

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Attorney in Albuquerque; [and] (4) The loan would be paid back concurrently in equal shares with the Restitution to investors from [Sample's] excess post tax earnings above $60,000/year."

44 *See supra* note 7.

45 *See Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 WL 294717, at *4 (Feb 4, 2008) ("While many of [the] investors executed declarations in support of Gibson, several of those investors apparently did not do so, and their opinions are unknown. In any event, we do not believe that the views of the investors who executed the Investor Declarations should be determinative. As we have held, we look beyond the interests of particular investors, in assessing the need for sanctions, to the protection of investors generally") (footnote omitted), *petition denied*, 561 F.3d 548 (6th Cir. 2009).

46 One investor letter, attached as "Exhibit 7" to Sample's brief, states that "the loss in the fund is extremely painful both financially and emotionally. I am angry at Mr. Sample and emotionally drained by the events surrounding [the fund]....However, despite the loss and my feelings toward Mr. Sample, I support his request because it would appear this is the only possible way of receiving my money." Another investor letter, attached as "Exhibit 8," states that "we support [Sample's] request for re-association, for the sole reason that we believe it to be the only way we may ever see restitution from his conduct."

above that doing so would be inconsistent with the broader public interest we are charged with protecting. Sample's remaining arguments are likewise unavailing and do not change our view that there are no "extraordinary circumstances" which would render the proposed association consistent with the public interest.[47]

An appropriate order will issue.[48]

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

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

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[47] For example, Sample argues that he has had a "spotless record" in the thirteen years before, and two years after, the bar; that he was under extreme emotional and financial distress during the events at issue; and that "[a] single violation over a limited period of time to a limited number of victims does not demand a 'life sentence' of exclusion" from the industry. We have considered and rejected such arguments when raised in mitigation of a respondent's violations or sanctions—and we see no basis for crediting them here. *See, e.g., Daniel Imperato*, Exchange Act Release No. 74596, 2015 WL 1389046, *7 (Mar. 27, 2015) (stating that a respondent failed to show mitigating factors when he argued that imposition of a bar was unfair because it "ties [his] hands in involuntary servitude for the rest of [his] life" and destroys his "income, reputation, and the abilities for the shareholders to ever receive their well-deserved rewards and recover their investments"); *Anthony Fields, CPA*, Exchange Act Release No. 74344, 2015 WL 728005, at *22 (Feb. 20, 2015) (stating that "[h]ow a respondent might in other respects suffer as a result of his or her misconduct or the sanctions that follow—*e.g.*, loss of money, unemployment, or harm to reputation—is not a mitigating factor"); *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *9 (Feb. 13, 2009) (stating that we do not view respondent's age or lack of disciplinary history as mitigating for sanctions).

[48] 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. We deny Sample's motion for oral argument, which the Division has opposed. Rule 451(a) provides that oral argument will be allowed only if we determine that that it will significantly aid the decisional process. 17 C.F.R § 201.451(a). It appears that oral argument will not aid the decisional process because the issues raised in the petition can be determined on the basis of the papers filed by the parties without the Commission hearing oral argument.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75893/September 10, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4193/September 10, 2015

Admin. Proc. File No. 3-15850

In the Matter of

MATTHEW D. SAMPLE

ORDER AFFIRMING ACTION TAKEN BY DELEGATED AUTHORITY

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

ORDERED that the Director of the Division of Enforcement's action taken by delegated authority on February 4, 2015 in the form of an order denying Matthew D. Sample's application for consent to associate pursuant to Rule of Practice 193 be, and it hereby is, affirmed.

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 EXCHANGE ACT OF 1934
Release No. 75883 / September 10, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16804

In the Matter of Empire Gold, Inc., GMS Capital Corp., Greater China Acquisition Corp., IC2E International Inc., Intelliservices, Inc., S.F.H. Holdings I, Inc., S.F.H. Holdings II, Inc., and Sowa Jisho 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. Empire Gold, Inc. ("EGIT") (CIK No. 70202) is a dissolved Indiana corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EGIT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the

[1]In cases where the short form of the issuer's name is in all capital letters, the short form is also its stock symbol.

period ended December 31, 2000, which reported a net loss of $75,188 for the prior year. As of April 29, 2015, the common stock of EGIT was not publicly quoted or traded.

2. GMS Capital Corp. ("GMCP") (CIK No. 1434830) is a Florida corporation located in Montreal, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GMCP 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 applicable to common shares of $280,455 for the prior nine months. As of April 29, 2015, the common stock of GMCP was not publicly quoted or traded.

3. Greater China Acquisition Corp. ("GRCH") (CIK No. 1386938) is a Delaware corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GRCH is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $3,134 for the period from inception on January 9, 2007 through September 30, 2007. As of April 29, 2015, the common stock of GRCH was not publicly quoted or traded.

4. IC2E International, Inc. ("IC2E International") (CIK No. 1136465) is a delinquent Colorado corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IC2E International 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, 2007, which reported a net loss of $146,382 for the prior year. Although IC2E International filed a Form 10-K for the period ended June 30, 2007, it failed to file a Form 10-Q for the period ended March 31, 2007. As of April 29, 2015, the common stock of IC2E International was not publicly quoted or traded.

5. Intelliservices, Inc. ("Intelliservices") (CIK No. 1303662) is a void Delaware corporation located in Carlsbad, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Intelliservices 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 $500 for the prior seven months. As of April 29, 2015, the common stock of Intelliservices was not publicly quoted or traded.

6. S.F.H. Holdings I, Inc. ("S.F.H. Holdings I") (CIK No. 1117403) 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). S.F.H. Holdings I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB12G on June 28, 2000, which reported no assets, liabilites, expenses, or revenues as of April 13, 2000. As of January 26, 2015, the common stock of S.F.H. Holdings I was not publicly quoted or traded.

7. S.F.H. Holdings II, Inc. ("S.F.H. Holdings II") (CIK No. 1117404) 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). S.F.H. Holdings II is

delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB12G on July 5, 2000, which reported no assets, liabilities, expenses, or income as of April 13, 2000. As of January 26, 2015, the common stock of S.F.H. Holdings II was not publicly quoted or traded.

8. Sowa Jisho International Inc. ("Sowa Jisho") (CIK No. 1497919) is a forfeited Delaware corporation located in Foster City, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sowa Jisho 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 $6,000 for the prior six months. As of January 26, 2015, the common stock of Sowa Jisho was not publicly quoted or traded.

B. DELINQUENT PERIODIC FILINGS

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

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

11. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/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 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. 75897 / September 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16806

In the Matter of **MSGI Technology Solutions, Inc. (a/k/a MSGI Security Solutions, Inc.),** **NMI Health, Inc.,** **PlushZone, Inc., and** **ProsorCons Sports & Entertainment Co.,** **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 MSGI Technology Solutions, Inc. (a/k/a MSGI Security Solutions, Inc.), NMI Health, Inc., PlushZone, Inc., and ProsorCons Sports & Entertainment Co.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. MSGI Technology Solutions, Inc. (a/k/a MSGI Security Solutions, Inc.) (CIK No. 14280) is a revoked Nevada corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MSGI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2010, which reported a net loss of over $1.4 million for the prior three months. As of September 1, 2015, the company's stock (symbol "MSGI") was traded on the over-the-counter markets.

2. NMI Health, Inc. (CIK No. 1088213) is a Nevada corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NMI Health 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, 2013, which reported a net loss of $425,930 for the prior twelve months. As of September 1, 2015, NMI Health's stock (symbol "NANM") was quoted on OTC Link (formerly, "Pink Sheets") operated by OTC Markets Group, Inc., had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. PlushZone, Inc. (CIK No. 1143086) is a void Delaware corporation located in East Farmingdale, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PlushZone 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 November 18, 2002.

4. ProsorCons Sports & Entertainment Co. (CIK No. 1132092) 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). ProsorCons is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on March 2, 2001.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75898 / September 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16807

In the Matter of **Charles Booth, Inc., and Chatsworth Acquisitions I, 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 Charles Booth, Inc. and Chatsworth Acquisitions I, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Charles Booth, Inc. (CIK No. 1103153) is a permanently revoked Nevada corporation located in Florence, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Charles Booth, Inc. 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, 2003, which reported a net loss of $129,226 from the company's February 22, 1996 inception to September 30, 2003.

2. Chatsworth Acquisition I, Inc. (CIK No. 1372605) is a Delaware corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Chatsworth Acquisitions I, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic

reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $96,764 from the company's July 22, 2005 inception to September 30, 2012.

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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75899; File No. SR-NSCC-2015-803)

September 11, 2015

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice to Enhance NSCC's Margining Methodology as Applied to Family-Issued Securities of Certain NSCC Members

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] ("Clearing Supervision Act") and Rule 19b-4(n)(1)(i)[2] under the Securities Exchange Act of 1934 ("Act"), notice is hereby given that on August 14, 2015, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the advance notice SR-NSCC-2015-803 ("Advance Notice") as described in Items I and II below, which Items have been prepared by NSCC.[3] The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

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

This Advance Notice consists of amendments to NSCC's Rules & Procedures ("Rules") in order to enhance NSCC's margining methodology as applied to family-

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

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

3 On August 14, 2015, NSCC filed this Advance Notice as a proposed rule change (SR-NSCC-2015-003) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4, 17 CFR 240.19b-4. A copy of the proposed rule change is available at http://www.dtcc.com/legal/sec-rule-filings.aspx.

from the volatility component, or "VaR" charge, and then charging an amount calculated by multiplying the absolute value of the long net unsettled positions in that Member's family-issued securities by a percentage that is no less than 40%. The haircut rate to be charged would be determined based on the Member's rating on the credit risk rating matrix and the type of family-issued security submitted to NSCC. Fixed income securities that are family-issued securities would be charged a haircut rate of no less than 80% for firms that are rated 6 or 7 on the credit risk rating matrix, and no less than 40% for firms that are rated 5 on the credit risk rating matrix; and equity securities that are family-issued securities would be charged a haircut rate of 100% for firms that are rated 6 or 7 on the credit risk rating matrix, and no less than 50% for firms that are rated 5 on the credit risk rating matrix. NSCC would have the authority to adjust these haircut rates from time to time within these parameters as described in Procedure XV of NSCC's Rules without filing a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Act,[6] and the rules thereunder, or an advance notice with the Commission pursuant to Section 806(e)(1) of the Clearing Supervision Act,[7] and the rules thereunder.

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5 As part of its ongoing monitoring of its membership, NSCC utilizes an internal credit risk rating matrix to rate its risk exposures to its Members based on a scale from 1 (the strongest) to 7 (the weakest). Members that fall within the higher risk rating categories (i.e. 5, 6, and 7) are considered on NSCC's "Watch List", and may be subject to enhanced surveillance or additional margin charges, as permitted under NSCC's Rules. See Section 4 of Rule 2B and Section I(B)(1) of Procedure XV of NSCC's Rules, supra Note 1 [sic].

6 15 U.S.C. 78s(b)(1).

7 12 U.S.C. 5465(e)(1).

Therefore, the overall impact of NSCC's proposal, as described above, on risks presented by NSCC would be to reduce NSCC's exposure to this type of wrong-way risk by enhancing its margin methodology as applied to the family-issued securities of its Members that are on its Watch List, and present a heightened credit risk to the clearing agency or have demonstrated higher risk related to their ability to meet settlement. NSCC believes a reduction in its exposures to wrong-way risk through a margining methodology that more effectively capture [sic] the risk characteristics of these positions would contribute to the goal of maintaining financial stability in the event of a Member default and reduce systemic risk overall. Because NSCC Members that are on its Watch List present a heightened credit risk to the clearing agency or have demonstrated higher risk related to their ability to meet settlement, NSCC believes that this charge would more effectively capture the risk characteristics of these positions and can help mitigate NSCC's exposure to wrong-way risk.

NSCC will continue to evaluate its exposures to wrong-way risk, specifically wrong-way risk presented by family-issued securities, including by reviewing the impact of expanding the application of the proposed margining methodology to the family-issued securities of those Members that are not on the Watch List. NSCC is proposing to apply the enhanced margining methodology to the family-issued securities of Members that are on the Watch List at this time because, as stated above, these Members present a heightened credit risk to the clearing agency or have demonstrated higher risk related to their ability to meet settlement. As such, there is a clear and more urgent need to address NSCC's exposure to wrong-way risk presented by these firms' family-issued securities. However, any future change to the margining methodology as applied to the family-normal market conditions. By more closely capturing the risk characteristics of these positions, the proposed enhancement to the margining methodology would also assist NSCC in its continuous efforts to ensure the reliability and effectiveness of its risk-based margining methodology. In this way, the proposal would help NSCC, as a central counterparty, maintain effective risk controls, contributing to the goal of maintaining financial stability in the event of a Member default. Therefore, NSCC believes the proposal is consistent with the requirements of Section 805(b)(1) of the Clearing Supervision Act and Rule 17Ad-22(b)(1) and (2), promulgated under the Act, cited above.

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

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. NSCC shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing NSCC with prompt written notice of the extension. The proposed change 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 NSCC in writing that it does not object to the proposed change and authorizes NSCC to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of NSCC and on DTCC's website (http://dtcc.com/legal/sec-rule-filings.aspx). 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-NSCC-2015-803 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75905 / September 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16586

In the Matter of JASON MATTHEW PENNINGTON, Respondent.	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to accept the Offer of Settlement submitted by Jason Matthew Pennington ("Respondent") pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of these proceedings initiated against Respondent on June 9, 2015, pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 *et seq.*, Respondent consents to the entry of an Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Exchange Act ("Order"), as set forth below.

III.

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

1. From April 2000 to June 2010, Pennington was associated with a registered broker-dealer. Pennington, age 43, is a resident of El Reno, Oklahoma.

2. On August 5, 2014, Pennington pled guilty to, among other things, a count of wire fraud in violation of 18 U.S.C. §§ 1343 and 1349, a felony, before the United States District Court, District of Kansas, in U.S. v. Jason Matthew Pennington, Case No. 13-10031-01-JTM. On January 12, 2015, a judgment in the criminal case was entered against Pennington. Pennington was sentenced to serve 42 months of incarceration.

3. In his plea agreement, Pennington agreed that in September 2009, he forged a request to a life insurance company to withdraw $278,250 on a policy owned by another individual and then obtained control over those funds.

IV.

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

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

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading 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 Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75906 / September 11, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31821 / September 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16543

In the Matter of **Richard Krill,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTIONS 21B AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 9(d) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

On May 19, 2015, the Securities and Exchange Commission ("Commission"), deeming it appropriate and in the public interest, instituted these public administrative proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act").

II.

Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions pursuant to Sections 21B and 21C of the Securities Exchange Act of 1934 and Section 9(d) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

The Commission's public official files disclose that, at all relevant times, Lighthouse Financial Group, LLC ("Lighthouse" or "the firm") was registered with the Commission as a broker-dealer.

IV.

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

1. Richard Krill, age 57, of Whitehouse Station, New Jersey, was the Financial and Operations Principal ("FinOp") and Chief Financial Officer of Lighthouse from November 2007 to August 2010. At all relevant times, and currently, Krill has held a Series 27 license.

2. Lighthouse was registered with the Commission as a broker-dealer from August 2, 2000 until October 23, 2010. In December 2010, Lighthouse filed a petition for liquidation under the U.S. Bankruptcy Code. At all relevant times, Lighthouse's principal place of business was New York, New York. During the relevant period Lighthouse acted as an introducing broker for retail and institutional customers, engaged in proprietary trading and market-making, and acted as an underwriter or placement agent for equity and bond issuances.

3. On May 19, 2015, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange of 1934 and Section 9(b) of the Investment Company Act of 1940, Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order, and Notice of Hearing (*In the Matter of Richard Krill*, Exchange Act Rel. No. 74994 (May 19, 2015) (AP File No. 3-16543), or the "May 19, 2015 Order").

4. The May 19, 2015 Order alleged that Lighthouse failed to make and keep certain accurate records pertaining to its net capital computations and failed to file accurate financial and operational information on Form X-17A-5 (Financial and Operational Combined Uniform Single Reports ("FOCUS reports")) for the months of December 2009 and January, February, and May 2010, and also failed to file an accurate annual audited report for the year ended December 31, 2009. The May 19, 2015 Order further alleged that Respondent, as Lighthouse's FinOp, failed to meet his responsibility for the accuracy of Lighthouse's FOCUS reports and annual audited report. The May 19, 2015 Order alleged that, in preparing Lighthouse's financial statements for the year ended December 31, 2009 and calculating Lighthouse's net capital as of that date, Respondent made several errors in calculating the firm's securities inventory – as a result of failing to exercise due care – that caused the firm's reported net capital to be overstated by nearly \$5 million, or approximately 350%. The May 19, 2015 Order also alleged that Respondent was

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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.

negligent in his calculation of percentage deductions from the firm's net capital, based on classes of securities held in Lighthouse's inventory and the deductions from their market value required by Exchange Act Rule 15c3-1 [17 CFR 24015c3-1], or financial "haircut" deductions. The May 19, 2015 Order alleged that Respondent was negligent in calculating the firm's required haircut deductions for foreign currency holdings and positions in foreign-denominated securities, which resulted in Lighthouse filing materially inaccurate FOCUS reports for the months of January, February, and May 2010.

5. As a result of the conduct alleged above, the May 19, 2015 Order alleged that Respondent caused Lighthouse's violations of Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder because he willfully made, or caused Lighthouse to make, material misstatements in reports required to be filed with the Commission and thus committed acts enumerated in Exchange Act Section 15(b)(4)(A).

6. Pursuant to the May 19, 2015 Order, and Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, Respondent was ordered to cease and desist from committing or causing any violations and any future violations of Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder and was suspended 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 for a period of 12 months, effective on the second Monday following the entry of the May 19, 2015 Order.

V.

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's Offer.

Accordingly, pursuant to Sections 21B and 21C of the Exchange Act and Section 9(d) of the Investment Company Act, it is hereby ORDERED that:

Respondent shall pay disgorgement of $20,833, prejudgment interest of $3,783, and civil penalties of $25,384 to the Commission. Payment shall be made in the following installments: (1) $25,000 within 10 days of the entry of this Order and (2) the balance of $25,000, and therefore the full $50,000, within twelve months of the entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to Commission's 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 Richard Krill as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Regional Director, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, 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. 75907 / September 11, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3693 / September 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16808

In the Matter of **STEVEN M. DOMBROWSKI, CPA** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to issue an order of forthwith suspension of Steven M. Dombrowski ("Respondent" or "Dombrowski") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].[1]

II.

The Commission finds that:

1. Dombrowski, age 50, resides in Chicago, Illinois. Dombrowski received a Certified Public Accountant ("CPA") certificate in the State of Illinois. After 2006, Dombrowski continued to hold himself out as a CPA despite not being licensed or registered as a CPA with the State of Illinois.

2. On July 15, 2015, a judgment of conviction was entered against Dombrowski in *United States v. Steven M. Dombrowski*, case no. 1:14-CR-00041 in the United States District Court for the Northern District of Illinois, finding him guilty of one count of securities fraud by insider trading in the securities of Dombrowski's former employer, Allscripts Healthcare

[1] Rule 102(e)(2) provides in relevant part that "any person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

Solutions, Inc., in violation of Title 15, U.S.C. Sections 78j(b) and 78ff(a), and Title 17 C.F.R. Section 240.10b-5.

3. As a result of this conviction, Dombrowski was sentenced to 12 months and 1 day imprisonment, to be followed by two years of supervised release, and ordered to forfeit $286,211 as proceeds of his crime.

III.

In view of the foregoing, the Commission finds that Dombrowski has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Steven M. Dombrowski is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Brent J. Fields
Secretary

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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75917; File No. 4-631)

September 14, 2015

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

I. Introduction

On July 31, 2015, the New York Stock Exchange LLC ("NYSE"), on behalf of the following parties to the National Market System Plan to Address Extraordinary Market Volatility (the "Plan")[1]: BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated ("CBOE"), Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, and National Stock Exchange, Inc., NYSE MKT LLC, and NYSE Arca, Inc. (collectively with the NYSE, the "Participants"),

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[1] On May 31, 2012, the Commission approved the Plan, as modified by Amendment No. 1. See Securities Exchange Act Release No. 67091, 77 FR 33498 (Jun. 6, 2012) (File No. 4-631). On February 26, 2013, the Commission published for immediate effectiveness the Second Amendment to the Plan. See Securities Exchange Act Release No. 68953 (Feb. 20, 2013), 78 FR 13113. On April 3, 2013, the Commission approved the Third Amendment to the Plan. See Securities Exchange Act Release No. 69287, 78 FR 21483 (Apr. 10, 2013). On September 3, 2013, the Commission published for immediate effectiveness the Fourth Amendment to the Plan. See Securities Exchange Act Release No. 70273 (Aug. 27, 2013), 78 FR 54321 (Fourth Amendment). On September 26, 2013, the Commission approved the Fifth Amendment to the Plan. See Securities Exchange Act Release No. 70530, 78 FR 60937 (Oct. 2, 2013). On January 13, 2014, the Commission published for immediate effective the Sixth Amendment to the Plan. See Securities Exchange Act Release No. 71247 (Jan. 7, 2014), 79 FR 2204 (Sixth Amendment). On April 3, 2014, the Commission approved the Seventh Amendment to the Plan. See Securities Exchange Act Release No. 71851, 79 FR 19687 (Apr. 9, 2014). On February 19, 2015, the Commission approved the Eight Amendment to the Plan. See Securities Exchange Act Release No. 74323, 80 FR 10169 (Feb. 25, 2015).

filed with the Securities and Exchange Commission ("Commission") pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act")[2] and Rule 608 thereunder,[3] a proposal to amend the Plan.[4] The proposal reflects changes unanimously approved by the Participants. The Amendment to the Plan proposes to extend the pilot period of the Plan from October 23, 2015 to April 22, 2016. A copy of the Plan, as proposed to be amended is attached as Exhibit A hereto. The Commission is publishing this notice to solicit comments from interested persons on the Amendment to the Plan.[5]

II. Description of the Plan

Set forth in this Section II is the statement of the purpose and summary of the Amendment, along with the information required by Rule 608(a)(4) and (5) under the Exchange Act,[6] prepared and submitted by the Participants to the Commission.[7]

A. Statement of Purpose and Summary of the Plan Amendment

The Participants filed the Plan on April 5, 2011, to create a market-wide limit up-limit down mechanism intended to address extraordinary market volatility in NMS Stocks, as defined in Rule 600(b)(47) of Regulation NMS under the Exchange Act. The Plan sets forth procedures that provide for market-wide limit up-limit down requirements that would prevent trades in individual NMS Stocks from occurring outside of the specified price bands. These limit up-limit down requirements are coupled with Trading Pauses, as defined in Section I(Y) of the Plan, to

2 15 U.S.C. 78k-1.

3 17 CFR 242.608.

4 See Letter from Elizabeth King, General Counsel, NYSE, to Brent Fields, Secretary, Commission, dated July 31, 2015 ("Transmittal Letter").

5 17 CFR 242.608.

6 See 17 CFR 242.608(a)(4) and (a)(5).

7 See Transmittal Letter, supra note 3.

accommodate more fundamental price moves. In particular, the Participants adopted this Plan to address the type of sudden price movements that the market experienced on the afternoon of May 6, 2010.

As set forth in more detail in the Plan, all trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the limit up-limit down requirements specified in the Plan. More specifically, the single plan processor responsible for consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Exchange Act will be responsible for calculating and disseminating a lower price band and upper price band, as provided for in Section V of the Plan. Section VI of the Plan sets forth the limit up-limit down requirements of the Plan, and in particular, that all trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trades at prices that are below the lower price band or above the upper price band for an NMS Stock, consistent with the Plan.

The Plan was initially approved for a one-year pilot period, which began on April 8, 2013.[8] Accordingly, the pilot period was scheduled to end on April 8, 2014. As initially contemplated, the Plan would have been fully implemented across all NMS Stocks within six months of initial Plan operations, which meant there would have been full implementation of the Plan for six months before the end of the pilot period. However, pursuant to the fourth amendment to the Plan,[9] the Participants modified the implementation schedule of Phase II of the Plan to extend the time period as to when the Plan would fully apply to all NMS Stocks.

8 See Section VIII of the Plan.

9 See Fourth Amendment, supra note 1.

Accordingly, the Plan was not implemented across all NMS Stocks until December 8, 2013. Pursuant to the sixth amendment to the Plan,[10] which further modified the implementation schedule of Phase II of the Plan, the date for full implementation of the Plan was moved to February 24, 2014.

In addition, pursuant to the seventh amendment to the Plan,[11] the pilot period was extended from April 8, 2014 to February 20, 2015, and submission of the assessment of the Plan operations was accordingly extended to September 30, 2014. Without such extension, the Plan would have been in effect for the full trading day for less than two months before the end of the pilot period. The Participants believed that this short period of full implementation of the Plan would have provided insufficient time for both the Participants and the Commission to assess the impact of the Plan and determine whether the Plan should be modified prior to approval on a permanent basis.

On September 29, 2014, the Participants submitted a Participant Impact Assessment,[12] which provided the Commission with the Participants' initial observations in each area required to be addressed under Appendix B to the Plan. On May 28, 2015, the Participants submitted a Supplemental Joint Assessment, in which the Participants recommended that the Plan be adopted as permanent with certain modifications, and discussed the areas of analysis set forth in Appendix B to the Plan.[13] These areas are intended to capture the key measures necessary to assess the impact of the Plan and to support recommendations relating to the calibration of the

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10 See Sixth Amendment, supra note 1.

11 See Securities Exchange Act Release No. 71851 (April 3, 2014), 79 FR 19687 (April 9, 2014).

12 See Joint SROs letter to Brent J. Fields, Secretary, SEC, dated September 29, 2014 ("Participant Impact Assessment").

13 See Letter from Christopher B. Stone, Vice President, FINRA, to Brent J. Fields, Secretary, SEC, dated May 28, 2015.

Percentage Parameters to help ensure that the stated objectives of the Plan are achieved – particularly: liquidity when approaching price bands; clearly erroneous trades; the appropriateness of the percentage parameters; the attributes of limit states; the impact of limit states on the options markets; whether process adjustments are needed when entering/exiting a limit state; and the length of trading pauses.

The Participants propose to amend Section VIII(C) of the Plan to extend the pilot period through April 22, 2016, to allow the Participants to conduct, and the Commission to consider, further analysis of data in support of the recommendations made in the Supplemental Joint Assessment, including around the attributes of limit states; the length of trading pauses; the use of an alternative reference price at the open of trading; and the alignment of the percentage parameters with the Clearly Erroneous Execution (CEE) thresholds (with the goal of largely eliminating the Participants' CEE authority). Thus, an extension of the pilot period would allow the Participants to finalize and file with the Commission any proposed amendments to the Plan resulting from such recommendations and further analysis. The Participants believe that extending the pilot period is appropriate in the public interest, for the protection of investors and the maintenance of a fair and orderly market because it provides Participants with additional time to perform further analysis on the appropriateness of current Plan components and parameters, and to finalize and propose recommended modifications to the Plan.

The Participants believe that the proposed amendment is consistent with Section 11A of the Securities Exchange Act of 1934 and Rule 608, of Regulation NMS thereunder,[14] which authorizes the Participants to act jointly in preparing, filing and implementing national market system plans. The Participants further believe that extending the pilot period will be beneficial

[14] 17 CFR 242.608.

in that it allows "the public, the Participants, and the Commission to assess the operation of the Plan and whether the Plan should be modified prior to approval on a permanent basis."[15]

The Participants note that the amended version of the Plan also includes the revised Appendix A – Schedule 1, which was updated for trading beginning July 1, 2015. As set forth in Appendix A – Percentage Parameters, the Primary Listing Exchange updates Schedule 1 to Appendix A semi-annually based on the fiscal year, and such updates do not require a Plan amendment.

1. Chicago Board Options Exchange, Incorporated Withdrawal

On March 30, 2015, CBOE provided written notice to Participants of CBOE's intent to withdraw from the Plan. Notice of withdrawal was made pursuant to Section IX of the Plan.

CBOE became a Participant due to the operation of the CBOE Stock Exchange, LLC ("CBSX"), a facility of the CBOE. CBSX engaged in NMS stock transactions. The last day of trading on CBSX was April 30, 2014. Because CBOE no longer operates a facility engaged in NMS stock transactions, CBOE would have no additional NMS stock data to provide nor any reason to avail itself of any further right under the Plan. Accordingly, CBOE proposes to be removed from the Plan.

B. Governing or Constituent Documents

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

C. Implementation of Plan

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

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

D. Development and Implementation Phases

The Plan was initially implemented as a one-year pilot program in two Phases, consistent with Section VIII of the Plan: Phase I of Plan implementation began on April 8, 2013 and was completed on May 3, 2013. Implementation of Phase II of the Plan began on August 5, 2013 and was completed on February 24, 2014. Pursuant to this proposed amendment, the Participants propose to extend the pilot period so that it is set to end April 22, 2016.

E. Analysis of Impact on Competition

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

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

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

G. Approval of Amendment of the Plan

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

H. Terms and Conditions of Access

Section II(C) of the Plan provides that any entity registered as a national securities exchange or national securities association under the Exchange Act may become a Participant by: (1) becoming a participant in the applicable Market Data Plans, as defined in Section I(F) of the Plan; (2) executing a copy of the Plan, as then in effect; (3) providing each then-current

Participant with a copy of such executed Plan; and (4) effecting an amendment to the Plan as specified in Section III(B) of the Plan.

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

Not applicable.

J. Method and Frequency of Processor Evaluation

Not applicable.

K. Dispute Resolution

Section III(C) of the Plan provides for each Participant to designate an individual to represent the Participant as a member of an Operating Committee. No later than the initial date of the Plan, the Operating Committee shall designate one member of the Operating Committee to act as the Chair of the Operating Committee. Any recommendation for an amendment to the Plan from the Operating Committee that receives an affirmative vote of at least two-thirds of the Participants, but is less than unanimous, shall be submitted to the Commission as a request for an amendment to the Plan initiated by the Commission under Rule 608.

On July 30, 2015, the Operating Committee, duly constituted and chaired by Ms. Karen Lorentz of the NYSE, on behalf of Committee Chairman Mr. Christopher B. Stone of FINRA, met and voted unanimously to amend the Plan as set forth herein in accordance with Section III(C) of the Plan. The Plan Advisory Committee was notified in connection with the Ninth Amendment and was in favor.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed Ninth Amendment is consistent with the Act.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-631 on the subject line.

Paper comments:

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

All submissions should refer to File Number 4-631. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the Plan that are filed with the Commission, and all written communications relating to the Plan between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the Participants' principal offices. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number 4-631 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Brent J. Fields
Secretary

SECURITIES AND EXCHANGE COMMISSION
Release No. 34-75919

September 15, 2015

ORDER PURSUANT TO SECTIONS 15F(b)(6) AND 36 OF THE SECURITIES EXCHANGE ACT OF 1934 EXTENDING CERTAIN TEMPORARY EXEMPTIONS AND A TEMPORARY AND LIMITED EXCEPTION RELATED TO SECURITY-BASED SWAPS

I. Introduction

On June 15, 2011, the Securities and Exchange Commission ("Commission") issued an order granting temporary exemptions and exceptions from compliance with certain provisions of the Securities Exchange Act of 1934 ("Exchange Act")[1] applicable to security-based swaps ("SB swaps"), that were amended or added by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[2] The Temporary Exemptions Order provided, among other things, a temporary exemption from Section 3E(f) of the Exchange Act for security-based swap dealers and major security-based swap participants (together, "SBS Entities"), a temporary and limited exception from Section 15F(b)(6) of the Exchange Act with respect to persons then currently associated with SBS Entities, and temporary exemptions from Section 29(b) of the Exchange Act with respect to violations of Sections 3E(f) and 15F(b)(6) in connection with SB swap contracts entered into on or after July 16, 2011. The Commission is extending the exemption from Section 3E(f) and exception from Section 15F(b)(6) until the compliance date of rules we have adopted to establish a process by which SBS Entities can

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1 15 U.S.C. 78a *et seq.*

2 *See* Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, Exchange Act Release No. 64678 (June 15, 2011), 76 FR 36287 (June 22, 2011) ("Temporary Exemptions Order").

register (and withdraw from registration) with the Commission.[3] In addition, the Commission is specifying when the related exemption for Section 29(b) with respect to SB swap contracts that involve violations of Sections 3E(f) or 15F(b)(6) will expire.

II. Background

Title VII of the Dodd-Frank Act amended the Exchange Act to establish a new regulatory framework for the security-based swap markets. The provisions of Title VII generally were effective as of July 16, 2011, unless a rulemaking or other Commission action is required. The Temporary Exemptions Order provided guidance with respect to the compliance dates of Exchange Act provisions added by Title VII. It also identified those provisions with which compliance was required by the effective date of the Title VII amendments to the Exchange Act and those with which compliance is triggered by registration, adoption of final rules, or other action by the Commission.[4] Where compliance was required by the effective date of Title VII, the Temporary Exemptions Order granted certain temporary exemptions and exceptions where necessary or appropriate in the public interest, and consistent with the protection of investors.[5] The Temporary Exemptions Order included temporary exemptions from Sections 3E(f) and 29(b), and a temporary and limited exception from Section 15F(b)(6).[6]

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[3] *See* Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964 (Aug.14, 2015) ("Registration Adopting Release").

[4] *See* Temporary Exemptions Order.

[5] *See id.*

[6] Section 36(c) of the Exchange Act, 15 U.S.C. 78mm(c), limits the Commission's exemptive authority with respect to certain provisions of the Exchange Act added by Title VII, including Section 15F. However, Section 15F(b)(6) expressly authorizes the Commission to establish exceptions to this provision by rule, regulation, or order.

Section 3E of the Exchange Act, added by Section 763(d) of the Dodd-Frank Act, regulates the collection and handling of collateral for SB swaps, and sets out certain rights of the counterparties who deliver such collateral.[7] Section 3E(f) requires SBS Entities to segregate initial margin amounts delivered by their counterparties in uncleared SB swap transactions if requested to do so by such counterparties.[8] The statutory compliance date for Section 3E(f) was July 16, 2011. As explained in the Temporary Exemptions Order, the segregation required under Section 3E(f) will require expenditures of resources and time, such as the establishment of accounts and the adoption of policies and procedures setting forth the proper collection and maintenance of collateral. The Commission found that a temporary exemption from Section 3E(f) for SBS Entities was necessary or appropriate in the public interest, and was consistent with the protection of investors because it would allow persons to register as an SBS Entity in accordance with the applicable registration requirements, once established, prior to expending resources to comply with the provisions of Section 3E(f), and because it would give SBS Entities additional time to establish the necessary accounts and adopt the policies and procedures required by Section 3E(f).[9] Under the Temporary Exemption Order, the temporary exemption from Section 3E(f) would expire on the date upon which the rules adopted by the Commission to register SBS Entities become effective.

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7 15 U.S.C. 78c-5.

8 15 U.S.C. 78c-5(f).

9 *See* Temporary Exemptions Order n. 98 (providing that, "Notwithstanding the exemption granted, market participants in uncleared SB swaps may continue to voluntarily negotiate for and receive similar protections to those provided in section 3E(f) of the Exchange Act, 15 U.S.C. 78c-5(f), until compliance with such section 3E(f) is required.").

Section 15F of the Exchange Act, added by Section 764(a) of the Dodd-Frank Act, establishes the regulatory framework for SBS Entities.[10] Section 15F(b)(6) provides that "except to the extent otherwise provided by rule, regulation or order of the Commission," it shall be unlawful for an SBS Entity to permit an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, if the SBS Entity knew or should have known of the statutory disqualification.[11] In the Temporary Exemptions Order, the Commission exercised its authority under Section 15F(b)(6) to provide a temporary and limited exception for SBS Entities from the application of the prohibition in that section. Specifically, the Temporary Exemptions Order provides that persons subject to a statutory disqualification who were, as of July 16, 2011, associated with an SBS Entity and who effected or were involved in effecting security-based swaps on behalf of such SBS Entity could continue to be associated with an SBS Entity until the date upon which rules adopted by the Commission to register SBS Entities become effective. In providing this exception, the Commission explained that it intended to separately consider issues related to how an associated person that is subject to a statutory disqualification may be involved in the security-based swap business of the SBS Entity.[12] The Commission also noted that existing business relationships and market activity could be unnecessarily disrupted if market participants were required to comply with Section 15F(b)(6) before the Commission considers, through notice and comment rulemaking, whether to adopt a procedure for potential modifications of the effect of statutory

10 15 U.S.C. 78o-10.

11 15 U.S.C. 78o-10(b)(6).

12 *See* Temporary Exemptions Order at 36301.

disqualifications under Title VII of the Dodd-Frank Act for SBS Entities and what any such procedure would require.[13]

Section 29(b) of the Exchange Act generally provides that contracts made in violation of any provision of the Exchange Act, or the rules thereunder, shall be void "(1) as regards the rights of any person who, in violation of any such provision, . . . shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contracts, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contracts in violation of any such provision . . . ."[14] In the Temporary Exemptions Order, the Commission temporarily exempted any SB swap contract entered into on or after July 16, 2011 from being void or considered voidable by reason of Section 29(b) because any person that is a party to a contract violated a provision of the Exchange Act that was amended or added by Title VII of Dodd-Frank and for which the Commission has taken the view that compliance will be triggered by registration of a person or by adoption of final rules by the Commission, or has provided an exception or exemption in the Temporary Exemptions Order, until such date as the Commission specifies. The temporary exemption from Section 29(b) applies to contracts that would otherwise involve violations of, among other provisions, Sections 3E(f) or 15F(b)(6) of the Exchange Act.

The Commission received several comments in response to the Temporary Exemptions Order.[15] Although none of the commenters specifically referred to Sections 3E(f), 15F(b)(6), or

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13 *See id.*

14 15 U.S.C. 78cc(b).

15 *See* Letter from American Bankers Association, Financial Services Roundtable, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets

29(b), one commenter noted that the Temporary Exemptions Order was, in general, reasonable in terms of its scope and duration.[16] In particular, the commenter stated that the exemption from specific requirements under the Dodd-Frank Act was appropriate where the Commission had not completed "other steps, such as finalizing rules, setting up the registration regime, or establishing infrastructure."[17] Another commenter urged the Commission "to align the implementation of the self-operative provisions with the provisions that are dependent on rulemaking to ensure a coherent realization of the new swaps regulatory regime."[18]

III. Discussion

In August, 2015, the Commission adopted rules to establish a process by which SBS Entities can register (and withdraw from registration) with the Commission ("Registration Rules").[19] These rules will become effective October 13, 2015, but compliance with the Registration Rules will not be required until the later of: six months after the date of publication in the Federal Register of final rules establishing capital, margin and segregation requirements

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Association, and U.S. Chamber of Commerce, (June 10, 2011); Letter from Jirí Król, Alternative Investment Management Association Limited (July 1, 2011); Letter from Bruce C. Bennett, Covington and Burling LLP (July 1, 2011); Letter from Dennis M. Kelleher, Stephen W. Hall, Better Markets, Inc. (July 6, 2011); Letter from Jeff Gooch, MarkitSERV (July 15, 2011); Letter from Kevin Gould, Markit North America, Inc. (July 26, 2011), *available at* http://www.sec.gov/comments/s7-24-11/s72411.shtml.

16 *See* Letter from Dennis M. Kelleher, Stephen W. Hall, Better Markets, Inc. (July 6, 2011), at 2, *available at* http://www.sec.gov/comments/s7-24-11/s72411-3.pdf.

17 *See id.*

18 *See* Letter from American Bankers Association, Financial Services Roundtable, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets Association, and U.S. Chamber of Commerce(June 10, 2011).

19 *See* Registration Adopting Release.

for SBS Entities;[20] the compliance date of final rules establishing recordkeeping and reporting requirements for SBS Entities;[21] the compliance date of final rules establishing business conduct requirements under Sections 15F(h) and 15F(k) of the Exchange Act;[22] or the compliance date for final rules establishing a process for a registered SBS Entity to make an application to the Commission to allow an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on the SBS Entity's behalf ("Registration Compliance Date"). At the same time, the Commission also proposed rules that would, if adopted, establish a process for an SBS Entity to make an application to the Commission to allow an associated person subject to statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.[23]

Under the terms of the Temporary Exemptions Order, the temporary exemption from Section 3E(f) of the Exchange Act and exception from Section 15F(b)(6) of the Exchange Act

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20 The Commission previously has proposed rules to establish capital, margin and segregation requirements for SBS Entities. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012).

21 The Commission previously has proposed rules to establish recordkeeping and reporting requirements for SBS Entities. *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25193 (May 2, 2014).

22 The Commission previously has proposed rules to establish business conduct standards for SBS Entities. *See* Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 64766 (June 29, 2011), 76 FR 42395 (July 18, 2011).

23 Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Consent for Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps, Exchange Act Release No. 75612 (Aug. 5, 2105), 80 FR 51683 (Aug. 25, 2015) (proposing new Rule of Practice 194).

will expire when rules adopted by the Commission to register SBS Entities become effective. Accordingly, absent an extension, the temporary exemption from the segregation requirements in Section 3E(f) and exception from the prohibition in Section 15F(b)(6) in the Temporary Exemptions Order will expire upon the effective date of the Registration Rules, even though SBS Entities would not be required to register until the Registration Compliance Date. As stated in the Temporary Exemptions Order, the Commission continues to believe that persons should be able to register in accordance with the applicable registration requirements prior to expending resources to comply with Section 3E(f). Therefore, the Commission is extending the temporary exemption from the requirements of Section 3E(f) until the Registration Compliance Date.[24]

The Commission also continues to believe that existing business relationships and market activity may be unnecessarily disrupted if market participants were required to comply with Section 15F(b)(6) of the Exchange Act before the Commission considered, through notice and comment rulemaking, whether to adopt a procedure for potential modifications of the effect of statutory disqualifications under Title VII for SBS Entities, and what any such procedure would require.[25] As noted above, the Commission has proposed rules relating to the requirements of

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24 The Commission also notes that this extension will allow persons to have the ability to review the final capital, margin and segregation rules before being required to comply with the requirements of Section 3E(f), as the compliance date of the Registration Rules will occur no earlier than six months after the date of publication in the Federal Register of final rules establishing capital, margin and segregation requirements for SBS Entities.

25 *See supra* note 23. The Commission has provided guidance in the Registration Adopting Release regarding the dates on which SBS Entities will become subject to registration requirements based on their status as either a SBS Dealer or Major SBS Participant. *See* Registration Adopting Release, 80 FR at 48988. In accordance with this guidance, we do not believe that any entity will have the status of an SBS Entity prior to the Registration Compliance Date. However, for the avoidance of doubt and possible legal uncertainty, the Commission is extending the previously granted temporary exemption from Section 3E(f) and the temporary and limited exception from Section 15F(b)(6) until the Registration Compliance Date.

Section 15F(b)(6). The Registration Compliance Date will occur no earlier than final rules establishing a process for a registered SBS Entity to make an application to the Commission to allow an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on the SBS Entity's behalf. Accordingly, the Commission is extending the temporary and limited exception from the requirements of Section 15F(b)(6) until the Registration Compliance Date.

As discussed in the Temporary Exemptions Order, the Commission does not believe that Section 29(b) of the Exchange Act would apply to the provisions of Title VII for which the Commission has taken the view that compliance will either be triggered by registration of a person or by adoption of final rules by the Commission, or for which the Commission has provided an exception or exemption in that order. For the avoidance of doubt and to avoid possible legal uncertainty or market disruption, the Temporary Exemptions Order granted a temporary exemption from Section 29(b) until such date as the Commission specifies.[26] The Commission believes that the exemption from Section 29(b) provided under the Temporary Exemptions Order with respect to Sections 3E(f) and 15F(b)(6) of the Exchange Act will continue to apply during the period of time covered by the extensions in this Order. However, to avoid any doubt or possible legal uncertainty regarding the continuing availability of the temporary exemption from Section 29(b) with respect to Sections 3E(f) and 15(b)(6), the Commission is exercising its authority under Section 36 of the Exchange Act to continue the exemption from Section 29(b) with respect to Sections 3E(f) and 15(b)(6) until the Registration Compliance Date.

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26 *See* Temporary Exemptions Order at 36305-06.

IV. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 36 of the Exchange Act, that SBS Entities are exempt from the requirements of Section 3E(f) of the Exchange Act until the Registration Compliance Date.

IT IS HEREBY FURTHER ORDERED, pursuant to Section 15F(b)(6) of the Exchange Act, that SBS Entities are temporarily excepted from the prohibition of Section 15F(b)(6) with respect to persons subject to a statutory disqualification who were associated with an SBS Entity as of July 16, 2011, and who effect or are involved in effecting SB swaps on behalf of such SBS Entity until the Registration Compliance Date.

IT IS HEREBY FURTHER ORDERED, pursuant to Section 36 of the Exchange Act, that no SB swap contract entered into on or after July 16, 2011 shall be void or considered voidable by reason of Section 29(b) of the Exchange Act because any person that is a party to the contract violated Section 3E(f) of the Exchange Act prior to the Registration Compliance Date.

IT IS HEREBY FURTHER ORDERED, pursuant to Section 36 of the Exchange Act, that no SB swap contract entered into on or after July 16, 2011 shall be void or considered voidable by reason of Section 29(b) of the Exchange Act because any person that is a party to the contract violated Section 15F(b)(6) of the Exchange Act prior to the Registration Compliance Date.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9913 / September 15, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75928 / September 15, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4196 / September 15, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31826 / September 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16813

In the Matter of **Jeffrey B. Rubin,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b) OF THE SECURITES 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 15(b) of the 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 Jeffrey B. Rubin ("Respondent" or "Rubin").

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, Section 15(b) 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, 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. From early 2008 through March 2011 (the "relevant time period"), Jeffrey B. Rubin, the president of Pro Sports Financial, Inc. ("Pro Sports"), failed to disclose to his clients the personal expenses he was reimbursed out of the proceeds of a securities offering in which he advised them to invest. In 2007, Rubin, a close friend to many professional athletes, started Pro Sports Financial, Inc. ("Pro Sports") to assist professional athletes with their various day-to-day personal needs. Rubin also served as the investment adviser to his Pro Sports clients ("Pro Sports Clients").

2. During the relevant time period, at least thirty Pro Sports Clients, either at the recommendation of Rubin or an Alabama businessman (the "Project Developer"), invested a total of approximately $40 million in the development of an entertainment complex and casino in Dothan, Alabama called Country Crossings (the "Country Crossings Offering"). Pursuant to a private placement memorandum ("PPM"), Rubin's Pro Sports Clients invested in Country Crossings by purchasing promissory notes to help secure the land for the project. In addition, as a note holder, investors received unit interests in Country Crossings. As stated in the PPM, Rubin had an equity interest in the success of Country Crossings.

3. Rubin also spearheaded the marketing of Country Crossings to all prospective investors. Rubin sought and received from the Project Developer reimbursement of approximately $600,000 out of the offering proceeds for purported marketing expense reimbursements when, in fact, Rubin had incurred the expenses not for Country Crossing marketing purposes but rather to fund his lavish lifestyle, including for the mortgage on a multi-million dollar home, the lease payments on a Lamborghini Gallardo Spyder, cruise vacations, designer handbags and spa services for friends, and a stake in a Florida nightclub. Rubin did not

disclose to his Pro Sports Clients that he had been reimbursed for these personal expenses from the offering proceeds.

Respondent

4. **Jeffrey B. Rubin**, age 41, is a resident of Denver, Colorado. He is the founder and former president of Pro Sports Financial, Inc. From July 2006 through February 2011, Rubin was a registered representative with two SEC-registered broker-dealers. From April 2008 through February 2010, he was associated with Alterna Wealth Management, LLC ("Alterna"), now known as Socius Family Office, LLC. During the period of Rubin's association with the firm, Alterna was registered as an investment adviser with the state of Florida and, as of October 5, 2009, also with Texas. Rubin previously held Series 6, 7, 24, and 63 licenses. In March 2013, FINRA permanently barred Rubin from the securities industry based upon similar conduct at issue here. Rubin has also been named as a defendant in several private lawsuits in both federal and state court, and has been a respondent in at least two FINRA arbitrations.

Other Relevant Entities

5. **Pro Sports Financial, Inc.** was formed in 2007 and until September 2012 was a Florida corporation with its principal place of business in Fort Lauderdale, Florida. Pro Sports provided its professional athlete clients with "concierge" services such as paying monthly bills, obtaining life insurance policies, booking travel, handling tax returns, and setting up trusts for family members. Pro Sports has never been registered with the Commission in any capacity.

6. **Socius Family Office, LLC ("Socius")**, a Florida limited liability company with its principal place of business in Boca Raton, Florida, was formed in 2012. From 2007 until 2012, Socius was known first as Alterna Wealth Management, Inc. and then later as Alterna Wealth Management, LLC. From 2007 through June 2010, Alterna was registered as an investment adviser with the state of Florida. Alterna was also registered as an investment adviser with Texas as of October 5, 2009, and with New York as of March 22, 2010. On June 22, 2010, Alterna (as Socius) filed a partial Form ADV-W withdrawing its state registrations as an investment adviser in favor of SEC registration. According to its most recent Form ADV filed with the Commission on March 31, 2015, Socius has assets under management of approximately $168 million.

Background

7. In 2007, Rubin formed Pro Sports to serve as a "concierge" service for professional athletes, largely current and former NFL players with whom Rubin shared a long-term friendship. At the time, Rubin had already been working in the securities industry as a registered representative with an SEC-registered broker-dealer.

8. Rubin set up Pro Sports to serve as a one-stop-shop for a professional athlete's day-to-day personal needs such as, among other things, facilitating online monthly bill payments,

securing life insurance policies, arranging travel, vacations, and relocations, running errands, event planning, and handling car and mortgage payments.

The Country Crossings Offering

9. In or around January 2008, at least two Pro Sports Clients learned about an investment opportunity through the Project Developer. At a meeting with Pro Sports Clients, and not in Rubin's presence, the Project Developer touted the financial prospects of the Country Crossings Offering.

10. In or around March 2008, the Project Developer approached a Florida-based law firm (the "FL Law Firm") that regularly provided legal services to Pro Sports Clients to provide the legal services needed for the Country Crossings Offering, including drafting the PPM, subscription agreements, and other offering related documents (the "Offering Documents").

11. Word of the Country Crossings Offering began to spread throughout NFL locker rooms as a promising investment. As a result, Rubin began receiving numerous phone calls from his Pro Sports Clients inquiring about the prospective financial investment.

12. Shortly thereafter, a partner at the FL Law Firm contacted Rubin about the Country Crossings Offering and encouraged him to attend a meeting at the firm, along with many Pro Sports Clients. Given his clients' interest and the potential opportunity presented, Rubin decided to attend the meeting.

13. At the meeting, the Project Developer presented the Country Crossings Offering, including a discussion of the casino. According to the Project Developer, the casino would include electronic bingo, a casino game that he represented was legal in the State of Alabama. He compared Country Crossings to Branson, Missouri, stating that it would be the next "destination spot."

14. Everyone at the meeting, including Rubin and his Pro Sports Clients, was enthusiastic about the financial opportunity presented. Shortly thereafter, the FL Law Firm, without any involvement from Rubin, began drafting the Offering Documents to facilitate the Country Crossings Offering.

15. Specifically, investments made in Country Crossings were effectuated by purchasing promissory notes from Ronnie Gilley Properties, LLC, an Alabama limited liability company and the entity securing the land for Country Crossings. In addition, as a note holder, investors received unit interests in Country Crossings LLC, Resorts & Entertainment Group, II, LLC, and Resorts Development Group II, LLC. Resorts & Entertainment Group II, LLC and Resorts Development Group II, LLC, both Alabama limited liability companies, were the operating and development companies of Country Crossings, respectively.

16. Ultimately, during the relevant time period, at least thirty Pro Sports Clients invested a total of approximately $40 million in the Country Crossings Offering. Rubin recommended the Country Crossings investment to his advisory clients, including the Pro Sports Clients. The Pro Sports Clients viewed Rubin as their investment adviser with respect to all financial matters, including the Country Crossings Offering.

17. Rubin had a 4% equity interest in Country Crossings, as disclosed in the Offering Materials. His equity interest came in the form of unit interests in Country Crossings which he received at the outset, before he started marketing the project. His equity interest was not contingent upon the success of his marketing efforts or the offering. Rubin orally informed at least some of the Pro Sports Clients about his stake in the project.

Rubin Receives Investor Proceeds Under the Guise of Reimbursement for Legitimate <u>Marketing Expenses</u>

18. In or around March 2008 through as late as March 2011, Rubin marketed the Country Crossings Offering by traveling around the country to meet with prospective investors, all of whom were his friends or Pro Sports Clients. Rubin also tried to generate interest in the project by pitching celebrities to serve as spokespeople or performers for the grand opening of Country Crossings.

19. Rubin was reimbursed by the Project Developer to market the Country Crossings Offering. The majority of his Pro Sports Clients knew about this financial arrangement, and they often capitalized on the reimbursable lavish meals and swank entertainment when Rubin pitched the investment to them.

20. During the relevant period, Rubin each month charged tens of thousands of dollars in costs associated with marketing the Country Crossings Offering to his credit cards.

21. The Project Developer without asking questions approved and reimbursed any expenses that Rubin submitted to him.

22. From August 2008 through at least July 2010, the Project Developer reimbursed Rubin for the expenses Rubin incurred in marketing the Country Crossings Offering. Rubin would then apply the funds to reduce his credit card balances.

23. During that same time period, apart from other reimbursements, the Project Developer also made numerous wire transfers purportedly to reimburse Rubin for additional legitimate marketing expenses totaling approximately $600,000 from a bank account (the "Bank Account") to an account at a different bank held in the name of Pankas Holdings, LLC (the "Pankas Account"). The Bank Account was the same account Pro Sports Clients used, as set forth in the subscription agreement, to wire funds to invest in the Country Crossings Offering. Rubin was the sole beneficiary of the Pankas Account.

24. Instead, these expenses totaling approximately $600,000 were false expenses Rubin submitted to the Project Developer under the guise of legitimate marketing expenses. Rubin used approximately $600,000 of investor proceeds reimbursed to him by the Project Developer to fund his lavish lifestyle to pay for a mortgage on a multi-million dollar home, the lease payments on a Lamborghini Gallardo Spyder, and a stake in a Florida nightclub, and to pay for personal credit card charges he incurred for cruise vacations, designer handbags and spa services for friends, and numerous outings to South Beach nightclubs.

25. In January 2010, Alabama law enforcement shut down the Country Crossings casino due to state issues related to the legality of electronic bingo. The Project Developer and Rubin continued to solicit investor proceeds to reopen Country Crossings. The casino never reopened.

26. In April 2011, the Project Developer pled guilty to, among other things, bribery and money laundering related to buying and selling votes on proposed gambling legislation designed to protect gambling facilities like Country Crossings. The Project Developer is currently serving an 80 month sentence.

27. In March 2013, FINRA permanently barred Rubin for the same conduct.

Violations

28. As a result of the conduct described above, Respondent willfully violated Sections 17(a)(1) and 17(a)(3) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

29. As a result of the conduct described above, Respondent willfully violated Section 206(1) of the Advisers Act, which prohibits any investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client.

30. As a result of the conduct described above, Respondent willfully violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from, directly or indirectly, engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

Disgorgement

31. Respondent has submitted a sworn Statement of Financial Condition dated May 12, 2015, and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) 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 shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act and Sections 206(1) and 206(2) of the Advisers Act.

B. 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;

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

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

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

D. Respondent shall pay a civil money penalty of $250,000 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). Within 10 days of the entry of this Order, Respondent shall pay $100,000, and the remaining balance shall be paid in equal installments of $50,000 within 120, 240, 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 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 Jeffrey B. Rubin 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 Riewe, Co-Chief, Asset Management Unit, 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 otheramounts 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

Chair White, Commissioner Aguilar Not participating Commissioner Piwowar Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75920 / September 15, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3694 / September 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16809

In the Matter of **WILFRED ROBERT SUTCLIFFE,** **Respondent.**	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSIONS 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 Wilfred Robert Sutcliffe ("Respondent" or "Sutcliffe") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Wilfred Robert Sutcliffe, age 52, is a citizen and resident of the United Kingdom. From April 2004 until May 2012, Sutcliffe was the Finance Director for Computer Sciences Corporation (CSC)'s multi-billion-dollar contract with the United Kingdom's National Health Service ("the NHS Contract"), to build and deploy an electronic patient records system across the UK. Sutcliffe studied accounting and business finance at Manchester University. He is a fellow of the Charted Institute of Management Accountants (CIMA) in the United Kingdom.

2. CSC, a Nevada corporation headquartered in Falls Church, Virginia, sells information technology services. At all relevant times, CSC's common stock traded on the New York Stock Exchange.

3. On June 5, 2015, the Commission filed a complaint in the United States District Court for the Southern District of New York against Sutcliffe in <u>Securities and Exchange Commission v. Wilfred Robert Sutcliffe</u>, Civil Action Number 15-cv-4340 (RJS). On September 9, 2015, the court entered an order permanently enjoining Sutcliffe, by consent, from future violations of Section 17(a) of the Securities Act of 1933 (the "Securities Act") and Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 10b-5(a) and (c) and 13b2-1 promulgated thereunder, and from aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 13a-1 and 13a-13 promulgated thereunder. Sutcliffe was also barred from acting as an officer or director of any public company pursuant to Section 20(e) of the Securities Act and Section 21(d)(2) of the Exchange Act and ordered to pay $6,003.33 in disgorgement and $1,060.62 in prejudgment interest.

4. The Commission's complaint alleged that, in September 2009, Sutcliffe manipulated CSC's accounting model for the NHS Contract to maintain a 16% profit margin after learning that the contract was likely to generate a loss. This allowed CSC to report $221 million in operating profit in Q2FY2010. But for Sutcliffe's fraudulent acts, the company

would have reported a materially lower amount for that quarter, and for fiscal year 2010.

IV.

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

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

A. Sutcliffe 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

Chair White,
Commissioner Aguilar
Not participating
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75921 / September 15, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3695 / September 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16810

In the Matter of **Edward Parker, CA,** **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 Edward Parker ("Respondent" or "Parker") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Edward Parker, 42, a citizen and resident of Australia, was Controller of Computer Sciences Corporation's Australian subsidiary from 2007 until the company suspended him in August 2011. He left the company in October 2012. Parker has been a licensed Chartered Accountant in Australia since 1994.

2. Computer Sciences Corporation ("CSC"), a Nevada corporation headquartered in Falls Church, Virginia, sells information technology services. At all relevant times, CSC's common stock traded on the New York Stock Exchange.

3. On June 5, 2015, the Commission filed a complaint in the United States District Court for the Southern District of New York against Parker in Securities and Exchange Commission v. Edward Parker, Civil Action Number 15-cv-4341 (ER). On September 9, 2015, the court entered an order permanently enjoining Parker, by consent, from future violations of Section 17(a) of the Securities Act of 1933 (the "Securities Act") and Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 10b-5(a) and (c) and 13b2-1 promulgated thereunder, and from aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 13a-1 and 13a-13 promulgated thereunder. Parker was also barred from acting as an officer or director of any public company pursuant to Section 20(e) of the Securities Act and Section 21(d)(2) of the Exchange Act for a period of five years and ordered to pay $2,800 in disgorgement of ill-gotten gains and $750 in prejudgment interest.

4. The Commission's complaint alleged that Parker fraudulently inflated CSC's earnings in its first quarter of fiscal year 2009. Parker manipulated the company's earnings by using a series of improper "cookie jar" reserves and by failing to record expenses as required. Parker's actions fraudulently overstated CSC's consolidated pretax income by over 5%. But for Parker's misconduct, CSC would have missed analysts' earnings targets for the first quarter of fiscal year 2009.

IV.

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

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

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

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

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

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

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

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

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

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his practicing license is current and he has resolved all other disciplinary issues with Chartered Accountants Australia and

New Zealand. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75926 / September 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16811

In the Matter of **AgriBioTech Inc.,** **Condor Capital, Inc., and** **Tuffnell 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 AgriBioTech Inc., Condor Capital, Inc., and Tuffnell Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. AgriBio Tech Inc. (CIK No. 876320) is a permanently revoked Nevada corporation located in Henderson, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AgriBio Tech is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 1999, which reported a net loss of $23,149,625 for the prior six months.

2. Condor Capital, Inc. (CIK No. 831375) 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). Condor Capital 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, 2001, which reported a net loss of $4,009,902 from October 1, 1990 through June 30, 2001.

3. Tuffnell Ltd. (CIK No. 1450551) is a dissolved Nevada corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tuffnell 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 $263,499 for the prior twelve months.

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's Rules of Practice.

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

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

By the Commission.

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. 75927 / September 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16812

In the Matter of **Aim Safety Co., Inc.** **(a/k/a AimGlobal Technologies Co., Inc.),** **Determination, Inc.,** **Franklyn Resources II, Inc.,** **Red Oak Mining Corp.** **(a/k/a Austin Developments Corp.,** **f/k/a Universal Wing Technologies Inc.),** **and** **travelbyus, Inc.** **(f/k/a Aviation 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 Aim Safety Co., Inc. (a/k/a AimGlobal Technologies Co., Inc.), Determination, Inc., Franklyn Resources II, Inc., Red Oak Mining Corp. (a/k/a Austin Developments Corp., f/k/a Universal Wing Technologies Inc.), and travelbyus, Inc. (f/k/a Aviation Group, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Aim Safety Co., Inc. (a/k/a AimGlobal Technologies Co., Inc.) (CIK No. 1000028) is a dissolved British Columbia corporation located in Delta, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange

Act Section 12(g). Aim Safety is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR on December 29, 1995, which it amended on November 27, 1998.

2. Determination, Inc. (CIK No. 1120814) is a dissolved Colorado corporation located in Colorado Springs, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Determination is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB12G registration statement on August 4, 2000.

3. Franklyn Resources II, Inc. (CIK No. 1101226) is a permanently revoked Nevada corporation located in Glendale, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Franklyn Resources II 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, 2008, which reported a net loss of $93,179 from the company's March 3, 1999 inception through June 30, 2008.

4. Red Oak Mining Corp. (a/k/a Austin Developments Corp., f/k/a Universal Wing Technologies Inc.) (CIK No. 1245108) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Red Oak Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR12G registration statement on June 30, 2003. As of September 15, 2015, the company's stock (symbol "UNIGF") was traded on the over-the-counter markets.

5. travelbyus, Inc. (CIK No. 355906) is a forfeited Texas corporation located in White Rock, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). travelbyus 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, 2001, which reported a net loss of $54,991 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75933 / September 16, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3696 / September 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16815

In the Matter of Joseph F. Apuzzo, CPA Respondent.	ORDER INSTITUTING PUBLIC 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 Joseph F. Apuzzo ("Respondent" or "Apuzzo") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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1 Rule 102(e)(3)(i) provides, in pertinent part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Public 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. Apuzzo, age 59, was licensed as a certified public accountant in the State of New York beginning in 1986 until he allowed his license to lapse in 1995. He served as Vice President of Finance of Terex Corporation ("Terex") from 1995 to 1996, Comptroller of Terex from 1996 to 1998, and Chief Financial Officer of Terex from October 1998 until September 2002, when he became President of Terex Financial Services. He resigned from Terex in August 2005.

2. Terex was, at all relevant times, a Delaware corporation with its principal place of business in Westport, Connecticut. Terex is a diversified global manufacturer of a broad range of equipment primarily for construction, infrastructure and surface to mining industries. At all relevant times, Terex's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and trades on the New York Stock Exchange.

3. On December 27, 2007, the Commission filed a complaint against Apuzzo in SEC v. Joseph F. Apuzzo (Civil Action No. 3:07-cv-01910-AWT). On September 8, 2015, the court entered an order permanently enjoining Apuzzo, by consent, from violation of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 thereunder, and from aiding and abetting violation of Sections 13(a) and13(b)(2)(A) of the Exchange Act and Rule 13a-1 thereunder. Apuzzo was also ordered to pay a civil money penalty in the amount of $100,000.

4. The Commission's complaint alleged, among other things, that Apuzzo knowingly and substantially aided and abetted former officers of United Rentals, Inc. ("URI") with URI's violations of the antifraud, reporting, and books and records provisions of the federal securities laws, by among other things, improperly recognizing revenue from two fraudulent sale-leaseback transactions between URI and Terex. In both transactions, URI sold used equipment to a financing company, General Electric Capital Corporation ("GECC"), and then leased it back for an 8-month period. The complaint alleges that URI also arranged, through Apuzzo, for Terex to remarket the equipment at the end of the lease period and to provide GECC

with a residual value guarantee under which Terex guaranteed that GECC would receive not less than 96 percent of the purchase price that it had paid URI for the used equipment. For one of the transactions, URI and Terex also entered into a "backup" remarketing agreement, signed by Apuzzo, under which URI effectively assumed Terex's remarketing obligations and guarantees to GECC and agreed to cover, through guaranteed future purchases, any losses to Terex over the amount of a $5 million advance payments made by URI. As a result of this fraudulent accounting, the complaint alleges that the financial statements and results that URI incorporated into its periodic filings and other materials disseminated to the investing public were materially false and misleading. The Complaint alleges that Apuzzo knowingly provided substantial assistance to URI in perpetrating the fraud by helping to conceal URI's assumption of the risks and obligations of the transactions from URI's auditors. The Complaint alleges that Apuzzo also knew that the price of the equipment being paid by GECC to URI was inflated above fair market value and would therefore cause Terex to suffer a loss.

IV.

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

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

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

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

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

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

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

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

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

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Brent J. Fields
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 270 and 274

Release No. IC-31828; File No. S7-07-11

RIN 3235-AL02

Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting certain amendments, initially proposed in March 2011 and re-proposed in July 2014, related to the removal of credit rating references in rule 2a-7, the principal rule that governs money market funds, and Form N-MFP, the form that money market funds use to report information to the Commission each month about their portfolio holdings, under the Investment Company Act of 1940 ("Investment Company Act" or "Act"). The amendments will implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). In addition, the Commission is adopting amendments to rule 2a-7's issuer diversification provisions to eliminate an exclusion from these provisions that is currently available for securities subject to a guarantee issued by a non-controlled person.

DATES: Effective Date: [insert date 30 days after date of publication in the Federal Register]; Compliance Date: October 14, 2016.

FOR FURTHER INFORMATION CONTACT: Adam Bolter, Senior Counsel; Erin C. Loomis, Senior Counsel; Amanda Hollander Wagner, Senior Counsel; Thoreau Bartmann, Branch Chief; or Sarah G. ten Siethoff, Assistant Director, Investment Company

Rulemaking Office, at (202) 551–6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–8549.

Table of Contents

I. BACKGROUND

A. Credit Rating References

Section 939A of the Dodd-Frank Act requires each federal agency, including the Commission, to "review any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument and any references to or requirements in such regulations regarding credit ratings."[1] That section further provides that each such agency shall "modify any such regulations identified by the review . . . to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations."[2]

As a step toward implementing these mandates, and as a complement to similar initiatives by other federal agencies,[3] in March 2011 the Commission proposed to replace references to credit ratings issued by nationally recognized statistical rating organizations ("NRSROs") in two rules and four forms under the Securities Act of 1933 ("Securities Act") and the Investment Company Act, including rule 2a-7 and Form N-MFP under the Investment Company Act.[4] We

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1 Pub. Law 111-203, Sec. 939A(a)(1)-(2). Section 939A of the Dodd-Frank Act applies to all federal agencies.

2 Pub. Law 111-203, Sec. 939A(b). Section 939A of the Dodd Frank Act provides that agencies shall seek to establish, to the extent feasible, uniform standards of creditworthiness, taking into account the entities the agencies regulate and the purposes for which those entities would rely on such standards.

3 A number of other federal agencies have also taken action to implement Section 939A of the Dodd-Frank Act, as discussed in Removal of Certain References to Credit Ratings and Amendment to the Issuer Diversification Requirement in the Money Market Fund Rule, Investment Company Act Release No. 31184 (Jul. 23, 2014) [79 FR 47986 (Aug. 14, 2014)] ("2014 Proposing Release" or "Proposing Release").

4 *See* References to Credit Ratings in Certain Investment Company Act Rules and Forms, Investment Company Act Release No. 29592 (Mar. 3, 2011) [76 FR 12896 (Mar. 9, 2011)] ("2011 Proposing Release").

subsequently adopted certain of the rule provisions proposed in 2011: namely, amendments to rule 5b-3 under the Investment Company Act, new rule 6a-5 under the Investment Company Act, and amendments to Forms N-1A, N-2, and N-3 under the Securities Act and the Investment Company Act.[5] But in light of comments received on the 2011 proposed amendments to rule 2a-7 and Form N-MFP, and in conjunction with the wider money market fund reforms that the Commission adopted in July 2014 (the "2014 money market fund reforms"),[6] we decided to re-propose the amendments to rule 2a-7 and Form N-MFP instead of adopting them directly following the 2011 proposal.[7] Specifically, the 2014 re-proposed amendments to rule 2a-7 and Form N-MFP (the "2014 Proposing Release," "Proposing Release," or "proposal"[8]) responded to concerns that commenters raised with respect to the 2011 proposal.

We received 16 comment letters on the 2014 proposal.[9] The majority of commenters generally supported the proposed amendments to varying degrees.[10] However, many

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5 In December 2013, we adopted amendments removing references to credit ratings in rule 5b-3 and eliminating the required use of credit ratings in Forms N-1A, N-2, and N-3. *See* Removal of Certain References to Credit Ratings under the Investment Company Act, Investment Company Act Release No. 30847 (Dec. 27, 2013) [79 FR 1316 (Jan. 8, 2014)] ("2013 Ratings Removal Adopting Release"). We adopted new rule 6a-5 on November 19, 2012. *See* Purchase of Certain Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption, Investment Company Act Release No. 30268 (Nov. 19, 2012) [77 FR 70117 (Nov. 23, 2012)].

6 *See* Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (Jul. 23, 2014) [79 FR 47736 (Aug. 14, 2014)] ("2014 Money Market Fund Adopting Release").

7 *See* 2014 Proposing Release, *supra* note 3.

8 For clarity and because the re-proposal issued in July 2014 functions as the proposal for this adopting release, we refer to the re-proposal simply as the proposal throughout.

9 The comment letters on the Proposing Release (File No. S7-07-11) are available at http://www.sec.gov/comments/s7-07-11/s70711.shtml. The Commission received 18 comment letters on the Proposing Release, but 2 of these letters did not discuss amendments to remove NRSRO credit ratings references from rule 2a-7 and Form N-MFP.

10 Comment Letter of Chris Barnard (Aug. 23, 2014) ("Barnard Comment Letter"); Comment Letter of Michael Mark-Berger (Jul. 28, 2014) ("Berger Comment Letter"); Comment Letter of

commenters expressed concern about the proposed "exceptionally strong" standard to replace credit ratings references in the requirements of rule 2a-7 for those securities eligible to be purchased by money market funds.[11] These commenters suggested that the proposed "exceptionally strong" standard could lead to interpretive confusion in light of the similar existing "minimal credit risk" requirement, and might potentially change the kinds of securities that funds could purchase, contrary to the intent of the proposal to retain a similar degree of credit quality standards as under current rule 2a-7.[12]

In adopting final amendments to rule 2a-7 and Form N-MFP to implement Section 939A of the Dodd-Frank Act, we have carefully considered the comments received, and the final amendments include certain modifications intended to respond to commenters' concerns. As proposed, we are adopting amendments to rule 2a-7 that would remove references to ratings and adopt a uniform standard to define an eligible security to be a security that has been determined

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BlackRock, Inc. (Oct. 14, 2014) ("BlackRock Comment Letter"); Comment Letter of CFA Institute (Oct. 14, 2014) ("CFA Institute Comment Letter"); Comment Letter of the Investment Company Institute (Oct. 14, 2014) ("ICI Comment Letter"); Comment Letter of the Independent Directors Council (Oct. 7, 2014) ("IDC Comment Letter"); Comment Letter of Invesco Ltd. (Oct. 14, 2014) ("Invesco Comment Letter"); Comment Letter of Mutual Fund Directors Forum (Sep. 14, 2014) ("MFDF Comment Letter"); Comment Letter of Charles Schwab Investment Management, Inc. (Oct. 14, 2014) ("Schwab Comment Letter").

11 We proposed to replace the reference to NRSRO credit ratings in rule 2a-7's definition of "eligible security" with a required finding that each security's issuer "has an exceptionally strong capacity to meet its short-term financial obligations." *See* 2014 Proposing Release, *supra* note 3, at section II.A.1. Many commenters expressed concern about this proposed standard. *See* Comment Letter of Better Markets, Inc. (Oct. 14, 2014) ("Better Markets Comment Letter"); Comment Letter of the Consumer Federation of America (Oct. 14, 2014) ("CFA Comment Letter"); Comment Letter of the Dreyfus Corporation (Oct. 14, 2014) ("Dreyfus Comment Letter"); Comment Letter of Fidelity Investments (Oct. 14, 2014) ("Fidelity Comment Letter"); ICI Comment Letter; Comment Letter of the Committee on Investment Management Regulation of the New York City Bar (Oct. 14, 2014) ("NYC Bar Comment Letter"); Schwab Comment Letter; Comment Letter of the Securities Industry and Financial Markets Association (Oct. 14, 2014) ("SIFMA Comment Letter"); Comment Letter of Vanguard (Oct. 14, 2014) ("Vanguard Comment Letter"); *see also infra* section II.A.

12 *See, e.g.,* Dreyfus Comment Letter; Fidelity Comment Letter.

to present minimal credit risks. However, we have eliminated the proposed "exceptionally strong capacity" standard from this determination, and as a substitute for this finding, the final rule amendments require that a minimal credit risk determination include, to the extent appropriate, an analysis of the guidance factors discussed in the preamble of the Proposing Release.[13] We believe that this approach will better fulfill the original goals of the rulemaking by replacing credit ratings references with a new standard that includes objective factors, which is designed to retain a similar degree of credit quality in money market fund portfolios as under the current rule.

For these reasons, we are also adopting a similar approach for funds to determine whether a long-term security subject to a conditional demand feature is an eligible security.[14] Finally, we are also adopting other amendments to rule 2a-7 and Form N-MFP, including the requirement that funds engage in ongoing monitoring of their portfolio securities and perform stress testing for a credit deterioration rather than specifically for a ratings downgrade, substantially as they were proposed, with certain changes as discussed below.

B. Exclusion from the Issuer Diversification Requirement

Rule 2a-7's risk limiting conditions require a money market fund's portfolio to be diversified, both as to the issuers of the securities it acquires and providers of guarantees and demand features related to those securities.[15] When we proposed the amendments to rule 2a-7 that were adopted as part of the 2014 money market fund reforms, we discussed and sought comment on alternatives to the rule's diversification provisions that we had considered to

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[13] *See* rule 2a-7(a)(11); *see also infra* section II.A.

[14] *See* rule 2a-7(d)(2)(iii); *see also infra* section II.B.

[15] *See* rule 2a-7(d)(3).

appropriately limit money market funds' risk exposure.[16] Some of the comments we received in response prompted us to re-evaluate the current exclusion to the issuer diversification requirement for securities subject to a guarantee issued by a non-controlled person.[17] In consideration of these comments, and consistent with our reform goal of limiting concentrated exposure of money market funds to particular economic enterprises, as part of the 2014 proposal we proposed an amendment that would eliminate this exclusion from rule 2a-7's issuer diversification requirement.[18]

We received 8 comment letters discussing the proposed issuer diversification amendment,[19] with most of these commenters opposing the proposed amendment.[20] After carefully considering the comments we received, as well as the staff's updated analysis of relevant data, the Commission is adopting the proposed diversification amendments as proposed.[21] We believe that, on balance, adopting the proposed issuer diversification amendment

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16 *See* Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 30551 (Jun. 5, 2013) [78 FR 36834 (Jun. 19, 2013)] ("2013 Money Market Fund Proposing Release").

17 *See, e.g.,* 2014 Money Market Fund Adopting Release, *supra* note 6, at n.1612 and accompanying text. Current rule 2a-7's risk limiting conditions generally require that money market funds limit their investments in the securities of any one issuer of a first tier security (other than government securities) to no more than 5 percent of total assets. Money market funds must also generally limit their investments in securities subject to a demand feature or a guarantee to no more than 10 percent of total assets from any one provider. Notwithstanding these conditions, a money market fund is not required to be diversified with respect to issuers of securities that are subject to a guarantee issued by a non-controlled person. *See* current rule 2a-7(d)(3); *see also infra* section II.F (detailed discussion of current issuer diversification requirements).

18 *See* Proposing Release, *supra* note 3, at section II.C.

19 *See* Better Markets Comment Letter; BlackRock Comment Letter; Dreyfus Comment Letter; ICI Comment Letter; Schwab Comment Letter; Comment Letter of the Structured Finance Industry Group (Oct. 14, 2014) ("SFIG Comment Letter"); SIFMA Comment Letter; Vanguard Comment Letter.

20 *See* BlackRock Comment Letter; Dreyfus Comment Letter; ICI Comment Letter; SFIG Comment Letter; SIFMA Comment Letter; Vanguard Comment Letter.

21 *See* rule 2a-7(d)(3).

will help increase the resiliency of money market funds, and thereby better protect their investors, by limiting their ability to have concentrated exposure to any particular issuer. We are also adopting several technical amendments to Form N-MFP and the portfolio diversification provisions of rule 2a-7.[22]

II. DISCUSSION

A. Eligible Securities

Under current rule 2a-7, money market funds must limit their portfolio investments to securities that are both "eligible securities" and have been determined by fund boards to pose minimal credit risks to the fund.[23] Currently, rule 2a-7 defines "eligible securities" largely by reference to NRSRO ratings, and generally requires that 97% of a fund's portfolio securities be rated in the top short-term credit quality category by an NRSRO[24] (known as "first tier" securities).[25]

The proposal would have eliminated the rule's reference to NRSRO ratings in the eligible security definition, and consolidated the minimal credit risk standard into a single new standard under rule 2a-7's definition of eligible security.[26] As a substitute for NRSRO ratings in the eligible security definition, the proposed new standard would have required an eligible security

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[22] *See infra* sections II.E. and II.F.

[23] Current rule 2a-7(d)(2)(i).

[24] Rule 2a-7 limits a money market fund's portfolio investments to "eligible securities," or securities that have received credit ratings from the "requisite NRSROs" in one of the two highest short-term rating categories or comparable unrated securities. A requisite NRSRO is an NRSRO that a money market fund's board of directors has designated for use (a "designated NRSRO") and that issues credit ratings that the board determines, at least annually, are sufficiently reliable for the fund to use in determining the eligibility of portfolio securities. *See* current rule 2a-7(a)(11), (a)(24).

[25] Current rule 2a-7(a)(12). The rule currently also permits up to 3% of a fund's portfolio to be invested in so called "second tier" securities, or securities which are rated in the second highest short-term credit quality category by an NRSRO. Current rule 2a-7(d)(2)(ii).

[26] *See* proposed rule 2a-7(a)(11).

to be a security with a remaining maturity of 397 calendar days or less that the fund's board of directors (or its delegate[27]) determined presents minimal credit risks, which determination would have included a finding that the security's issuer has an exceptionally strong capacity to meet its short-term financial obligations. Thus, under our proposal, a money market fund would have been limited to investing in securities that the fund's board (or its delegate) had determined present minimal credit risks, notwithstanding any rating the security may have received. To assist funds in their minimal credit risk determination under the revised standard, the proposal also included as guidance a number of factors that funds should consider, to the extent appropriate,a s part of that process.[28] These credit analysis factors were presented in both a primary list of factors generally applicable to all securities, and a secondary list of factors applicable to specific asset classes. In addition, under the proposal, fund boards would no longer have been required to designate NRSROs or to use their ratings to determine first or second tier status.[29] Accordingly, the proposal would have eliminated the distinction between first and second tier securities, and would have removed the prohibition on funds investing more than

27 *See* current rule 2a-7(j) (permitting a money market fund's board to delegate to the fund's investment adviser or officers a number of the determinations required to be made by the fund's board under the rule, including minimal credit risk determinations).

28 Proposing Release, *supra* note 3, at 47991-47993. The proposal also requested comment on these factors and whether codifying these factors would further ensure that funds use objective factors and market data in making credit quality determinations and thereby promote uniformity in making minimal credit risk determinations and/or assist money market fund managers in understanding their obligations pertaining to portfolio quality under rule 2a-7.

29 *See* proposed rule 2a-7(a)(11); 2a-7(d)(2); current rule 2a-7(d)(2)(ii). In conforming changes, the proposal would have moved the requirement currently in the definition of eligible security that the issuer of a demand feature or guarantee promptly notify the holder of the security in the event the demand feature or guarantee is substituted with another demand feature or guarantee (if such substitution is permissible) to the paragraphs of the rule that address securities subject to guarantees and conditional demand features. *Compare* current rule 2a-7(a)(12)(iii)(B) *with* proposed rule 2a-7(d)(2)(ii) and 2a-7(d)(2)(iii)(D). We are adopting these amendments as proposed.

3 percent of their portfolios in second tier securities.[30] The intent of these proposed amendments was to remove references to NRSRO ratings from rule 2a-7 while retaining a degree of credit risk similar to that permitted under the current rule.

Most of the commenters who discussed the proposed definition of "eligible security" generally supported it,[31] although, as described below, many of these commenters expressed certain reservations about details of the Commission's approach and various aspects of the proposed definition. Two commenters supported the elimination of the first and second tier distinction.[32] However, two other commenters expressed concern that removal of the distinction and the limit on second tier securities could lead to funds purchasing more risky securities.[33] Some of the commenters who supported the amendment stated that the Commission's proposed definition of eligible security would provide an appropriate substitute standard of creditworthiness in rule 2a-7.[34] Other commenters who opposed the definition,[35] and even some that generally supported the Commission's approach,[36] cautioned that the lack of objective criteria in the proposed definition could make it more likely that money market funds would increase their exposure to riskier securities. Specifically, some commenters argued that the

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30 Money market funds also are currently limited from investing more than 0.5% of their assets in second tier securities of a single issuer and 2.5% of their portfolios in second tier securities issued, guaranteed or subject to a demand feature issued by the same entity. *See* current rule 2a-7(d)(3)(i)(C) and 2a-7(d)(3)(iii)(C). These limits also would be eliminated under the final rule.

31 *See, e.g.,* CFA Institute Comment Letter; MFDF Comment Letter; Schwab Comment Letter.

32 *See* Fidelity Comment Letter; MFDF Comment Letter.

33 *See* Better Markets Comment Letter; CFA Comment Letter.

34 CFA Institute Comment Letter; Invesco Comment Letter; MFDF Comment Letter.

35 CFA Comment Letter; Vanguard Comment Letter.

36 BlackRock Comment Letter; CFA Institute Comment Letter.

proposed definition would produce an incentive for money market funds to reach for yield.[37] A number of commenters also contended that the proposed definition might decrease uniformity among funds in evaluating credit risk, which could cause certain funds to present significantly greater risks to investors than others.[38]

Some commenters who acknowledged that the removal of credit ratings from rule 2a-7 could create incentives for funds to invest in riskier securities also suggested that certain countervailing factors would alleviate this concern. These commenters stated that revising the definition of eligible security should mitigate concerns about increased credit risk and decreased uniformity by creating a single standard for identifying eligible securities, particularly when viewed in conjunction with the proposed Form N-MFP disclosure requirements and new disclosure requirements that were adopted as part of the 2014 money market fund reforms (which we expect would help to expose the increased volatility and other risks that could accompany greater investment in riskier portfolio holdings).[39]

While generally supporting the overall approach of incorporating the eligible security definition into the general minimal credit risk determination, multiple commenters expressed concerns about the proposed secondary "exceptionally strong capacity" standard incorporated in the proposed definition of eligible security. They suggested that the Commission should reconsider or clarify this standard for a number of reasons. Several commenters argued that the word "exceptional" implies something unusual or extraordinary, which could be read as not including a large number of money market securities of very high credit quality that comprise a

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[37] *See id.*

[38] BlackRock Comment Letter; CFA Comment Letter; CFA Institute Comment Letter; NYC Bar Comment Letter; Schwab Comment Letter; Vanguard Comment Letter.

[39] *See* CFA Institute Comment Letter; Invesco Comment Letter; Schwab Comment Letter; SIFMA Comment Letter.

portion of money market fund portfolios today.[40] Commenters also argued that the word "exceptional" is not commonly used with gradations, yet rule 2a-7 was designed to allow different gradations of high quality securities.[41] Accordingly, these commenters argued that the proposed standard might have the effect of restricting the universe of securities which money market funds could purchase, contrary to the stated goal of the proposal of seeking to retain a similar degree of credit quality in fund portfolios as under the current rule.[42]

Some commenters also contended that the "exceptionally strong capacity" language adds an unnecessary standard to a money market fund's minimal credit risk analysis and imposes burdens on advisers without any corresponding benefit to investors.[43] Specifically, these commenters argued that money market funds' minimal credit risk determinations already provide the framework for making a definitive finding of creditworthiness, and previously provided staff guidance regarding minimal credit risk factors has enhanced clarity and consistency in the application of this standard across the industry.[44] Commenters argued that the "exceptionally strong capacity" standard would result in confusion for the industry[45] and operational and

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40 Fidelity Comment Letter; Dreyfus Comment Letter; ICI Comment Letter; NYC Bar Comment Letter; Schwab Comment Letter; SIFMA Comment Letter.

41 Dreyfus Comment Letter; ICI Comment Letter; NYC Bar Comment Letter; SIFMA Comment Letter.

42 *See, e.g.,* Dreyfus Comment Letter; ICI Comment Letter; NYC Bar Comment Letter; SIFMA Comment Letter.

43 Dreyfus Comment Letter; Fidelity Comment Letter; SIFMA Comment Letter.

44 Dreyfus Comment Letter; Fidelity Comment Letter; SIFMA Comment Letter. In addition to presenting updated guidance on credit analysis factors, *see supra* note 28, the Proposing Release noted that Commission staff has previously provided guidance on specific factors that a board could consider in making minimal credit risk determinations under rule 2a-7. *See* Letter to Registrants from Kathryn McGrath, Director, Division of Investment Management, SEC (May 8, 1990) ("1990 Staff Letter"); *see also* Letter to Matthew Fink, President, Investment Company Institute from Kathryn McGrath, Director, Division of Investment Management, SEC (Dec. 6, 1989) ("1989 Staff Letter").

45 Dreyfus Comment Letter; Fidelity Comment Letter.

procedural burdens[46] that money market funds' current minimal credit risk analysis does not entail. Commenters raising these concerns advocated for a modified approach that restricts money market fund investments to those that the fund's board (or the board's delegate) determines present minimal credit risks, but this determination would not involve an additional finding that the security's issuer has an exceptionally strong capacity to meet its short-term financial obligations (or any similar finding).[47] In addition, some commenters argued that the difference between the "exceptionally strong" and "very strong" (the proposed new standard relating to conditional demand features discussed below) standards is not readily apparent, and argued that a consistent credit risk standard should apply equally to eligible securities and securities subject to a conditional demand feature, as discussed below.[48]

Numerous commenters expressed support for the guidance factors included in the Proposing Release.[49] One commenter, however, objected to the inclusion of the asset-specific factors, suggesting that they could become stale and outdated.[50] Commenters who supported the use of these factors stated that the factors were consistent with best practices and appropriately tailored.[51] Some commenters presented technical recommendations about specific guidance factors.[52] One commenter suggested including additional guidance factors regarding

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46 Fidelity Comment Letter.

47 Dreyfus Comment Letter; Fidelity Comment Letter; SIFMA Comment Letter.

48 IDC Comment Letter; Schwab Comment Letter; *see infra* section II.B.

49 *See, e.g.,* Better Markets Comment Letter; BlackRock Comment Letter; CFA Comment Letter; ICI Comment Letter; IDC Comment Letter; NYC Bar Comment Letter; Schwab Comment Letter.

50 ICI Comment Letter.

51 IDC Comment Letter; MFDF Comment Letter.

52 Fidelity Comment Letter; ICI Comment Letter. The first commenter provided suggestions regarding guidance on two of the asset-specific credit factors, asset-backed securities and repurchase agreements. These suggestions have been adopted in this release, as discussed below. The second commenter suggested that the phrase "worst case scenario" should be removed from

counterparty relationships and the effects of rising interest rates on credit risk.[53]

Commenters' opinions varied on whether the guidance factors should be codified. Multiple commenters expressed support for preserving the factors as guidance, rather than codifying them, in order to provide funds with flexibility and the ability to respond to changing market conditions, financing terms, laws, and regulations.[54] Conversely, some commenters urged the Commission to codify the guidance factors as part of rule 2a-7.[55] One commenter argued that codification of the factors would enhance investor protections.[56] Another commenter stated that the inclusion of the factors in rule 2a-7 would promote uniform credit quality standards in the absence of specific NRSRO ratings requirements, and would facilitate inspections by Commission staff to aid in maintaining those standards.[57] The commenters who specifically mentioned the secondary list of asset-specific factors mostly supported them.[58] Two of these commenters believed that the asset-specific factors should be incorporated into the rule,[59] but others opposed codification of any of the factors, including the asset-specific ones.[60]

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the list of general factors. Because the phrase limited the situations that might be analyzed under this factor, we are not including this phrase in the final rule. *See* rule 2a-7(a)(11)(i)(C).

53 CFA Institute Comment Letter.

54 ICI Comment Letter; IDC Comment Letter; Schwab Comment Letter. Similarly, some commenters suggested that the Commission reiterate that the list of factors is not meant to be exhaustive. *See* IDC Comment Letter; MFDF Comment Letter; SIFMA Comment Letter.

55 Better Markets Comment Letter; CFA Comment Letter; NYC Bar Comment Letter.

56 Better Markets Comment Letter.

57 NYC Bar Comment Letter. Two of the commenters supporting codification also recommended that the Commission require a fund's analysis of the factors to be appropriately documented. *See* Better Markets Comment Letter; CFA Comment Letter.

58 Better Markets Comment Letter; BlackRock Comment Letter; MFDF Comment Letter; NYC Bar Comment Letter; Schwab Comment Letter.

59 Better Markets Comment Letter; NYC Bar Comment Letter.

60 *See, e.g.,* BlackRock Comment Letter; Schwab Comment Letter; ICI Comment Letter. *See also* CFA Institute Comment Letter (providing a list of factors that it considered appropriate,

One commenter opposed the inclusion of the asset-specific factors even as guidance, stating that the dynamic nature of the marketplace could cause such specific guidance to become stale and outdated.[61]

1. Revised "Eligible Security" Definition

After review of comments received, we are today adopting a revised standard for eligible securities under rule 2a-7 that does not require an "exceptionally strong capacity" fund board finding, but instead requires a single uniform minimal credit risk finding, based on the capacity of the issuer or guarantor of a security to meet its financial obligations.[62] As a complement to this uniform minimal credit risk standard, we are also today codifying the general credit analysis factors into rule 2a-7, the use of which should assist fund boards by serving as objective and verifiable tools to rely on in the absence of NRSRO ratings and which should help to achieve our goal of maintaining a similar degree of credit risk as in current money market fund portfolios.[63]

We have been persuaded by the commenters that suggested that the "exceptionally strong

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comprised of only the primary factors with two suggested additions, though it did not discuss possible codification).

61 ICI Comment Letter.

62 Rule 2a-7(a)(11). We are also adopting as proposed the elimination of the following defined terms from the rule: "designated NRSRO," "first tier security," "rated security," "requisite NRSROs," "second tier security," and "unrated security." We are also making final several proposed revisions of provisions in the rule that currently reference these terms. *See* current rule 2a-7(a)(12) (eligible security); rule 2a-7(d)(2) (portfolio quality); rule 2a-7(d)(3)(i)(A)(1) and (C) (portfolio diversification); rule 2a-7(d)(3)(iii)(C) (portfolio diversification); rule 2a-7(f)(1) (downgrades); rule 2a-7(h)(3) (record keeping and reporting); rule 2a-7(j) (delegation). In addition, fund boards will no longer have to designate NRSROs, disclose them in the statement of additional information or use their ratings to determine first or second tier status. Finally, we are also adopting as proposed a conforming change to the recordkeeping requirements under the rule to reflect that funds must retain a written record of the determination that a portfolio security is an eligible security, including the determination that it presents minimal credit risks.

63 The codified factors only include the general factors that were discussed in the Proposing Release. Proposing Release, *supra* note 3, at 47991-47992. The asset-specific factors are not codified, but revised as discussed in section II.A.2 below, and continue to be included as guidance.

capacity" determination could create an unclear standard for determining eligible securities that might change the current credit quality profile of money market funds. Variations in how this language may be understood could lead to some funds only purchasing the lowest risk securities possible, creating a risk profile even more stringent than the current standard. Others might interpret the standard differently and not limit their securities purchases in the same way,which might thereby create significant disparities between money market funds. Such different interpretations might also lead to difficulties in our inspection staff's review of compliance with the proposed standard. We also appreciate commenters' concerns that it may be difficult to determine the difference between "exceptionally strong" and other similar standards such as "very strong" credit quality. Accordingly, the Commission has decided that adopting a uniform standard based on the well-developed existing requirement that a security present minimal credit risks, in conjunction with codifying the general factors to be considered, as discussed below, will more effectively achieve the goals of the proposal.

The requirement that a security present minimal credit risks to a money market fund has been part of rule 2a-7 since it was adopted in 1983.[64] The minimal credit risk determination was meant to provide an independent assurance of safety above and beyond the existence of a "high quality" rating by an NRSRO, as explained in the original adopting release:

> [T]he mere fact that an instrument has or would receive a high quality rating may not be sufficient to ensure stability. The Commission believes that the instrument must be evaluated for the credit risk that it presents *to the particular fund* at that time in light of the risks attendant to the use of amortized cost valuation or penny-rounding (emphasis added).[65]

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64 Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies, Investment Company Act Release No. 13380 (Jul. 11, 1983) [48 FR 32555 (Jul. 18, 1983).]

65 *Id.* at 32560.

Under this existing standard, a board (or its delegate) should determine that a security presents minimal credit risks not just in isolation, but also in the context of the fund as a whole. The 2014 Proposing Release made clear that the removal of NRSRO ratings is not intended to change the current risk profile of money market funds, or their evaluation of minimal credit risks.[66] In determining whether a security presents minimal credit risks, therefore, a board (or its delegate) should consider not just the individual risks of the security, but also the overall impact of adding that security to the fund in light of the fund's other holdings.[67] Such consideration might include an examination of correlation of risk among the securities held or purchased, the credit risks associated with market-wide stresses, or specific security credit or liquidity disruptions. Based on comments received, we are persuaded that this existing requirement to evaluate the minimal credit risk of portfolio securities on the fund as a whole (not just on a security-by-security basis) will help mitigate potential risks that money market funds might change their current credit risk profile after our removal of NRSRO ratings references from the rule as part of the final amendments.

2. Codified Factors

Although we believe that the minimal credit risk standard should serve as an effective limitation on credit risk in money market fund portfolios even without the proposed secondary "exceptionally strong" finding, we appreciate commenters' concerns that eliminating the "floor" provided by NRSRO ratings in the rule without a replacement might lead to fund managers

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66 *See, e.g.*, Proposing Release, *supra* note 3, at 47989.

67 In order to clarify that the requirements of the minimal credit risks analysis have not changed from the original requirements as described in the 1983 release, the phrase "to the fund" has been added to the final rule definition of eligible security. Rule 2a-7(a)(11). This phrase is intended to indicate that, unlike a security's NRSRO rating that measures only the security's risks in isolation, the minimal credit risk determination must consider any credit risk introduced by the security to the entire fund.

taking on additional credit risk if the rule does not provide objective and verifiable standards. As discussed above, several commenters suggested that codifying the general factors would enhance investor protections and promote uniform credit quality standards in the absence of specific NRSRO ratings requirements. We agree.

Accordingly, the final rule amendments now include, as part of the analysis of minimal credit risks, a requirement to consider, to the extent appropriate, the general credit analysis factors from the Proposing Release.[68] As noted in the Proposing Release, our staff has had opportunities to observe how money market fund advisers evaluate minimal credit risk, and although staff has noted a range in the quality and breadth of credit risk analyses among the money market funds examined, staff has also observed that most of the advisers to these funds evaluate some common factors that bear on the ability of an issuer or guarantor to meet its short-term financial obligations. Based on staff observations in examinations and prior staff guidance, we understand that most money market fund managers already generally take these factors into account, as appropriate, when they determine whether a portfolio security presents minimal credit risks. We believe that codifying the general factors will help provide a uniform and objective check on credit risk that can be verified by our examiners. We also believe that incorporating these factors into the rule text will further promote effective and uniform application of the risk standard. Although multiple commenters expressed support for preserving the factors as guidance, rather than codifying them,[69] the Commission believes that codification

68 Rule 2a-7(a)(11)(i). The Proposing Release included a second list of asset-specific factors that staff had observed funds making use of for credit analysis of specific types of securities which will be retained as guidance as discussed further below. Proposing Release, *supra* note 3, at 47992-47993.

69 ICI Comment Letter; IDC Comment Letter; Schwab Comment Letter. Similarly, some commenters suggested that the Commission reiterate that the list of factors is not meant to be exhaustive. *See* IDC Comment Letter; MFDF Comment Letter; SIFMA Comment Letter. As

of these factors is justified by the need for verifiable credit quality determinations in the absence of required references to NRSRO ratings. In addition, the Commission believes that the changes to the proposed standard made in this final rule should reduce the likelihood of increased credit risk because funds will have to perform a rigorous analysis using the codified factors and consider how each security affects the aggregate risk of the portfolio.

As discussed above, commenters disagreed over the proposed elimination of the first and second tier distinction,[70] with two commenters expressing concern that removing the distinction and the limit on second tier securities could lead to funds purchasing more risky securities.[71] However, we believe that the codification of the credit analysis factors in the final rule, combined with the increased transparency gained through our amendments to Form N-MFP disclosures (both adopted today, as well as the amendments adopted as part of the 2014 money market fund reforms[72]), should mitigate this concern. The codified credit factors should establish a minimum baseline that should help guard against the risk that funds' approach to credit analysis will become less uniform, or that some funds would substantially increase the riskiness of their portfolios by increasing their investments in second tier securities. Such changes would not likely be consistent with a minimal credit risk analysis using the factors we are codifying today.

Therefore, the final rule requires a money market fund's board (or its delegate) to

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noted below, we state that the list of factors in the rule and the additional factors discussed in this release as guidance are not meant to be exhaustive, and there may be additional factors that could be relevant depending on the type of security analyzed.

70 *See* Fidelity Comment Letter; MFDF Comment Letter; Better Markets Comment Letter; CFA Comment Letter.

71 *See* Better Markets Comment Letter; CFA Comment Letter.

72 For example, the 2014 money market fund reforms eliminated the 60-day delay in making public the information filed on Form N-MFP.

consider, in making its minimal credit risk determinations, the capacity of each security's issuer, guarantor, or provider of a demand feature, to meet its financial obligations, and in doing so, consider, to the extent appropriate, the following factors: (1) financial condition; (2) sources of liquidity; (3) ability to react to future market-wide and issuer- or guarantor-specific events, including ability to repay debt in a highly adverse situation; and (4) strength of the issuer or guarantor's industry within the economy and relative to economic trends, and issuer or guarantor's competitive position within its industry.[73] In incorporating the credit analysis factors into the rule, we have revised them to make them as generally applicable as possible to all money market funds. As we discussed in the Proposing Release, and as reflected in a number of comments received, we understand that the majority of the industry already typically considers these factors when making minimal credit risk determinations.[74] One commenter's recommendation suggested that we include as a codified factor an analysis of the existence, nature, and magnitude of any counterparty relationships.[75] However, in its observations of how money market funds evaluate minimal credit risk, our staff has not identified this factor as one of the common factors that bear on the ability of an issuer or guarantor to meet its short-term financial obligations and we are not aware of other information that suggests that many money market funds are currently performing (or have the information readily available to perform) this type of analysis. Accordingly, we are not including as a codified factor an analysis of counterparty relationships, although we believe that, to the extent that funds have such

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[73] As explained in the Proposing Release, many of these considerations have been included in staff guidance as well as in best practices for determining minimal credit risk set forth in Appendix I of the Report of the Money Market Working Group submitted to the Board of Governors of the Investment Company Institute in 2009. *See also* 1990 Staff Letter and 1989 Staff Letter, *supra* note 44.

[74] *See* Proposing Release, *supra* note 3, section II.A.1, at nn.53-57 and accompanying text.

[75] CFA Institute Comment Letter.

information available, analyzing counterparty relationships should assist funds in making minimal credit risk determinations.

As discussed in the Proposing Release, the financial condition factor generally should include examination of recent financial statements, including consideration of trends relating to cash flow, revenue, expenses, profitability, short-term and total debt service coverage, and leverage (including financial and operating leverage). The second factor, sources of liquidity, generally should include consideration of bank lines of credit and alternative sources of liquidity. The third factor, involving market-wide events, generally should include analysis of risk from various scenarios, including changes to the yield curve or spreads, especially in a changing interest rate environment. The fourth factor, the competitive position of the firm and its industry, generally should include consideration of diversification of sources of revenue, if applicable.[76] As explained in the proposal, in addition to the codified factors used to evaluate the issuer or guarantor of a security, a minimal credit risk evaluation may also include consideration of whether the price and/or yield of the security itself is similar to that of other securities in the fund's portfolio.[77]

The Commission is not codifying the asset-specific factors into the final rule text. As one commenter pointed out,[78] overly specific and numerous factors could over time become dated. Consistent with the concern raised by this commenter, the Commission is mindful of the pitfalls

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76 *See* Proposing Release, *supra* note 3, section II.A.1, at 47991-47992.

77 *See* 2014 Proposing Release, *supra* note 3. This consideration is not being incorporated into the rule text because it does not relate to the overall strength of a security's issuer or guarantor, as do the codified factors. We therefore believe that it would be more useful for a fund's manager to evaluate a security's price and/or yield (as compared with other similar portfolio securities) as a way to quickly assess the appropriateness of a given security, and hence is provided only as guidance.

78 ICI Comment Letter.

that may result from codifying too many factors, and/or factors that are not sufficiently broad and yet relevant enough to withstand changing markets over time. The Commission believes that keeping these asset-specific factors as guidance may help avoid any unintended burden while providing funds with additional and potentially relevant considerations that may be useful when making minimal credit risk determinations in the absence of required references to NRSRO ratings. Accordingly, we are limiting the factors we are codifying into the rule itself to the list of general factors that we believe are sufficiently universal and tested enough to avoid this problem, but that will form the basis of a rigorous analysis. Nonetheless, where relevant, funds may wish to consider whether the asset-specific factors should also be evaluated in making minimal credit risk determinations, especially if they make significant investment in such asset classes. In addition, we have included a cross reference in the rule text to the guidance regarding the asset specific factors, to better inform readers of the applicability of the asset specific factor guidance discussed here.[79]

Accordingly, to the extent applicable, fund advisers may wish to consider the following asset-specific factors:

- For municipal securities: (i) sources of repayment; (ii) issuer demographics (favorable or unfavorable);[80] (iii) the issuer's autonomy in raising taxes and revenue; (iv) the issuer's reliance on outside revenue sources, such as revenue from a state or federal government entity; and (v) the strength and stability of the supporting economy.[81]

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79 We have also incorporated technical recommendations from two commenters on the assets specific factor guidance. ICI Comment Letter; Fidelity Comment Letter. We have (1) combined the two bullets on repurchase agreements into one; (2) altered language in the guidance on repurchase agreements, reflecting increased standardization of the market; and (3) removed the reference to analyzing underlying assets in the asset-backed securities bullet.

80 Demographics could include considerations such as the type, size, diversity and growth or decline of the local government's tax base, including income levels of residents, and magnitude of economic activity.

81 *See* 1989 Staff Letter, *supra* note 44 (additional factors such as sources of repayment, autonomy

- For conduit securities under rule 2a-7:[82] analysis of the underlying obligor for all securities except asset-backed securities (including asset-backed commercial paper).[83]
- For asset-backed securities, such as asset-backed commercial paper: (i) analysis of the terms of any liquidity or other support provided; and (ii) legal and structural analyses to determine that the particular asset-backed security involves no more than minimal credit risks for the money market fund.[84]
- For other structured securities, such as variable rate demand notes,[85] tender option

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in raising taxes and revenue, reliance on outside revenue sources and strength and stability of the supporting economy should be considered with respect to tax-exempt securities); *see also* Guidance on Due Diligence Requirements in Determining Whether Securities are Eligible for Investment, Office of the Comptroller of the Currency, Docket ID OCC-2012-0006 [77 FR 35259 (Jun. 13, 2012)] ("OCC Guidance") (matrix of examples of factors for national banks and federal savings associations to consider as part of a robust credit risk assessment framework ("OCC credit risk factors") for certain investment securities includes capacity to pay and assess operating and financial performance levels and trends).

82 Under rule 2a-7, a "conduit security" means a security issued by a municipal issuer involving an arrangement or agreement entered into, directly or indirectly, with a person other than a municipal issuer, which arrangement or agreement provides for or secures repayment of the security. Rule 2a-7(a)(7). A "municipal issuer" is defined under the rule to mean a state or territory of the United States (including the District of Columbia), or any political subdivision or public instrumentality of a state or territory of the United States. *Id.* A conduit security does not include a security that is: (i) fully and unconditionally guaranteed by a municipal issuer; (ii) payable from the general revenues of the municipal issuer or other municipal issuers (other than those revenues derived from an agreement or arrangement with a person who is not a municipal issuer that provides for or secures repayment of the security issued by the municipal issuer); (iii) related to a project owned and operated by a municipal issuer; or (iv) related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a municipal issuer. *Id.*

83 *See* OCC Guidance, *supra* note 81 (OCC credit risk factors for revenue bonds include consideration of the obligor's financial condition and reserve levels).

84 *See* Money Market Fund Reform, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10060 (Mar. 4, 2010)] ("2010 Money Market Fund Adopting Release") at section II.A.3 (citing Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 21837 (Mar. 21, 1996) [61 FR 13956 (Mar. 28, 1996)] ("1996 Money Market Fund Adopting Release") at section II.E.4).

85 A variable rate demand obligation ("VRDO") (which includes variable rate demand notes) is a security for which the interest rate resets on a periodic basis and holders are able to liquidate their security through a "put" or "tender" feature, at par. To ensure that the securities are able to be "put" or "tendered" by a holder in the event that a remarketing agent is unable to remarket the security, a VRDO typically operates with a liquidity facility – a Letter of Credit or Standby Bond Purchase Agreement – that ensures that an investor is able to liquidate its position. *See* Electronic Municipal Market Access, Understanding Variable Rate Demand Obligations, *available at* http://emma.msrb.org/EducationCenter/UnderstandingVRDOs.aspx.

bonds,[86] extendible bonds[87] or "step up" securities,[88] or other structures: in addition to analysis of the issuer or obligor's financial condition, analysis of the protections for the money market fund provided by the legal structure of the security.[89]

- For repurchase agreements under rule 2a-7: a financial analysis and assessment of the minimal credit risk of the counterparty, an assessment as to whether the haircut level is appropriate for the particular type of collateral based upon price volatility in the market for such collateral type, and a legal analysis of the protections for the money market fund provided by the terms of the repurchase agreements.

The list of factors in the rule and the additional factors discussed in this release as guidance are not meant to be exhaustive, and there may be additional factors that could be relevant depending on the type of security analyzed. We recognize that the range and type of specific factors appropriate for consideration could vary depending on the category of issuer and particular security or credit enhancement under consideration, and that the board (or its delegate) therefore may determine to include other factors in its credit assessment.[90] We also recognize

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86 A tender option bond is an obligation that grants the bondholder the right to require the issuer or specified third party acting as agent for the issuer (*e.g.*, a tender agent) to purchase the bonds, usually at par, at a certain time or times prior to maturity or upon the occurrence of specified events or conditions. *See* Municipal Securities Rulemaking Board, Glossary of Municipal Securities Terms, Tender Option Bond, *available at* http://www.msrb.org/glossary/definition/tender-option-bond.aspx. Tender option bonds are synthetically created by a bond dealer or other owner of a long-term municipal obligation purchased in either the primary or secondary markets, or already in a portfolio.

87 An extendible bond is a long-term debt security with an embedded option for either the investor or the issuer to extend its maturity date. To qualify as an eligible security under rule 2a-7, the issuer must not have the right to extend the maturity of the bond so that it is more than 397 days to maturity at any time. Typically, if an extendible bond is of the type that qualifies as an eligible security under rule 2a-7, a money market fund will have the option to either extend the maturity of the bond to no more than 397 days in the future, or elect not to extend, in which case the bond's maturity must be no longer than 397 days at that time.

88 A "step up" security pays an initial interest rate for the first period, and then a higher rate for the following periods.

89 *See* OCC Guidance, *supra* note 81 (OCC credit risk factors for structured securities include evaluation and understanding of specific aspects of the legal structure including loss allocation rules, potential impact of performance and market value triggers, support provided by credit and liquidity enhancements, and adequacy of structural subordination).

90 As discussed in the 2014 Proposing Release, *supra* note 3, money market fund boards of directors

that specific purchases may require more or less analysis depending on the security's risk characteristics. As discussed in greater detail below, amended rule 2a-7 will also require that the written record of the minimal credit risk determination address any factors considered and the analysis of those factors.[91]

B. Conditional Demand Features

Rule 2a-7 limits money market funds to investing in securities with remaining maturities of no more than 397 days.[92] A long-term security subject to a conditional demand feature[93] ("underlying security"), however, may be determined under the current rule to be an eligible security (or a first tier security) if among other conditions: (i) the conditional demand feature is an eligible security or a first tier security; and (ii) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating, as the case may be, within the highest two categories from the requisite NRSROs or is a comparable unrated security.[94] The rule currently requires this analysis of both the short-term and long-term credit aspects of the demand instrument because a security subject to a conditional demand feature combines both short-term

typically delegate minimal credit risk determinations to the fund's adviser, as provided for in rule 2a-7(j).

91 *See infra* section II.C.; rule 2a-7(h)(3).

92 *See* current rule 2a-7(a)(12).

93 A conditional demand feature is a demand feature that a fund may be precluded from exercising because of the occurrence of a condition. *See* rule 2a-7(a)(6) (defining "conditional demand feature" as a demand feature that is not an unconditional demand feature); rule 2a-7(a)(30) and proposed rule 2a-7(a)(25) (defining "unconditional demand feature" as a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security). For purposes of rule 2a-7, a demand feature allows the security holder to receive, upon exercise, the approximate amortized cost of the security, plus accrued interest, if any, at the later of the time of exercise or the settlement of the transaction, paid within 397 calendar days of exercise. Current rule 2a-7(a)(9).

94 Current rule 2a-7(d)(2)(iv). Although underlying securities are generally long-term securities when issued originally, they become short-term securities when the remaining time to maturity is 397 days or less.

and long-term credit risks.[95]

The Commission's proposal would have required a similar analysis, but consistent with Section 939A of the Dodd-Frank Act, it would have removed the requirement in the rule that the fund board (or its delegate) consider credit ratings of underlying securities.[96] Under the proposal, a fund would have had to determine, as with any short-term security, that the conditional demand feature is an eligible security.[97] In addition, a fund's board of directors (or its delegate) would have had to evaluate the long-term risk of the underlying security and determine that it (or its

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95 The quality of a conditional demand instrument depends both on the ability of the issuer of the underlying security to meet scheduled payments of principal and interest and upon the availability of sufficient liquidity to allow a holder of the instrument to recover the principal amount and accrued interest upon exercise of the demand feature. *See* Acquisition and Valuation of Certain Portfolio Instruments by Registered Investment Companies, Investment Company Act Release No. 14607 (Jul. 1, 1985) [50 FR 27982 (Jul. 9, 1985)], at n.33. The current rule permits the determination of whether a security subject to an unconditional demand feature is an eligible or first tier security to be based solely on whether the unconditional demand feature is an eligible or first tier security because credit and liquidity support will be provided even in the event of default of the underlying security. *See* current rule 2a-7(d)(2)(iii).

96 In a conforming change, the Commission proposed to remove two provisions in current rule 2a-7 that reference credit ratings in connection with securities subject to a demand feature or guarantee of the same issuer that are second tier securities: rule 2a-7(d)(3)(i)(C) (limiting a fund's investments in securities subject to a demand feature or guarantee of the same issuer that are second tier securities to 2.5% of the fund's total assets); rule 2a-7(f)(1)(iii) (providing that if, as a result of a downgrade, more than 2.5% of a fund's total assets are invested in securities issued by or subject to demand features from a single institution that are second tier securities, a fund must reduce its investments in these securities to no more than 2.5% of total assets by exercising the demand feature at the next succeeding exercise date(s)). In other conforming changes, the Commission proposed to amend two rules under the Act that reference the definition of "demand feature" and "guarantee" under rule 2a-7, which references would have changed under the proposed amendments. Specifically, the Commission proposed to amend: (i) rule 12d3-1(d)(7)(v), to replace the references to "rule 2a-7(a)(8)" and "rule 2a-7(a)(15)" with "§ 270.2a-7(a)(9)" and "§ 270.2a-7(a)(16)"; and (ii) rule 31a-1(b)(1), to replace the phrase "(as defined in § 270.2a-7(a)(8) or § 270.2a-7(a)(15) respectively)" with "(as defined in § 270.2a-7(a)(9) or § 270.2a-7(a)(16) respectively.)" We are adopting these changes as proposed.

97 *See* proposed rule 2a-7(d)(2)(iii)(A). The Proposing Release also reiterated the existing monitoring and substitutability requirements for conditional demand features in rule 2a-7, and noted that the Commission believed it would be prudent for a money market fund to avoid investing in securities whose eligibility as portfolio securities depended on a conditional demand feature that may be terminated if the underlying portfolio security is downgraded a single ratings category. *See* Proposing Release, *supra* note 3, at n.90 and accompanying and preceding text.

guarantor) "has a very strong capacity for payment of its financial commitments."[98] We proposed this standard because it was similar to those articulated by credit rating agencies for long-term securities assigned the second highest rating.[99] Because the conditional demand feature could be terminated by a ratings downgrade, we believed that the underlying security should present only limited credit risk.[100]

The commenters who addressed this section generally opposed the proposed approach of requiring a different "very strong" standard for conditional demand features as compared to the proposed "exceptionally strong" standard for all other eligible securities. Instead, most commenters that addressed this issue suggested that the Commission adopt a single uniform standard for both eligible securities and conditional demand features as such a uniform standard would eliminate any potential inconsistences and confusion. We agree, and therefore the final amendments do not include the proposed "very strong" standard for conditional demand features, but instead apply the single uniform minimal credit risk standard (including an analysis of relevant factors) for all eligible security determinations, including conditional demand features.

Most commenters' discussion of the credit analysis of securities subject to conditional demand features focused on aligning the credit quality standard for these securities with the standard used to identify eligible securities generally.[101] One commenter stated that employing the same standard would minimize confusion among investors.[102] Another commenter argued

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98 Proposed rule 2a-7(d)(2)(iii)(C). An underlying security that is a short-term security (because its remaining maturity is less than 397 days, although its original maturity may have been longer) also would have had to meet the proposed standard.

99 *See* Proposing Release, *supra* note 3, at n.83 and accompanying text.

100 *Id*, at n.89 and accompanying text.

101 Dreyfus Comment Letter; ICI Comment Letter; IDC Comment Letter; Schwab Comment Letter.

102 IDC Comment Letter.

that the termination of a conditional demand feature has much the same effect as a default on other securities, and thus the degree of risk permitted with respect to the termination of a conditional demand feature should be equivalent to the risk of default with respect to other eligible securities.[103] Commenters were split in their opinions about what uniform standard to use, if the same credit quality standard were to be employed for eligible securities and securities subject to a conditional demand feature. Some argued that the "very strong" capacity standard should be used in both contexts.[104] Commenters who advised that the minimal credit risk standard should stand alone, without an additional "exceptionally strong capacity" finding (or similar finding), maintained that this stand-alone minimal credit risk standard should apply equally to eligible securities and securities subject to a conditional demand feature.[105]

We agree with these commenters' concerns and are adopting the rule amendments without the proposed "very strong capacity" standard.[106] Instead, the final amendments require application of a single uniform "minimal credit risk" standard that will apply to all securities purchased by money market funds, pursuant to the revised eligible security definition as discussed above.[107] We agree with commenters' reasoning that a uniform credit quality standard would be appropriate given the similar degree of risk presented by the termination of a conditional demand feature and the default of a portfolio security. We also agree with commenters that the difference between the terms "very strong" and "exceptionally strong" is not readily apparent and that a uniform minimal credit risk standard will thus reduce confusion,

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103 ICI Comment Letter. *See also supra* note 93.

104 ICI Comment Letter; Schwab Comment Letter.

105 Dreyfus Comment Letter; Fidelity Comment Letter.

106 Rule 2a-7(d)(2)(iii).

107 Rule 2a-7(a)(11).

and still preserve a similar degree of credit quality to that currently present in fund portfolios. Therefore, under the uniform standard that we are adopting today for conditional demand features, a fund's board (or its delegate) must determine that both the conditional demand feature and the underlying security (or guarantee) are eligible securities.[108]

As noted in the Proposing Release and reiterated here, we do not believe that securities that are rated by NRSROs in the third-highest category for long-term ratings (or comparable unrated securities) would satisfy the standard that underlying securities present minimal credit risks to the fund. We also note that funds currently can invest exclusively in underlying securities rated in the second-highest category if the instrument meets the other conditions for eligibility.[109] We estimate that most underlying securities held by money market funds (77 percent) are rated in the second-highest long-term category, and a smaller portion (23 percent) are rated in the highest long-term category.[110] For these reasons, we do not currently anticipate that funds are likely to increase the portion of their underlying securities that are rated in the second-highest long-term category as a result of the adopted amendments (since these funds do not currently invest in these securities to the extent permitted under existing rules).

C. Monitoring Minimal Credit Risks

Currently, rule 2a-7 requires a money market fund board (or its delegate) to promptly reassess whether a security that has been downgraded by an NRSRO continues to present

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108 The credit risk standard that is being adopted for conditional demand features aligns the credit quality standard for these securities with the standard used to identify eligible securities by requiring the fund's board (or its delegate) to determine that these securities are eligible securities. We note that such a determination, by expressly incorporating the definition of eligible securities, will also incorporate the requirement of a fund to consider, to the extent appropriate, the general credit analysis factors discussed above. Rule 2a-7(a)(11); *see supra* section II.A.2 ("Codified Factors").

109 Current rule 2a-7(d)(2)(iv).

110 *See infra* note 258 and accompanying text.

minimal credit risks, and to take such action as it determines is in the best interests of the fund and its shareholders.[111] In the Proposing Release, the Commission proposed to eliminate this requirement and instead require each money market fund to adopt written procedures that would require the fund adviser to provide an ongoing review of the credit quality of each portfolio security to determine that the security continues to present minimal credit risks.[112]

As discussed in the Proposing Release, such ongoing monitoring of minimal credit risks would include the determination of whether the issuer of the portfolio security, and the guarantor or provider of a demand feature, to the extent relied upon by the fund to determine portfolio quality, maturity or liquidity, continues to have the capacity to repay its financial obligations such that the security presents minimal credit risks. The review would typically update the information that was used to make the initial minimal credit risk determination and would have to be based on, among other things, financial data of the issuer or provider of the guarantee or demand feature.[113] The Commission noted that funds could continue to consider external factors, including credit ratings, as part of the ongoing monitoring process.[114]

All of the commenters who addressed the ongoing monitoring provision supported the

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[111] Rule 2a-7(f)(1)(i)(A). This current reassessment is not required, however, if the downgraded security is disposed of or matures within five business days of the specified event and in the case of certain events (specified in rule 2a-7(f)(1)(i)(B)), the board is subsequently notified of the adviser's actions. Rule 2a-7(f)(1)(ii). In addition, rule 2a-7 requires ongoing review of the minimal credit risks associated with securities for which maturity is determined by reference to a demand feature. Rule 2a-7(g)(3).

[112] Proposing Release, *supra* note 3, at 47994-47996; proposed rule 2a-7(g)(3). The Commission proposed to remove current rule 2a-7(f)(1)(i) (downgrades) and 2a-7(g)(3) (securities for which maturity is determined by reference to demand features). Proposed rule 2a-7 included a new paragraph (g)(3), which would contain the required procedures for the ongoing review of credit risks.

[113] *See* proposed rule 2a-7(g)(3)(ii).

[114] We note that a fund adviser's obligation to monitor risks to which the fund is exposed will, as a practical matter, require the adviser to monitor for downgrades by relevant credit rating agencies because such a downgrade would likely affect the security's market value.

proposed requirement.[115] Commenters agreed with the Commission's belief that most fund advisers currently engage in similar types of ongoing monitoring and that an explicit monitoring requirement would not significantly change current fund practices,[116] nor would it impose significant extra costs.[117] Commenters also stated that the ongoing monitoring requirement would assist funds to better position themselves to quickly identify potential risks of credit events that could impact portfolio security prices.[118] Accordingly, as discussed in more detail below, we are now adopting these amendments as proposed.[119]

1. Frequency of Monitoring

Three commenters requested more specificity regarding the frequency of the monitoring requirement.[120] One of these commenters requested that the Commission adopt a specific periodic basis for the ongoing review, so that the process would occur with a minimum frequency.[121] The other two commenters requested that the Commission make clear that "ongoing" monitoring does not necessarily mean a constant or daily evaluation.

We are not specifying a periodic basis for the ongoing monitoring requirement adopted

115 *See* Barnard Comment Letter; BlackRock Comment Letter; CFA Institute Comment Letter; Dreyfus Comment Letter; Fidelity Comment Letter; ICI Comment Letter; IDC Comment Letter; Invesco Comment Letter; Schwab Comment Letter; Vanguard Comment Letter.

116 All commenters that specifically addressed this issue agreed with the Commission's understanding of current practices. *See* BlackRock Comment Letter; Fidelity Comment Letter; Barnard Comment Letter; Schwab Comment Letter. Although the NYC Bar Comment Letter did not specifically answer this question, it suggested that the Proposing Release had not presented a sufficiently detailed description of those current practices. This comment is discussed further below.

117 The only commenter to address the question about costs stated that it did not believe that most funds would experience additional costs beyond the initial adoption and implementation. *See* Schwab Comment Letter.

118 Fidelity Comment Letter; Schwab Comment Letter; Barnard Comment Letter.

119 Rule 2a-7(g)(3).

120 Better Markets Comment Letter; NYC Bar Comment Letter; SIFMA Comment Letter.

121 Better Markets Comment Letter.

today. As a preliminary matter, doing so would conflict with the intent of an explicit ongoing monitoring requirement. Specifying a periodic frequency for monitoring might suggest that regular awareness of the credit profile of portfolio securities is not required, and might also interfere with the discretion of fund managers to react to changing market conditions. In addition, as discussed above, specifying the frequency of monitoring would be inconsistent with our understanding of how a majority of the industry currently evaluates minimal credit risk.[122]

Although we are not codifying a specific frequency upon which monitoring must occur, we expect that for purposes of the rule, ongoing monitoring would mean that monitoring efforts should occur on a regular and frequent basis. We understand that many funds today engage in daily monitoring of changes in the markets or conditions relating to issuers that may affect their credit evaluation of portfolio holdings, and do so even on an hourly basis if there are rapidly changing events. We believe that this type of monitoring is consistent with the ongoing monitoring requirement adopted today.

One commenter who requested a specific periodic basis for minimal credit risk evaluations also suggested that the Commission require that the fund's board be notified when a portfolio security no longer meets the minimal credit risk standard (and thus, the definition of an eligible security).[123] As a general matter, the Commission expects, as explained in the Proposing Release, that a fund board generally will establish procedures for the adviser to notify the board when a security no longer meets the minimal credit risk standard,a nd thus expect that a board

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122 Similarly, in response to the Commission's query as to whether the rule should include specific objective events that would require a reevaluation of minimal credit risks, the only commenter to address the question stated that such a change might cause fund managers to limit their reviews to those triggering events, rather than truly evaluating risk on an ongoing basis. Schwab Comment Letter. We agree, and are not requiring specific events that would trigger a reevaluation.

123 Better Markets Comment Letter.

would be notified as the commenter suggested. We also note that under current rule 2a-7 and the final rule, a fund must dispose of a security that is no longer an eligible security, unless the board makes a finding that it would not be in the interests of the fund to do so.[124] Therefore, if a fund chooses not to dispose of a security that is no longer an "eligible security," the fund's board will already have had the notice sought by this commenter, and thus we do not believe that further specific notification requirements are necessary.

2. Recordkeeping

Today, funds are required to retain a written record of the determination that a portfolio security is an eligible security, including the determination that it presents minimal credit risks. If the proposed requirement to conduct an ongoing review of the credit quality of a fund's portfolio securities were adopted, rule 2a-7's current recordkeeping requirement could have been understood to require the fund to provide for an ongoing documentation of the adviser's ongoing review, which could prove burdensome. Accordingly, we had proposed to make conforming amendments to the recordkeeping provision,re quiring the fund to maintain and preserve a written record of the determination that a portfolio security presents minimal credit risks at the time the fund acquires the security, or at such later times (or upon such events) that the board of directors determines that the investment adviser must reassess whether the security presents minimal credit risks.[125]

One commenter objected to the way the recordkeeping provision was phrased, stating that the rule was not clear as to the extent of the monitoring and whether and when

124 Current rule 2a-7(f)(2)(ii).

125 *See* proposed rule 2a-7(h)(3).

recordkeeping was required.[126] However, another commenter expressed support for how the Commission proposed the new recordkeeping requirement.[127] We are adopting the amendments as proposed and reiterate that the recordkeeping amendments require recordkeeping of the minimal credit risk determination only when the security is first acquired or during periodic or event-driven reassessments, as determined by the board (or its delegate).

3. Other Issues

Three commenters objected to the nature of the standard to be applied in determining minimal credit risks through ongoing monitoring.[128] Two of these commenters objected to the need to determine on an ongoing basis that the capacity to repay short-term financial obligations is "exceptionally strong." The other commenter requested that the standard be made clearer and stronger by inclusion of the specific factors to be considered in determining whether a security presents minimal credit risks. We note that the final amended definition of "eligible security" addresses these comments by eliminating the "exceptionally strong" standard and also codifying general credit analysis factors.[129]

The proposed amendments specified that government securities would not be subject to the initial minimal credit risk determination or the ongoing monitoring requirement. One commenter suggested that money market funds held in the fund's portfolio, which also would not be subject to the initial minimal credit risk determination, should be treated the same and carved out of the ongoing monitoring requirement as well.[130] We are not making such a change

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126 NYC Bar Comment Letter.

127 ICI Comment Letter.

128 Dreyfus Comment Letter; BlackRock Comment Letter; Better Markets Comment Letter.

129 Rule 2a-7(a)(11). *See supra* section II.A.

130 ICI Comment Letter. (The Vanguard Comment Letter expressed support for the ICI comments.)

to the rule because we believe there are significant differences between the risk profile of government securities and shares of money market funds, as was evident in the recent financial crisis, that make ongoing monitoring prudent for shares of money market funds.[131] Nonetheless, the difference in risk profiles between shares of money market funds and other portfolio securities may influence the specific written ongoing monitoring procedures adopted by the board pursuant to this final rule.[132]

We believe that explicitly requiring that funds perform ongoing monitoring of credit risks will help to ensure that funds are better positioned to quickly identify potential risks of credit events that could impact portfolio security prices and ultimately, for certain funds, the ability of the fund to maintain its stable net asset value.[133] Accordingly, we are adopting these amendments largely as proposed.

The ICI Comment Letter also suggested two technical corrections to the ongoing monitoring provision, which the Commission is adopting. First, the language of clause (i) of 2a-7(g)(3) has been made consistent with the language of clause (ii) and now includes reference to the financial data of a provider of a guarantee or demand feature in addition to the financial data of an issuer of a security. Also, an erroneous citation in 2a-7(g)(3)(ii) has been corrected.

[131] For example, in the 2014 Money Market Fund Adopting Release, we discussed how investor money flowed out of institutional prime money market funds and into government money market funds (and government securities) during the financial crisis following the Reserve Primary Fund's "breaking the buck." See 2014 Money Market Fund Adopting Release, *supra* note 6, at sections II.B and D.

[132] For example, a fund may decide to use different outside sources to assist it in evaluating the ongoing credit quality of portfolio securities it determines present a heightened credit risk profile (as compared with other portfolio securities held by the fund).

[133] As under the current rule and discussed in the proposal, the process undertaken by the fund's board (or adviser) for establishing credit quality and the records documenting that process would be subject to review in regulatory examinations by Commission staff. *See* 2014 Proposing Release, *supra* note 3. In the context of such an examination, a fund should be able to support each minimal credit risk determination it makes with appropriate documentation to reflect that process and determination. A fund that acquires portfolio securities without having adopted, maintained, or implemented written policies and procedures reasonably designed to assess minimal credit risk, as required under rules 2a-7 and 38a-1, could be subject to disciplinary action for failure to comply with those rules. *See id.* *See also* Ambassador Capital Management LLC, *et al.,* Investment Company Act Release No. 30809 (Nov. 26, 2013).

D. Stress Testing

Money market funds currently must adopt written procedures for stress testing their portfolios and perform stress tests according to these procedures on a periodic basis.[134] These required tests include consideration of certain hypothetical events, including the downgrade of particular portfolio security positions.[135] In the Proposing Release, the Commission proposed to replace this reference to ratings downgrades in the stress testing requirement with a hypothetical event that is designed to have a similar impact on a money market fund's portfolio, namely an "event indicating or evidencing credit deterioration" of particular portfolio security positions.[136] Thus, under the proposed amendments, funds could continue to test their portfolios against a potential downgrade or default in addition to any other indication or evidence of credit deterioration they determine appropriate.

All commenters addressing the stress testing amendment supported it.[137] One commenter suggested that allowing a choice of hypothetical events to be used would improve disclosure by increasing variation in the testing.[138] Another commenter stated that it would prefer retaining the original reference to a downgrade, but that the proposed change was appropriate.[139] We continue to believe that amending the stress testing provision as proposed will continue to promote

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134 *See* current rule 2a-7(g)(8).

135 *See* current rule 2a-7(g)(8)(i).

136 Proposing Release, *supra* note 3, at 47996-47997; proposed rule 2a-7(g)(8)(i)(B) (the proposal would require stress testing for an event indicating or evidencing the credit deterioration, such as a downgrade or default, of a portfolio security position representing various portions of the fund's portfolio (with varying assumptions about the resulting loss in the value of the security), in combination with various levels of an increase in shareholder redemptions).

137 ICI Comment Letter; Barnard Comment Letter; BlackRock Comment Letter; CFA Institute Comment Letter; MFDF Comment Letter; Vanguard Comment Letter.

138 CFA Institute Comment Letter.

139 MFDF Comment Letter.

effective stress testing while implementing Section 939A of the Dodd-Frank Act. Accordingly, we are adopting the amendment as proposed.

E. Form N-MFP

As part of the money market fund reforms adopted in 2010, money market funds must provide to the Commission a monthly electronic filing of portfolio holdings information on Form N-MFP.[140] The information that money market funds must disclose with respect to each portfolio security (and any guarantee, demand feature, or other enhancement associated with the portfolio security) includes the name of each designated NRSRO for the portfolio security and the rating assigned to the security.[141] Our staff, however, issued a no-action letter in response to the passage of Section 939A of the Dodd-Frank Act indicating that, among other things, they would not object if a fund did not "designate NRSROs and [did] not make related disclosures in its statement of additional information before the Commission has completed the review of rule 2a-7 required by the [Dodd-Frank Act] and has made any modifications to the rule."[142] Notwithstanding the staff's position, many funds are already reporting this information on Form N-MFP.

Instead of disclosure of designated NRSRO ratings, the Commission's Proposing Release

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140 *See* rule 30b1-7; *see also* 2010 Money Market Fund Adopting Release, *supra* note 84, at 10082-10086.

141 *See* current Form N-MFP Items 34 (requiring disclosure of each designated NRSRO for a portfolio security and the credit rating given by the designated NRSRO for each portfolio security); 37b-c (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security demand feature); 38b-c (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security guarantee); and 39c-d (requiring disclosure of each designated NRSRO and the credit rating given by the designated NRSRO for each portfolio security enhancement).

142 Letter to Karrie McMillan, General Counsel, Investment Company Institute from Robert E. Plaze, Associate Director, Division of Investment Management, SEC (Aug. 19, 2010). Because the requirements of today's rule supersede the staff letter, the letter is withdrawn as of the compliance date of this rule.

would have required that each money market fund disclose, for each portfolio security, (i) each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO's services, as well as the name of the agency providing the rating, and (ii) any other NRSRO rating that the fund's board of directors (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating.[143]

Most commenters addressing the proposed provision supported the Commission's proposal to require disclosure of NRSRO ratings, though many commenters suggested changes, in particular related to the subscription requirements, as discussed below.[144] As suggested by commenters, we are not adopting the proposed requirement that a fund disclose the ratings of the NRSROs to which it subscribes. We are, however, adopting as proposed, a requirement that funds disclose those NRSRO ratings that the fund's board of directors (or its delegate) considered, if any, in making its minimal credit risk determination for a given security, along with the name of the agency that provided the rating.

1. Use of Subscriptions

Many commenters stated that requiring funds to disclose each rating assigned by any NRSRO that a fund or its adviser subscribes to would create unnecessary cost burdens for money market funds, as well as cause other problems.[145] These commenters explained that funds do not consider every rating of every NRSRO they subscribe to when determining the credit profile of a

143 *See* proposed Form N-MFP Item C.10. In a conforming change, the proposal would have also amended Form N-MFP Item C.9 to require disclosure of whether the portfolio security is an eligible security. We did not receive any comments on this provision. This conforming change is now adopted in the final rule.

144 *See* Consumer Federation of America Comment Letter; Better Markets Comment Letter; MFDF Comment Letter; BlackRock Comment Letter; Schwab Comment Letter.

145 MFDF Comment Letter; BlackRock Comment Letter; ICI Comment Letter; Vanguard Comment Letter; SIFMA Comment Letter; Fidelity Comment Letter.

given security. They stated that subscriptions are often used for many other reasons, such as evaluating pricing levels, monitoring market activity and context, and assessing other securities. These commenters also suggested that such disclosures would be unhelpful or even misleading to investors, since the ratings disclosed would often be unrelated to the determinations of minimal credit risks. One commenter stated that the required disclosure of every rating of a portfolio security for which the fund has a subscription would discourage subscriptions, and potentially interfere with the NRSRO market.[146] Another commenter suggested that any usefulness of receiving this information on Form N-MFP for purposes of Commission monitoring was minimal because the information is readily available elsewhere.[147] In addition, one commenter suggested that NRSROs may decide that inclusion of ratings information on Form N-MFP constitutes publication of the ratings and therefore assess extra fees associated with publication.[148] In regard to the general requirement of disclosing any NRSRO ratings on Form N-MFP, one commenter objected that the proposed provision conflicts with Section 939A of the Dodd-Frank Act.[149]

After considering the comments received, we are persuaded by those commenters who argued, as discussed above, that requiring disclosure of each rating assigned by any NRSRO if the fund or its adviser subscribes to that NRSRO's services, as well as the name of the agency providing the rating, is unnecessary and potentially misleading. Except as discussed elsewhere in the section, these commenters did not oppose general disclosure of ratings information on

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146 ICI Comment Letter.

147 SIFMA Comment Letter.

148 Schwab Comment Letter.

149 SIFMA Comment Letter.

Form N-MFP, provided the requirement is not based on subscribing to an NRSRO's service.[150] Consequently, the final rule requires that funds disclose on Form N-MFP any NRSRO rating that the fund's board of directors (or its delegate) considered in making its minimal credit risk determination for that particular security, as well as the name of the agency providing the rating. This requirement will provide meaningful and concise information to investors and the SEC regarding the process by which a fund evaluates its securities. If a fund's adviser has considered more than one NRSRO rating in making a minimal credit risk determination for a particular portfolio security, the Form N-MFP disclosure will need to reflect each rating considered. We believe this information on ratings will be useful both to the Commission and to investors to monitor credit ratings that funds use in evaluating the credit quality of portfolio securities and to evaluate risks that fund managers take. Moreover, we believe this requirement is consistent with many funds' current Form N-MFP disclosure practices.[151] Disclosures of individual portfolio securities ratings will provide investors, Commission staff, and others with a snapshot of potential trends in a fund's overall risk profile, which can in turn impose discipline on the industry to continually research and evaluate whether that profile is changing.

In regard to the comment that requiring disclosure might trigger the charging of publication fees by the NRSROs, numerous money market funds currently voluntarily report ratings on Form N-MFP, and we are not aware of the imposition of such fees on funds. In regard to the comment suggesting that requiring disclosure of ratings on Form N-MFP conflicts with Section 939A of the Dodd-Frank Act, we believe that requiring disclosure of the NRSRO ratings

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150 Commenters did not specifically object to our proposed disclosure requirement based on a fund board's (or its delegate's) "consideration" of such ratings in making minimal credit risk determinations.

151 *See* Proposing Release, *supra* note 3, at section II.B.

considered satisfies the requirements of Section 939A. We do not believe that requiring disclosure of credit ratings considered by funds as part of their minimal credit risk determinations conflicts with Section 939A, which requires federal agencies to "remove any reference to or requirement of *reliance* on credit ratings...."

2. Other Issues

Some commenters suggested that fund website disclosure of NRSRO ratings would be more useful and effective than disclosure on Form N-MFP.[152] These commenters stated that such website disclosure could be made clearer and more understandable for investors than the proposed disclosure. Although we appreciate the benefits associated with website disclosure, we expect that the ready public availability of the information on Form N-MFP should achieve many of the same benefits. We also note that the 2014 money market reforms eliminated the 60-day delay on public availability of the information filed on Form N-MFP (making such information public immediately upon filing). Accordingly, we are not adopting a fund website disclosure requirement for NRSRO ratings at this time. We note, however, that nothing in our final rule prohibits money market funds from making such disclosure on fund websites.

One commenter suggested another approach that we did not propose, namely that the Commission require disclosure on Form N-MFP of the factors that a fund considers when determining whether a security presents minimal credit risks and the details of that determination.[153] The commenter stated that this expanded disclosure would enhance investors' and regulators' understanding of risks in money market fund portfolios. We believe that expanding disclosures in this way is unlikely to provide additional useful information because all

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[152] Schwab Comment Letter; ICI Comment Letter; Fidelity Comment Letter.

[153] Better Markets Comment Letter.

funds will be required to use the codified general factors that we had initially proposed as guidance. All funds will now have to apply the specific factors the Commission is requiring in the rule and retain records of the specifics of the determination made for possible review by the Commission. Although public disclosure of the details of the reasoning behind the funds evaluation of each factor and overall minimal credit risk determination would provide additional information to investors, we currently do not believe that many investors would be likely to benefit from this potentially voluminous disclosure for each security held. Such a disclosure requirement would also effectively require funds to publicly disclose their entire credit risk evaluation process, which may include proprietary data. On balance, it is not clear that the potential benefits of this particular disclosure would justify the potentially significant costs. Therefore, we are not adopting such a disclosure requirement at this time.

Finally, one commenter stated that government money market funds should not have to disclose ratings information.[154] We note that no money market funds, including government money market funds, are required by the final rule to disclose ratings information if that information is not considered in evaluating a particular security. Accordingly, to the extent that government money market funds do not consider ratings in selecting portfolio securities, any burden should be minimal.

3. Technical Amendments

In addition to the substantive amendments to Form N-MFP, the Commission is also making a technical change to one of the definitions of "money market fund" on Form N-MFP.[155]

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[154] ICI Comment Letter.

[155] The definition in the heading of the Instructions did not match the version in the Definitions section. For consistency and clarity, we are now adopting the heading definition in both places, as well as on Form N-1A.

We are also making a technical change to the definition of "collateralized fully" in rule 2a-7.[156]

F. Exclusion from the Issuer Diversification Requirement

We are amending the rule 2a-7 diversification provision as proposed.[157] Under the current rule, in addition to the provisions regarding credit quality discussed above, rule 2a-7's risk limiting conditions require a money market fund's portfolio to be diversified, both as to the issuers of the securities it acquires and providers of guarantees (and demand features)[158] related to those securities.[159] These diversification provisions were designed to diversify the risks to which money market funds may be exposed and thereby reduce the impact of any single issuer's or guarantor's (or demand feature provider's) financial distress on a fund.[160] Generally, money

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156 *See* rule 2a-7(a)(5). We are eliminating from the definition of "collateralized fully" in rule 2a-7(a)(5) an erroneous cross reference to rule 5b-3(c)(1)(iv)(D) (which has since been removed). See 2013 Ratings Removal Adopting Release, *supra* note 5.

157 We are also adopting several technical amendments to the portfolio diversification provisions of rule 2a-7, as described below in this section.

158 A "demand feature" means a feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the later of the time of exercise or the settlement of the transaction, paid within 397 calendar days of exercise. Rule 2a-7(a)(9) (definition of demand feature). A "guarantee" as defined in rule 2a-7 includes an unconditional demand feature. *See* rule 2a-7(a)(18) (definition of guarantee). An "unconditional demand feature" means a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities. Rule 2a-7(a)(30) (definition of unconditional demand feature).

159 *See* current rule 2a-7(d)(3). The diversification requirements of rule 2a-7 differ in significant respects from the requirements for diversified management investment companies under section 5(b)(1) of the Investment Company Act. A money market fund that satisfies the applicable diversification requirements of paragraphs (d)(3) and (e) of rule 2a-7 is deemed to have satisfied the requirements of section 5(b)(1). Rule 2a-7(d)(3)(v). Subchapter M of the Internal Revenue Code contains other diversification requirements for a money market fund to be a "regulated investment company" for federal income tax purposes. 26 U.S.C. 851 *et seq.*

160 *See* Money Market Fund Reform, Investment Company Act Release No 28807 (Jun. 30, 2009) [74 FR 32688 (Jul. 8, 2009)] ("2009 Money Market Fund Proposing Release") at n.220 and accompanying text; Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No. 17589 (Jul. 17, 1990) [55 FR 30239 (Jul. 25, 1990)], at text accompanying n.23 ("Diversification limits investment risk to a fund by spreading the risk of loss among a number of securities.").

market funds must today limit their investments in the securities of any one issuer of a first tier security to no more than 5 percent of total assets, other than with respect to government securities and securities subject to a guarantee by a non-controlled person.[161] A single state money market fund, however, may also currently invest up to 25 percent of its total assets in the securities of any single issuer.[162] In addition to the issuer diversification provisions, money market funds must generally limit their investments in securities subject to a guarantee (or demand feature) to no more than 10 percent of total assets from any one provider.[163] A money market fund is permitted to take on greater indirect exposure to a guarantor because rather than looking solely to the issuer, the money market fund would have two potential sources of repayment—the issuer whose securities are subject to the guarantees and the providers of those guarantees if the issuer defaults. Most recently, the Commission adopted amendments to certain provisions of these diversification requirements as part of the 2014 money market fund reforms.[164]

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161 Current rule 2a-7(d)(3)(i)(A) and (B). A fund also may invest no more than 0.5 percent of fund assets in any one issuer of a second tier security. Current rule 2a-7(d)(3)(i)(C). The rule provides a safe harbor under which a taxable or national tax-exempt fund may invest up to 25 percent of its total assets in the first tier securities of a single issuer for a period of up to three business days after acquisition (but a fund may use this exception for only one issuer at a time). Current rule 2a-7(d)(3)(i)(A). Because the amendments we are adopting today eliminate the distinction between first and second tier securities, the issuer diversification requirements and the safe harbor, as amended, will not refer to or rely on a portfolio security's rating.

162 Current rule 2a-7(d)(3)(i)(B).

163 Rule 2a-7 also provides a "fifteen percent basket" for tax-exempt (including single state) money market funds, under which as much as 15 percent of the value of securities held in a tax-exempt fund's portfolio may be subject to guarantees or demand features from a single institution. *See* rule 2a-7(d)(3)(iii)(B). The tax-exempt fund, however, may only use the 15 percent basket to invest in demand features or guarantees issued by non-controlled persons that are first tier securities. *See* rule 2a-7(d)(3)(iii). Under the amendments we are adopting today, the 15 percent basket will be available with respect to any demand feature or guarantee issued by a non-controlled person without regard to the rating of the security, guarantee or demand feature.

164 *See* 2014 Money Market Fund Adopting Release, *supra* note 6. Among other things, the 2014 money market fund amendments require that money market funds treat certain entities that are

Notwithstanding the 5 percent issuer diversification provision, rule 2a-7 currently does not require a money market fund to be diversified with respect to issuers of securities that are subject to a guarantee by a non-controlled person.[165] This exclusion could allow, for example, a fund to invest a significant portion or all of the value of its portfolio in securities issued by the same entity if the securities were guaranteed by different non-controlled person guarantors and none of the guaranteed securities had a value exceeding 10 percent of the fund's total assets. We continue to be concerned that a fund that relies on this issuer diversification exclusion could have a highly concentrated portfolio and would be subject to substantial risk if the single issuer in whose securities it had such a significant investment were to come under stress or default.

The diversification amendments that we adopt today will remove the current exclusion to the issuer diversification requirement for securities subject to a guarantee issued by a non-controlled person. That is, under today's amendment, each money market fund that invests in securities subject to a guarantee (whether or not the guarantor is a non-controlled person) will have to comply with both the 10 percent diversification requirement for the guarantor as well as the 5 percent diversification requirement for the issuer.[166]

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affiliated with each other as single issuers when applying the 5 percent issuer diversification provision of rule 2a-7 and treat the sponsors of asset-backed securities as guarantors subject to the 10 percent diversification provision of rule 2a-7 applicable to guarantees and demand features, unless the fund's board makes certain findings. These amendments were intended to increase the resiliency of and reduce risk in money market funds by limiting their ability to concentrate investments in a single economic enterprise.

165 *See* current rule 2a-7(d)(3). A guarantee issued by a non-controlled person means a guarantee issued by a person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the guarantee (*control* means "control" as defined in section 2(a)(9) of the Act) (15 U.S.C. 80a-2(a)(9)), or a sponsor of a special purpose entity ("SPE") with respect to an asset-backed security. Rule 2a-7(a)(17).

166 *But see* rule 2a-7(e). If the fund's board of directors has determined that the fund is not relying on a guarantee to determine the quality, maturity or liquidity of a portfolio security and maintains a record of this determination, then the fund need not comply with the 10 percent guarantor diversification requirement with respect to such guarantee.

One commenter supported the proposed issuer diversification amendment.[167] Another commenter did not specifically oppose the proposal but questioned the additive value of the proposed amendment.[168] The majority of commenters, however, that discussed the diversification proposal opposed it, for a variety of reasons as further discussed below.[169]

1. Credit Quality of the Guarantor and Two Sources of Repayment

In cases where a money market fund invests in a security subject to a guarantee, the guarantor assumes the credit risks presented by a particular issuer by agreeing to provide principal and interest payments in the event the issuer of the underlying security is unable to do so. Accordingly, rule 2a-7 allows a money market fund to look to the credit quality of the guarantor as opposed to the issuer to meet rule 2a-7's portfolio quality provisions.[170] Several commenters emphasized a money market fund's ability to rely on the credit quality of the guarantor in this case, arguing that it is appropriate to direct the minimal credit risk determination to the guarantor as opposed to refocusing the analysis on issuer concentration risk.[171] One of these commenters also suggested that securities subject to a guarantee in many cases trade on the basis of the credit quality of the provider of that guarantee, and thus exposure to the underlying security issuer may not be relevant to a money market fund's ability to

167 *See* Better Markets Comment Letter. This commenter also opined that there was no rationale for setting a more generous limit for guarantors of the securities than for issuers and that accordingly, the Commission should strengthen the diversification requirements by preventing any one guarantor from guaranteeing more than 5 percent of a fund's assets as opposed to 10 percent.

168 *See* Schwab Comment Letter.

169 *See* BlackRock Comment Letter; Dreyfus Comment Letter; ICI Comment Letter; SFIG Comment Letter; SIFMA Comment Letter; Vanguard Comment Letter.

170 *See* rule 2a-7(d)(2)(iii).

171 *See* Dreyfus Comment Letter; Schwab Comment Letter; SIFMA Comment Letter.

maintain a stable net asset value in these cases.[172] Another commenter suggested that complying with the proposed requirement for guaranteed securities could be construed to require the manager to also conduct a credit review and on-going monitoring of the issuer.[173] We are not amending the provision in rule 2a-7 that permits money market funds to look to the credit quality of the guarantor as opposed to the issuer to meet rule 2a-7's portfolio quality provisions.

As we discussed in the Proposing Release, by permitting money market funds a higher 10 percent limit on their indirect exposures to a single provider of a guarantee than the 5 percent limit on direct investments in any one issuer, rule 2a-7 permits a money market fund to take on greater indirect exposures to providers of guarantees. As we previously discussed, and as acknowledged by commenters, a money market fund is permitted to take on greater indirect exposure because,ra ther than looking solely to the issuer, the money market fund would have two potential sources of repayment—the issuer whose securities are subject to the guarantees and the providers of those guarantees if the issuer defaults.[174] Both the issuer and the guarantor would have to default at the same time for the money market fund to suffer a loss. And if a guarantor were to come under stress, the issuer may be able to obtain a replacement.[175]

By diversifying solely against the guarantor, as is the case under the current issuer diversification exclusion, a fund could rely on the guarantors' credit quality or repayment ability, not the issuer's. Thus, in addition to looking to the credit quality of the guarantor as opposed to

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172 *See* SIFMA Comment Letter.

173 *See* Schwab Comment Letter.

174 *See* BlackRock Comment Letter; SFIG Comment Letter.

175 *See, e.g.*, Revisions to Rules Regulating Money Market Funds, Investment Company Act Release No.19959 (Dec. 17, 1993) [58 FR 68585 (Dec. 28, 1993)] at n.83 and accompanying text (observing that, if the guarantor of one of the money market fund's securities comes under stress, "issuers or investors generally can either put the instrument back on short notice or persuade the issuer to obtain a substitute for the downgraded institution").

the issuer to meet rule 2a-7's portfolio quality provisions, the fund would also effectively substitute the credit of the guarantor for that of the issuer for diversification purposes, without imposing the tighter 5 percent requirement that rule 2a-7 generally applies for issuer diversification. This means that a fund could have a highly concentrated portfolio and could be subject to substantial risk if it has a significant investment in securities of a single issuer, and such issuer were to come under stress or default. As we stated in the Proposing Release, we are concerned that a money market fund relying on the exclusion from the issuer diversification provision need only comply with the 10 percent guarantor diversification requirement, notwithstanding the credit substitution discussed above. In consideration of our reform goal of limiting concentrated exposure of money market funds to particular economic enterprises, we continue to believe that ignoring a fund's exposure to the issuer in these circumstances is not appropriate.[176]

In the Proposing Release, we requested comment as to whether commenters agreed with our proposed approach to treat securities subject to a guarantee by a non-controlled person similar to other securities with a guarantee under rule 2a-7, or whether we should instead require that a guarantor be treated as the issuer and subject to a 5 percent diversification requirement when a money market fund is relying exclusively on the credit quality of the guarantor or when the security need not meet the issuer diversification requirements. We also asked in the 2013 Money Market Fund Proposing Release more generally whether we should continue to distinguish between a fund's exposure to guarantors and issuers by providing different

176 *See* 2014 Money Market Fund Adopting Release, *supra* note 6, at text following n.1600 and accompanying n.1601. The exclusion from the 5 percent issuer diversification requirement for certain guaranteed securities was adopted in the 1996 money market fund amendments to provide flexibility in municipal investments, and was premised on the ability of a money market fund to rely on the guarantee if an issuer became distressed. *See* 1996 Money Market Fund Adopting Release, *supra* note 84.

diversification requirements for these exposures.[177] We explained that rule 2a-7 permits a money market fund, when determining if a security subject to a guarantee satisfies the credit quality standards, to rely exclusively on the credit quality of the guarantor.[178] As in the Proposing Release, we also specifically asked whether the guarantor should be treated as the issuer and subject to a 5 percent diversification requirement whenever the money market fund is relying exclusively on the credit quality of the guarantor. Although most commenters did not specifically address this issue, one commenter argued that guarantors and demand feature providers should generally be subject to the same 5 percent issuer diversification requirements instead of a higher 10 percent limit.[179] We continue to believe, however, that the approach we are adopting today is preferable to making both the guarantor and issuer subject to a 5 percent diversification requirement because, among other things, the approach we are adopting today would treat securities subject to a guarantee by a non-controlled person similarly to other securities with a guarantee under rule 2a-7.

As discussed further in the economic analysis section below, we believe that the potential costs of requiring both the guarantor and issuer to be subject to a 5 percent diversification requirement would likely be more significant than the costs of the amendment we are adopting today. As of the end of April 2015, we estimate that approximately 110 (of 214) prime money market funds had total exposure to a single entity (including directly issued, asset-backed

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177 *See* 2013 Money Market Fund Proposing Release, *supra* note 16, at sections III.J.1 – 2.

178 Rule 2a-7(d)(2)(iii). As noted above, a money market fund is permitted to take on greater indirect exposure because the fund has two potential sources of repayment. However, the fact that a money market fund has both the issuer and guarantor as sources of repayment may not fully reduce the risks of the investment in all cases because in the event that both the issuer and guarantor default at the same time the fund could suffer a loss. Additionally, the issuer of the guaranteed securities need not satisfy rule 2a-7's credit quality requirements.

179 *See* Better Markets Comment Letter.

commercial paper sponsorship, and provision of guarantees and demand features) in excess of 5 percent. If we adopted an amendment that both the guarantor and issuer are subject to a 5 percent diversification requirement, any fund that had exposure to an entity greater than 5 percent when those assets matured would have to reinvest the proceeds of the securities creating that exposure in different securities or securities with a different guarantor. Those changes may or may not require those funds to invest in alternative securities, and those securities might present greater risk if they offered lower yields, lower liquidity, or lower credit quality. In addition, we believe the approach we take today is preferable to making both the guarantor and issuer subject to a 5 percent diversification requirement because unlike a security that is not subject to a guarantee, a security that is subject to a guarantee would continue to have two sources of repayment.

Another commenter stated that the Commission has provided for the higher 10 percent limit on indirect exposure of money market funds to guarantors in part because of the "double-barreled" protection, as discussed above, and suggested that the same logic should apply in imposing an issuer diversification limit on guaranteed securities.[180] This commenter recommended that a 10 percent issuer diversification limit be applied under the rule for securities of an issuer that are guaranteed by a non-controlled person.[181] Rather than subject these issuers to a unique 10 percent requirement, however, we continue to believe that a better approach would be to restrict risk exposures to all issuers of securities subject to a guarantee or demand feature under rule 2a-7 in the same way. As noted above, a money market fund is permitted to take on greater exposure to guarantees because rather than solely looking to the issuer, the

[180] *See* SFIG Comment Letter.

[181] *See id.*

money market fund would have two sources of repayment. We believe that this rationale applies to all securities equally (whether the security is subject to a guarantee by a controlled person or a non-controlled person), and that if a money market fund is permitted to take on a greater exposure to a guarantor, then it must also comply with the underlying 5 percent issuer diversification provision. Therefore, under today's amendments, each money market fund that invests in securities subject to a guarantee (whether or not the guarantor is a non-controlled person) will have to comply with both the 10 percent diversification requirement for the guarantor as well as the 5 percent diversification requirement for the issuer. As a result, except for the special provisions regarding single state money market funds, no money market fund non-government portfolio security would be excluded from rule 2a-7's limits on issuer concentration.[182]

2. Tax-Exempt Funds

Several commenters argued that the proposed issuer diversification amendment should not be applied to tax-exempt money market funds in particular.[183] A couple of these commenters stated that the Commission has previously recognized that tax-exempt money market funds should have unique treatment in certain instances due to the particular characteristics of tax-exempt money market funds, including the more constrained supply of investable securities as opposed to other types of money market funds.[184] Several commenters argued that removing the issuer diversification exclusion would cause greater supply challenges, particularly in the tax-

182 *See* rule 2a-7(d)(3)(i)(B) (issuer diversification requirements for single state money market funds).

183 *See* Dreyfus Comment Letter; Fidelity Comment Letter; ICI Comment Letter.

184 *See* ICI Comment Letter; Fidelity Comment Letter.

exempt market.[185] One of these commenters stated that the proposed amendment would be particularly difficult for single state money market funds due to the limited supply of eligible securities, but these commenters did not acknowledge that the 5 percent issuer diversification limit for single state funds applies to only 75 percent of a single state fund's total assets.[186] Another commenter stated that the proposal assumes a ready supply of securities supported by the same guarantor with different issuers so that a fund could comply with the issuer diversification requirement without reducing its holdings of the guarantor's securities, but that this is not the case, particularly in the tax-exempt market.[187]

One commenter suggested that tax-exempt money market funds regularly rely on the exclusion for securities guaranteed by non-controlled persons to exceed the 5 percent diversification limit.[188] In the Proposing Release, staff believed that based on an analysis of February 2014 Form N-MFP data, only 8 out of 559 money market funds, the majority of which were tax-exempt money market funds, held securities with a guarantee issued by a non-controlled person that exceeded the 5 percent diversification requirement for issuers. A couple commenters suggested that Commission staff review a broader sample of data from Form N-MFP to determine the magnitude of funds that rely on the issuer diversification exclusion.[189] One of these commenters also suggested that Commission staff confirm that for any given fund the staff are aggregating an issuer's securities subject to guarantees by non-controlled persons with the issuer's securities subject to guarantees by control persons and the issuer's securities

185 *See* Dreyfus Comment Letter; Fidelity Comment Letter; ICI Comment Letter.

186 *See* Dreyfus Comment Letter. *See also* rule 2a-7(d)(3)(i)(B).

187 *See* ICI Comment Letter.

188 *See id.*

189 *See* Dreyfus Comment Letter; ICI Comment Letter.

that are not guaranteed, in order to determine whether a fund is potentially relying on the issuer diversification exclusion by exceeding the 5 percent issuer diversification limit.[190]

In order to obtain a greater sample, and in response to commenters, the staff supplemented its analysis using October 2014 and April 2015 Form N-MFP data to review the number of funds that exceeded the 5 percent issuer diversification limit, which would indicate that such funds were potentially relying on the 5 percent issuer diversification exclusion.[191] As discussed further in the economic analysis section below, the staff's analysis shows that for October 2014, 60 money market funds out of 553 total money market funds, or approximately 10.8 percent of all money market funds, were potentially relying on the 5 percent issuer diversification exclusion. In addition, staff analysis shows that as of October 2014, only 0.0482 percent of total money market fund assets were above the 5 percent issuer diversification threshold.[192] For April 2015, staff analysis shows that 63 money market funds out of 542 total money market funds, or approximately 11.6 percent of all money market funds, were potentially relying on the 5 percent issuer diversification exclusion. In addition, staff analysis shows that as of April 2015, only 0.0624 percent of total money market fund assets were above the 5 percent issuer diversification threshold.[193]

Based on their updated analysis, Commission staff believes that only tax-exempt money

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190 *See* ICI Comment Letter.

191 In calculating funds' issuer concentrations, staff made assumptions about the relationships among issuers. Such assumptions may have caused the number of funds that appear to be relying on the 5 percent issuer diversification exclusion to be overstated. To be conservative, staff assumed, for example, that a position in a tender option bond that is over 5 percent of the fund's assets is exposure to a single issuer, even though tender option bond trusts may have more than one issuer as the underlying obligor. We expect that funds' analysts, portfolio managers and counsel can make these determinations based on specific facts that were not available to the staff.

192 This percentage amount corresponds to $1,447,300,000 in assets.

193 This percentage amount corresponds to $1,833,000,000 in assets.

market funds appeared to be relying on the 5 percent issuer diversification exclusion. For October 2014, staff analysis shows that 16 national tax-exempt money market funds out of 72 total national tax-exempt money market funds were potentially relying on the 5 percent issuer diversification exclusion. In addition, staff analysis shows that as of October 2014, only 0.1 percent of national tax-exempt money market fund assets were above the 5 percent issuer diversification threshold.[194] For April 2015, staff analysis shows that 25 national tax-exempt money market funds out of 71 total national tax-exempt money market funds were potentially relying on the 5 percent issuer diversification exclusion. In addition, staff analysis shows that as of April 2015, only 0.5 percent of national tax-exempt money market fund assets were above the 5 percent issuer diversification threshold.[195]

One commenter argued that the proposed amendment would particularly affect single state money market funds.[196] In response to this commenter, and because a single state fund may currently invest up to 25 percent of its total assets in the first tier securities of any single issuer, Commission staff also separately identified the number of single state money market funds that appear to be relying on the issuer diversification exclusion. For October 2014, staff analysis shows that 44 single state money market funds out of 97 total single state money market funds were potentially relying on the 5 percent issuer diversification exclusion. In addition, staff analysis shows that as of October 2014, only 1.7 percent of single state money market fund assets were above the 5 percent issuer diversification threshold (while taking into account the 25

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194 This percentage amount corresponds to $198,500,000 in assets.

195 This percentage amount corresponds to $893,400,000 in assets.

196 *See* Dreyfus Comment Letter.

percent issuer diversification basket).[197] For April 2015, staff analysis shows that 38 single state money market funds out of 90 total single state money market funds were potentially relying on the 5 percent issuer diversification exclusion. In addition, staff analysis shows that as of April 2015, only 1.3 percent of single state money market fund assets were above the 5 percent issuer diversification threshold (while taking into account the 25 percent issuer diversification basket).[198]

These updated analyses confirm the Commission's initial assumption that overall, few money market funds would be affected by the issuer diversification amendment. As indicated by the staff's analysis above, and as discussed further in the economic analysis section below, we continue to believe a small number of all money market funds rely on the 5 percent issuer diversification exclusion and therefore believe the amendment's effect on funds, including the available supply of investable securities, would be minimal. We recognize that although overall few money market funds are relying on the 5 percent issuer exclusion, the amendment to remove such exclusion would disproportionately affect tax-exempt money market funds and single state money market funds. However, we believe that our staff's analysis of the percentage of assets in excess of the 5 percent issuer diversification threshold provides an accurate reflection of the potential impact that the elimination of the 5 percent issuer diversification exclusion would have on money market funds. We also believe that looking to the percentage of assets in addition to the number of funds (which shows only absolute numbers), comprehensively shows the corresponding level of assets that will need to be reinvested. The above data shows that for October 2014 and April 2015, approximately 99.95 percent and 99.94 percent, respectively, of

[197] This percentage amount corresponds to $1,248,800,000 in assets.

[198] This percentage amount corresponds to $939,600,000 in assets.

total money market fund assets are not above the 5 percent issuer diversification threshold. Thus, because most money market funds are not using the exclusion and because a very high percentage of money market fund assets are not above the threshold, we continue to believe any negative effects for money market funds will generally be minimal.

We also note that money market funds will not be required to sell any of their portfolio securities as a result of our diversification amendment because rule 2a-7's diversification limits are measured at acquisition, and they may therefore retain these assets until they mature. Although we understand that national tax-exempt money market funds and single state money market funds may have made greater use of the 5 percent issuer exclusion in the past (and might do so in the future if we retained the 5 percent issuer diversification exclusion), we remain concerned that funds were previously exposed to concentrated risks inconsistent with the purposes of rule 2a-7's diversification requirements. As discussed above, we also continue to believe that restricting risk exposures to all issuers of securities subject to a guarantee or demand feature in the same way will appropriately limit the concentration of exposure that a money market fund could otherwise have to a particular issuer. Accordingly, we continue to believe that removing the exclusion to the 5 percent issuer diversification provision furthers our reform goal of limiting concentrated exposure of money market funds to particular economic enterprises.

3. Technical Amendments

The Commission is also making technical amendments to certain diversification provisions in rule 2a-7.[199] First, the Commission is amending rule 2a-7(d)(3)(i)(A)(*2*) to clarify

[199] *See* rule 2a-7(d)(3)(i) (issuer diversification) and rule 2a-7(d)(3)(iii) (diversification rules for demand features and guarantees).

that a tax-exempt fund (other than a single state fund) is required to comply with rule 2a-7(d)(3)(i)(A)(*2*) with respect to only 85 percent of its total assets.[200]

Second, the Commission is clarifying the use of the three-day safe harbor as it pertains to issuer diversification. The current three-day safe harbor provides that a money market fund may invest up to 25 percent of its total assets in first tier securities of a single issuer for a period of three business days after the acquisition thereof.[201] Specifically, rule 2a-7(d)(3)(i)(A)(*1*) generally prohibits a money market fund (other than a single state fund) from investing more than 5 percent of its total assets in an issuer's first tier securities, provided that such a fund may invest up to 25 percent of its total assets in the first tier securities of a single issuer for a period of up to three business days after the acquisition thereof. In addition, rule 2a-7(d)(3)(i)(A)(*2*) prohibits, at the time of any acquisition, investment of more than ten percent of a money market fund's total assets in securities issued by *or* subject to demand features or guarantees from the institution that issued the demand feature or guarantee, without making reference to the three-day safe harbor. Because the three-day safe harbor is referenced solely in subparagraph (*1*) of rule 2a-7(d)(3)(i)(A) and not in subparagraph (*2*) of rule 2a-7(d)(3)(i)(A), it may have been unclear as to whether a money market fund (other than a single state fund) could invest up to 25 percent of its total assets in a single issuer's securities for a period of up to three business days if some of

200 *See* rule 2a-7(d)(3)(i)(A)(*2*). Current rule 2a-7(d)(3)(i)(A)(*2*) could be read to suggest that a tax-exempt money market fund must not invest more than 10 percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee. However, the 2014 money market fund reform amendments provided that as much as 15 percent of the value of securities held in a tax-exempt money market fund's portfolio may be subject to guarantees or demand features from a single institution. The technical amendment incorporates and reflects these 2014 money market fund reform amendments and clarifies that a tax-exempt fund need only comply with this provision with respect to 85 percent of its total assets, and not with respect to all of its total assets.

201 *See supra* note 161. In the amendments we are adopting today, the three-day safe harbor will not refer to investments in first-tier securities.

the money market fund's securities were subject to guarantees or demand features provided by such issuer. In order to clarify that a money market fund (other than a single state fund) can invest up to 25 percent of its total assets in a single issuer's securities for a period of up to three business days if some of the money market fund's securities are subject to guarantees or demand features provided by such issuer, the Commission is amending rule 2a-7(d)(3)(i)(A) to clarify that the three-day safe harbor for issuer diversification should be read to apply to both subparagraphs (*1*) and (*2*).[202]

Last, the Commission is amending rule 2a-7(d)(3)(i)(B)(*2*) to clarify that a single state fund is required to comply with the diversification limitations of rule 2a-7(d)(3)(i)(B)(*2*) with respect to only 75 percent of its total assets, so long as not more than 15 percent of its total assets are invested in securities subject to guarantees or demand features provided by an institution as provided for in rule 2a-7(d)(iii)(B).[203] These amendments are intended only to clarify the diversification amendments that the Commission adopted as part of the 2014 money market reform.

III. COMPLIANCE PERIOD FOR THE FINAL RULE AND FORM AMENDMENTS

In the Proposing Release, we proposed a compliance date for the final amendments to rule 2a-7 and Form N-MFP that would coordinate compliance with the rule 2a-7 amendments

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[202] *See* rule 2a-7(d)(3)(i)(A).

[203] *See* rule 2a-7(d)(3)(i)(B)(*2*). Current rule 2a-7(d)(3)(i)(B)(*2*) could be read to suggest that a single state fund must not invest more than 10 percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee. However, a single state fund may invest up to 25 percent of its total assets in securities of any single issuer. In addition, the 2014 money market fund reform amendments provided that as much as 15 percent of the value of securities held in a single state fund's portfolio may be subject to guarantees or demand features from a single institution. The technical amendment incorporates and reflects these provisions and clarifies that a single state fund need only comply with this provision with respect to 75 percent of its total assets, and not with respect to all of its total assets.

relating to diversification, stress testing, and Form N-MFP, adopted in the 2014 Money Market Fund Adopting Release. We solicited comments on this compliance period in the Proposing Release, and one commenter addressed the issue, suggesting that the date be pushed back so that funds will have at least one full year to comply.[204]

In response to this comment, we are now adopting October 14, 2016 as the compliance date for this final rule. This date will give funds more than a full year to comply, which we agree is appropriate, and will also coordinate with the floating net asset value, liquidity fee,a nd redemption gate provisions in the 2014 Money Market Fund Adopting Release. We believe that this compliance date will provide an adequate period of time for money market funds to review and revise their policies and procedures for complying with amended rule 2a-7.[205] Although this compliance date will not coincide with the compliance date for the rule 2a-7 amendments relating to diversification, stress testing, and Form N-MFP adopted in the 2014 Money Market Fund Adopting Release, we believe that coordinating the compliance date of today's amendments with the compliance date of the floating net asset value amendments adopted in the 2014 Money Market Fund Adopting Release should reduce costs by consolidating changes to be made to a fund's policies and procedures at that time, while also providing more than a year for implementation of today's amendments.

IV. PAPERWORK REDUCTION ACT ANALYSIS

Certain provisions of this final rule contain "collections of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[206] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays

[204] Schwab Comment Letter.

[205] *See infra* section V.A.2.v.

[206] 44 U.S.C. 3501-3520.

a currently valid control number. The titles and control numbers for the existing collections of information that are affected by the rule amendments are: (1) "Rule 2a-7 under the Investment Company Act of 1940, Money market funds" (OMB Control No. 3235-0268); (2) "Rule 30b1-7 under the Investment Company Act of 1940, Monthly report for money market funds" (OMB Control No. 3235-0657); and (3) "Form N-MFP under the Investment Company Act of 1940, Monthly schedule of portfolio holdings of money market funds" (OMB Control No. 3235-0657). This final rule contains no new collections of information not present in the proposed rule. The Commission published notice soliciting comments on the collection of information requirements in the Proposing Release and submitted the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. We did not receive any comments on the collection of information requirements.

A. Rule 2a-7

As discussed above, we are removing references to credit ratings in rule 2a-7, which affect five elements of the rule: (i) determination of whether a security is an eligible security; (ii) determination of whether a security is a first tier security; (iii) credit quality standards for securities with a conditional demand feature; (iv) requirements for monitoring securities for ratings downgrades and other credit events; and (v) stress testing. These amendments involve collections of information, and the respondents to the collections of information are money market funds. This collection of information will be mandatory for money market funds that rely on rule 2a-7, and to the extent that the Commission receives confidential information pursuant to the collection of information, such information will be kept confidential, subject to the provisions of applicable law.[207]

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[207] *See, e.g.*, 5 U.S.C. 552 (Exemption 4 of the Freedom of Information Act provides an exemption

1. <u>Eligible Security Determinations for Money Market Fund Portfolio Securities, Including Securities That Are Subject to a Conditional Demand Feature</u>

Rule 2a-7 limits a money market fund's portfolio investments to "eligible securities," which are currently defined as securities that have received credit ratings from a requisite NRSRO in one of the two highest short-term rating categories, or comparable unrated securities.[208] The rule also restricts money market fund investments to securities that the fund's board, or its delegate, determines present minimal credit risks, and requires a fund to adopt policies and procedures regarding minimal credit risk determinations.[209] As discussed above, we are adopting amendments to rule 2a-7 that will remove any reference to, or requirement of reliance on, credit ratings in rule 2a-7 and modify the credit quality standard to be used in determining the eligibility of a money market fund's portfolio securities, including securities that are subject to a conditional demand feature. Specifically, the amendments will eliminate the current requirement that an eligible security be rated in one of the two highest short-term rating categories by an NRSRO or be of comparable quality, and will combine the current "first tier" and "second tier" credit risk categories into a single standard, which will be included as part of rule 2a-7's definition of eligible security. A security will be an eligible security only if the money market fund's board of directors (or its delegate) determines that it presents minimal credit risks, which determination will involve consideration of specified credit analysis factors

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for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, or on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. 552(b)(8)).

208 *See* current rule 2a-7(a)(12).

209 *See* rules 2a-7(d)(2)(i); 2a-7(j)(1); 38a-1.

that are listed in the rule.[210] The amendments also require that, with respect to a security (or its guarantee) subject to a conditional demand feature, the underlying security (or its guarantee) must meet the same minimal credit risks standard.[211]

Money market funds are required to have written policies and procedures regarding minimal credit risk determinations.[212] Thus, each money market fund complex will incur one-time costs to comply with these amendments. Specifically, each fund complex will incur costs to review the amended provisions of rule 2a-7 and, as it determines appropriate in light of the amendments, revise its policies and procedures to incorporate the amended credit quality standards to be used in determining the eligibility of a money market fund's portfolio securities. As discussed below, we anticipate that many funds are likely to retain their investment policies as currently required under rule 2a-7, which incorporate NRSRO ratings and which will be permitted under the rule amendments.[213] Some funds, on the other hand, may choose to revise their investment policies to remove references to NRSRO ratings and to incorporate the standards provided in the rule. Even if funds choose to eliminate references to ratings in their investment policies, funds' investment policies may not change substantially, as funds are already required to assess credit quality apart from ratings as part of their minimal credit risk

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210 Rule 2a-7(a)(11); *see supra* section II.A.

211 Rule 2a-7(d)(2)(iii)(C); *see supra* section II.B. The proposal included a further finding that the issuer of the demand feature would have a very strong capacity for payment of its financial commitments. See proposed rule 2a-7(d)(2)(iii)(C). As discussed below, because the minimal credit risk standard, as proposed, remains in the amendments we are adopting today, and, because the strong capacity standard, as commenters noted, would be generally superfluous and subsumed by the overriding minimal credit risk determination, we are not revising our burden estimate from the proposal.

212 *See* rule 2a-7(j)(1).

213 *See infra* section V.A.

determinations.[214] As we noted in the discussion above, based on staff observations in examinations and prior staff guidance, we believe that most money market fund managers currently take the codified credit analysis factors into account, as appropriate, when they determine that a portfolio security presents minimal credit risks.

The Proposing Release provided the credit analysis factors as guidance, rather than in rule text, and required that the fund make a finding that the issuer of a security had an "exceptionally strong capacity" to meet its short-term financial obligations.[215] Because the final rule is merely codifying the analysis that staff believes money market fund managers currently take into account, we do not believe that the burden associated with the final rule will be different from that estimated for the proposed rule. The estimates associated with the analysis for the proposal assumed use of the credit analysis factors presented as guidance, thus providing the fund sufficient information to make the minimal credit risk and "exceptionally strong capacity" findings. Therefore, we believe that codifying the factors and eliminating the "exceptionally strong capacity" finding will have no effect on the burden estimates, because use of the factors was already assumed in those estimates and the "exceptionally strong capacity" finding was assumed to be built into that analysis, creating no additional burden. Similarly, the proposal included a further finding that the issuer of a conditional demand feature would have a "very strong capacity" for payment of its financial commitments.[216] As with the "exceptionally strong capacity" finding, this "very strong capacity" finding was assumed to be built into the credit analysis, and we do not believe that removal of this finding will change the estimated

214 *See* current rule 2a-7(d)(2)(i).

215 *See* proposed rule 2a-7(a)(11).

216 *See* proposed rule 2a-7(d)(2)(iii)(C).

burden associated with this requirement.

While we cannot predict with precision the extent to which funds may revise their policies and procedures for determining minimal credit risk, we estimate that each money market fund complex on average will incur a one-time burden of 9 hours,[217] at a cost of $2,838,[218] to review and revise, as appropriate, its policies and procedures. Using an estimate of 103 money market fund complexes,[219] we estimate that money market funds would incur, in aggregate, a total one-time burden of 927 hours,[220] at a cost of $292,314,[221] to comply with the amended provisions of rule 2a-7 modifying the credit quality standard to be used in determining the eligibility of a fund's portfolio securities. Amortizing these hourly and cost burdens over three years results in an average annual increased burden for all money market fund complexes of 309

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217 We estimate that the lower range of the one-time hour burden for a money market fund complex to review and revise, as appropriate, its policies and procedures for determining minimal credit risk would be 6 hours (4 hours by a compliance manager, and 2 hours by an attorney). We estimate that the upper range of the one-time hour burden for a money market fund complex to review and revise, as appropriate, its policies and procedures for determining minimal credit risk would be 12 hours (8 hours by a compliance manager, and 4 hours by an attorney). For purposes of our estimates for the PRA analysis, we have taken the mid-point of this range (mid-point of 6 hours and 12 hours = 9 hours (6 hours by a compliance manager, and 3 hours by an attorney)).

218 This estimate is based on the following calculation: (6 hours (mid-point of 4 hours and 8 hours incurred by a compliance manager) x $283 (rate for a compliance manager) = $1,698) + (3 hours (mid-point of 2 hours and 4 hours incurred by an attorney) x $380 (rate for an attorney) = $1,140) = $2,838. All estimated wage figures discussed here and throughout this release are based on published rates that have been taken from SIFMA's Management & Professional Earnings in the Securities Industry 2013, *available at* http://www.sifma.org/research/item.aspx?id=8589940603, modified by Commission staff to account for an 1800 hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

219 Based on data from Form N-MFP and iMoneyNet as of April 30, 2015. The Proposing Release PRA statement was based on data as of February 28, 2014. We have updated the estimates used in this final PRA to reflect more current data as of April 30, 2015.

220 This estimate is based on the following calculation: 9 hours x 103 money market fund complexes = 927 hours.

221 This estimate is based on the following calculation: $2,838 x 103 money market fund complexes = $292,314.

hours[222] at a cost of $97,438.[223] We do not believe that funds would newly implement or change any annual review of policies and procedures that they currently perform as a result of the adopted amendments. There will be no external costs associated with this collection of information.

2. Monitoring Minimal Credit Risks

Rule 2a-7 currently requires a money market fund board (or its delegate) to promptly reassess whether a security that has been downgraded by an NRSRO continues to present minimal credit risks.[224] As discussed above, we are adopting as proposed amendments to rule 2a-7 that will eliminate the current use of credit ratings in the rule's downgrade and default provisions. Rule 2a-7 instead will require a money market fund to adopt written procedures requiring the fund adviser, or any person to whom the fund's board of directors has delegated portfolio management responsibilities, to provide ongoing review of each portfolio security to determine that the issuer continues to present minimal credit risks.[225] To comply with these amendments, a fund complex will incur one-time costs to review the amended provisions of rule 2a-7 and adopt policies and procedures providing for ongoing review to determine whether a money market fund's portfolio securities continue to present minimal credit risks. Money market funds are not currently required to maintain policies and procedures that specifically address ongoing minimal credit risk monitoring. Although we understand, based on staff experience, that most money market funds currently monitor portfolio securities for minimal

222 This estimate is based on the following calculation: 927 hours ÷ 3 years = 309 hours.

223 This estimate is based on the following calculation: $292,314 ÷ 3 years = $97,438.

224 *See* current rule 2a-7(f)(1)(i).

225 Rule 2a-7(g)(3); *see supra* section II.C.

credit risk on an ongoing basis,[226] we are assuming that all money market fund complexes would need to adopt new written policies and procedures to provide for this ongoing review in order to comply with the amended provisions of rule 2a-7.

We estimate that each money market fund complex on average would incur a one-time burden of 5 hours,[227] at a cost of $3,619,[228] to adopt policies and procedures for ongoing review of minimal credit risks. Using an estimate of 103 money market fund complexes,[229] we estimate that money market funds will incur, in aggregate, a total one-time burden of 515 hours,[230] at a

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226 *See supra* note 116 and accompanying text.

227 These hour estimates assume that the process of adopting written policies and procedures will consist primarily of transcribing and reviewing any existing policies and procedures that funds currently use when monitoring minimal credit risk on an ongoing basis. Because we cannot predict the extent to which funds may need to develop these policies and procedures to comply with the amended provisions of rule 2a-7, or may need to transcribe and review any existing policies and procedures, we have taken, as an estimated average burden, the mid-point of a range of hour estimates discussed below in the following paragraph for purposes of our PRA analysis.

We estimate that the lower range of the one-time hour burden for a money market fund complex to adopt policies and procedures for ongoing review to determine whether a money market fund's portfolio securities continue to present minimal credit risks would be 3.5 hours (2 hours by a compliance manager and 1 hour by an attorney to develop and review policies and procedures (or transcribe and review pre-existing policies and procedures) + 0.5 hours for the fund's board to adopt the policies and procedures). We estimate that the upper range of the one-time hour burden for a money market fund complex to adopt such policies and procedures would be 6.5 hours (4 hours by a compliance manager and 2 hours by an attorney to develop and review policies and procedures (or transcribe and review pre-existing policies and procedures) + 0.5 hours for the fund's board to adopt the policies and procedures). The mid-point of the lower range estimate and the upper range estimate is 5 hours.

228 This estimate is based on the following calculation: (3 hours (mid-point of 2 hours and 4 hours incurred by a compliance manager) x $283 (rate for a compliance manager) = $849) + (1.5 hours (mid-point of 1 hour and 2 hours incurred by an attorney) x $380 (rate for an attorney) = $570) + (0.5 hours x $4,400 per hour for a board of 8 directors = $2,200)= $3,619. The staff previously estimated in 2009 that the average cost of board of director time was $4,000 per hour for the board as a whole, based on information received from funds and their counsel. Adjusting for inflation, the staff estimates that the current average cost of board of director time is approximately $4,400 per hour.

229 Based on data from Form N-MFP and iMoneyNet as of April 30, 2015. The Proposing Release PRA statement was based on data as of February 28, 2014. We have updated the estimates used in this final PRA to reflect more current data as of April 30, 2015.

230 This estimate is based on the following calculation: 5 hours x 103 money market fund complexes

cost of $372,757,[231] to comply with the amended provisions of rule 2a-7. Amortizing these hourly and cost burdens over three years results in an average annual increased burden for all money market fund complexes of 172 hours[232] at a cost of $124,252.[233] There will be no external costs associated with this collection of information.

3. Stress Testing

Rule 2a-7 currently requires money market funds to adopt written stress testing procedures and to perform stress tests according to these procedures on a periodic basis.[234] We are adopting as proposed amendments to rule 2a-7 that would replace the reference to ratings downgrades in the rule's stress testing provisions with a hypothetical event that is designed to have a similar impact on a money market fund's portfolio.[235] The amendment is designed to retain a similar standard for stress testing as under current rule 2a-7. Specifically, while rule 2a-7 currently requires a fund to stress test its portfolio based on certain hypothetical events, including a downgrade of portfolio securities, the adopted amendment will require a fund to stress test for an event indicating or evidencing credit deterioration in a portfolio security, and will include a downgrade or default as examples of that type of event. As discussed below, we recognize that a money market fund could use its current policies and procedures to comply with the amendment, and could continue to use credit quality evaluations prepared by outside sources,

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= 515 hours.

231 This estimate is based on the following calculation: $3,619 x 103 money market fund complexes = $372,757.

232 This estimate is based on the following calculation: 515 hours ÷ 3 years = 172 hours.

233 This estimate is based on the following calculation: $372,757 ÷ 3 years = $124,252.

234 *See* current rule 2a-7(g)(8).

235 Rule 2a-7(g)(8)(i)(B); *see supra* section II.D.

including NRSRO downgrades, in stress tests.[236] Because the rule currently requires testing for a downgrade as a hypothetical event, we do not believe that funds will take any additional time to review and revise their policies and procedures with respect to the continued use of downgrades in stress testing. Accordingly, we do not expect the amendments will significantly change current collection of information burden estimates for rule 2a-7.[237]

Total Burden for Rule 2a-7. The current approved collection of information for rule 2a-7 is 632,244 annual aggregate hours. The aggregate additional burden hours associated with the adopted amendments to rule 2a-7 increase the burden estimate to 632,725 hours annually for all funds.[238]

B. Rule 30b1-7 and Form N-MFP

Rule 30b1-7 requires money market funds to file a monthly report electronically on Form N-MFP within five business days after the end of each month. The information required by the form must be data-tagged in XML format and filed through EDGAR. Preparing Form N-MFP is a collection of information under the PRA.[239] The respondents to this collection of information are money market funds. A fund must comply with the requirement to prepare Form N-MFP in order to hold itself out to investors as a money market fund or the equivalent of a money market fund in reliance on rule 2a-7. This collection of information is mandatory for money market funds that rely on rule 2a-7, and responses to the disclosure requirements of

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236 *See infra* text surrounding note 288.

237 *See id.*

238 This estimate is based on the following calculation: 632,244 hours (current approved burden) + 309 hours (eligible security determinations for money market fund portfolio securities, including securities that are subject to a conditional demand feature) + 172 hours (monitoring minimal credit risks) = 632,725 hours.

239 For purposes of the PRA analysis, the current burden associated with the requirements of rule 30b1-7 is included in the collection of information requirements of Form N-MFP.

Form N-MFP are not kept confidential.

Money market funds are currently required to disclose on Form N-MFP, with respect to each portfolio security, whether the security is a first or second tier security or is unrated, as well as the "designated NRSROs" for each security (and for each demand feature, guarantee, or credit enhancement).[240] As discussed above, the adopted amendments will require that each money market fund disclose on Form N-MFP, for each portfolio security, any rating assigned by an NRSRO that the fund's board of directors (or its delegate) considered in determining that the security presents minimal credit risks (together with the name of the assigning NRSRO).[241] Because we believe that the majority of funds will continue to refer to credit ratings in making minimal credit risk determinations, we do not believe the amendments to Form N-MFP will result in material changes to the ongoing burden for most funds.[242] However, we believe that funds will incur one-time costs to re-program their filing software to reflect the new requirements of Form N-MFP.

We estimate that each fund will incur a one-time burden of 3 hours,[243] at a cost of $943 per fund,[244] to comply with the amended disclosure requirements of Form N-MFP. Using an

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[240] *See* Form N-MFP Items C.9, C.10, C.14.b-c, C.15.b-c, C.16.c-d.

[241] *See* Form N-MFP Items C.9, C.10, C.14.e, C.15.c, C.16.d; *supra* section II.E.T he proposal also would have required disclosure of any rating assigned by an NRSRO to whose services the fund or its adviser subscribes (together with the name of the assigning NRSRO). Because the estimated burden assigned to the form amendments is only the one-time re-programming cost, which will not be affected by the change from the proposal to the adopting release, the burden estimate above has not been reduced to reflect the removal of this requirement.

[242] *See supra* note 114.

[243] We estimate that the one-time hour burden for a money market fund to re-program its Form N-MFP filing software to reflect the new requirements of Form N-MFP would be 3 hours (1 hour by a senior systems analyst, 1 hour by a senior programmer, and 1 hour by an attorney).

[244] This estimate is based on the following calculation: (1 hour x $260 (rate for a senior systems analyst) = $260) + (1 hour x $303 (rate for a senior programmer) = $303) + (1 hour x $380 (rate for an attorney) = $380) = $943.

estimate of 537 money market funds that are required to file reports on Form N-MFP,[245] we estimate that money market funds will incur, in the aggregate, a total one-time burden of 1,611 hours,[246] at a cost of $506,391,[247] to comply with the amended disclosure requirements of Form N-MFP. Amortizing these hourly and cost burdens over three years results in an average annual increased burden for all money market funds of 537 hours[248] at a cost of $168,797.[249] There will be no external costs associated with complying with the amended disclosure requirements of Form N-MFP.[250]

The current approved collection of information for Form N-MFP is 83,412 annual aggregate hours and $4,780,736 in external costs. The aggregate additional hours associated with the amendments to Form N-MFP increase the burden estimate to 83,949 hours annually for

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245 This estimate is based on a review of reports on Form N-MFP filed with the Commission for the month ended April 30, 2015. The Proposing Release PRA statement was based on data as of February 28, 2014. We have updated the estimates used in this final PRA to reflect more current data as of April 30, 2015.

246 This estimate is based on the following calculation: 3 hours x 537 money market funds = 1,611 hours.

247 This estimate is based on the following calculation: $943 x 537 money market funds = $506,391.

248 This estimate is based on the following calculation: 1,611 hours ÷ 3 years = 537 hours.

249 This estimate is based on the following calculation: $506,391 ÷ 3 years = $168,797.

250 We understand that a certain percentage of money market funds that report information on Form N-MFP license a software solution from a third party that is used to assist the funds to prepare and file the required information, and that a certain percentage of money market funds retain the services of a third party to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-MFP. *See* 2014 Money Market Fund Adopting Release, *supra* note 6, at text accompanying nn.2334-2336.

We recognize that, in general, software service providers that modify their software may incur additional external costs, which they may pass on to money market funds in the form of higher annual licensing fees. *See id.* at text accompanying n. 2340. However, on account of the relatively low per-fund one-time hour burden that we estimate in connection with the amended disclosure requirements of Form N-MFP, we expect that any increase in licensing fees will be insignificant, and thus we estimate that there are no external costs associated with the amended Form N-MFP disclosure requirements.

all funds.[251] Because we estimate no external costs associated with complying with the amended Form N-MFP disclosure requirements, the annual external costs associated with the Form N-MFP collection of information would remain $4,780,736.

V. ECONOMIC ANALYSIS

As discussed above, we are adopting amendments to rule 2a-7 and Form N-MFP under the Investment Company Act to implement Section 939A of the Dodd-Frank Act, which requires the Commission, to "review any regulation issued by [the Commission] that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and any references to or requirements in such regulations regarding credit ratings."[252] That section further provides that the Commission shall "modify any such regulations identified by the review . . . to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as [the Commission] shall determine as appropriate for such regulations."[253]

We are also amending rule 2a-7 to eliminate the exclusion to the issuer diversification requirement for securities subject to a guarantee issued by a non-controlled person. As a result, most non-government securities subject to a guarantee (including an asset-backed security with a presumed sponsor guarantee) will have to comply with both the 5 percent diversification requirement for issuers (including SPE issuers) and the 10 percent diversification requirement for

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[251] This estimate is based on the following calculation: 83,412 hours (current approved burden) + 537 hours = 83,949 hours.

[252] Pub. Law 111-203, Sec. 939A(a)(1)-(2). Section 939A of the Dodd-Frank Act applies to all federal agencies.

[253] Pub. Law 111-203, Sec. 939A(b). Section 939A of the Dodd Frank Act provides that agencies shall seek to establish, to the extent feasible, uniform standards of creditworthiness, taking into account the entities the agencies regulate and the purposes for which those entities would rely on such standards.

guarantors and providers of demand features.[254]

The economic baseline for our economic analysis is the regulatory framework as it exists immediately before the adoption of these amendments, that is, the regulatory framework after the amendments to rule 2a-7 were adopted in the 2014 Money Market Fund Adopting Release. As discussed in more detail below, that release makes material changes to rule 2a-7 that we believe may result in material changes to the money market fund industry. Because there is an extended compliance period for those amendments, and we are not aware of any funds that are already complying with all of the amendments, we do not know how market participants, including money market fund managers selecting portfolio securities, may react as a result. Thus, we are not able to provide quantitative estimates for the incremental effects of this rule's amendments. For example, under the baseline, institutional prime money market funds have floating NAVs and maintain the distinction between first and second tier securities. We are unable to estimate how institutional prime funds will choose to allocate their portfolios among first and second tier securities under our amendments when they have floating NAVs and no commenters provided any estimates. We discuss potential economic effects of complying with the amendments to the rule, but without knowing how fund portfolio allocations may change we cannot quantify these potential effects. For the remainder of our economic analysis, we discuss separately the rule 2a-7 amendments to remove and replace ratings references, Form N-MFP amendments, and the amendments to rule 2a-7's issuer diversification provision.

A. Rule 2a-7: Ratings Removal and Related Amendments

[254] As discussed above, the asset-backed security presumed guarantee is counted toward the 10% limitation on guarantees and demand features provided by the same institution. Up to 15% of the value of securities held in a tax-exempt money market fund's portfolio may be subject to guarantees or demand features from a single institution, and up to 25% of the value of securities held in a single state money market fund portfolio may be issued by any single issuer. *See supra* section II.F.

The amendments to rule 2a-7 will affect five elements of the current rule. These are: (i) determination of whether a security is an eligible security; (ii) determination of whether a security is a first tier security; (iii) credit quality standards for securities with a conditional demand feature; (iv) requirements for monitoring securities for ratings downgrades and other credit events; and (v) stress testing.[255] The amendments are designed to remove any requirement of reliance on credit ratings and to substitute standards of creditworthiness that we believe are appropriate.

1. Economic Baseline

As discussed above, the current credit risk limitations in rule 2a-7 require that money market funds undertake a two-step analysis before acquiring a portfolio security.[256] First, funds must determine whether a security has received credit ratings from the "requisite NRSROs" in one of the two highest short-term rating categories or, if the security is unrated, determine that it is of comparable quality. A money market fund must currently invest at least 97 percent of its portfolio in first tier securities, which are eligible securities that have received a rating from the requisite NRSROs in the highest short-term rating category for debt obligations, or unrated securities of comparable quality. Second, the fund's board of directors (or its delegate) must determine that the security presents minimal credit risks, based on factors pertaining to credit quality in addition to any rating assigned to such securities by a designated NRSRO. In addition, under current rule 2a-7, a security subject to a conditional demand feature may be determined to

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[255] The final rule will also make conforming amendments to rule 2a-7's recordkeeping and reporting requirements. *See* rule 2a-7(h)(3).

[256] *See supra* note 25 and accompanying and preceding text. The credit risk limitations of current rule 2a-7, as well as the other specific provisions of current rule 2a-7 that reference credit ratings, were not changed by the adoption of the amendments discussed in the 2014 Money Market Fund Adopting Release.

be an eligible security or a first tier security if, among other conditions: (i) the conditional demand feature is an eligible security or a first tier security, and (ii) the underlying security (or its guarantee) has received either a short-term rating or a long-term rating,as the case may be, within the highest two categories from the requisite NRSROs or is a comparable unrated security.

Based on Form N-MFP filings from April 30, 2015, the Commission estimates that 98.26 percent of aggregate money market fund assets are in first tier securities, 0.14 percent of aggregate money market fund assets are in second tier securities, and 1.6 percent of aggregate money market fund assets are in unrated securities. Among the 537 funds that filed Form N-MFP that month, 412 funds reported that they held only first tier securities, 477 funds reported that they held no second tier securities, and 447 funds reported that they held no unrated securities. In addition, less than 4 percent of all money market funds held the maximum amount of second tier securities permitted under current rule 2a-7. Using additional data from the Federal Reserve Board, we estimate that money market fund holdings of second tier commercial paper represent 0.9 percent of the outstanding issues of second tier commercial paper.[257]

Securities subject to a conditional demand feature are typically variable rate demand notes issued by municipalities that have a conditional demand feature issued by a bank. Based on Form N-MFP filings as of April 30, 2015, the Commission estimates that 9.3 percent of money market fund assets are invested in securities with a demand feature. We estimate further that securities with conditional demand features represent 3.9 percent of securities with demand

[257] This data is based on the Federal Reserve Board's statistics on outstanding volume of commercial paper as of April 30, 2015. *See* Commercial Paper Outstanding by special categories,*a vailable at* http://www.federalreserve.gov/releases/cp/outstanding.htm. The Proposing Release used earlier data from this website. We have updated the figures used in this final rule analysis to reflect more current data as of April 30, 2015.

features and 0.4 percent of all securities held by money market funds. We further estimate that 77 percent of those underlying securities (or their issuers or guarantors) have received an NRSRO rating in the second-highest long-term rating category, while 23 percent have received an NRSRO rating in the highest long-term category.[258]

Rule 2a-7 currently requires a money market fund board (or its delegate) to promptly reassess whether a security that has been downgraded by an NRSRO continues to present minimal credit risks.[259] We understand that downgrades are rare among money market fund portfolio securities.[260] As discussed above, we believe, based on staff experience, that most, if not all, money market funds currently monitor portfolio securities for minimal credit risk on an ongoing basis.[261] We assume for purposes of this analysis, however, that these funds do not have written policies and procedures that specifically address ongoing minimal credit risk monitoring.

Finally, rule 2a-7 currently requires money market funds to stress test their portfolios.[262] Under the rule, a money market fund's board of directors must adopt written procedures to test the ability of a fund to maintain at least 10 percent of its total assets in weekly liquid assets and minimize principal volatility (and, in the case of a money market fund using the amortized cost

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258 An underlying long-term security would become a short-term security when its remaining time to maturity is less than 397 days. *See supra* note 94. These estimates are based on a random sample of 10% of the securities that have demand features that were reported in April 2015 Form N-MFP filings.

259 *See supra* note 111 and accompanying text.

260 *See, e.g.*, Response to Questions Posed by Commissioners Aguilar, Paredes, and Gallagher, a report by staff of the Division of Risk, Strategy, and Financial Innovation (Nov. 30, 2012), *available at* http://www.sec.gov/news/studies/2012/money-market-funds-memo-2012.pdf, at 14-16 (discussing events such as credit rating downgrades that have led money market fund sponsors to choose to provide support to the fund or to seek staff no-action assurances permitting such support). Staff continues to monitor credit rating downgrades among portfolio securities and other issues concerning money market funds through the monthly information provided on Form N-MFP.

261 *See supra* note 116 and accompanying text.

262 Current rule 2a-7(g)(8).

method of valuation or penny rounding method of pricing, the fund's ability to maintain a stable price per share) based on certain hypothetical events, including a downgrade or default of particular portfolio security positions, each representing various portions of the fund's portfolio. We believe that funds stress test at least monthly.[263]

2. Economic Analysis

The amendments to rule 2a-7 will assist in further implementing Section 939A of the Dodd-Frank Act. They are designed to establish credit quality standards similar to those currently in the rule. By replacing references to credit ratings, the amendments will, particularly when considered together with other amendments the Commission has adopted that remove credit ratings references in other rules and forms under the federal securities laws, contribute to the Dodd-Frank Act goals of reducing perceived government endorsement of NRSROs and over-reliance on credit ratings by market participants.[264]

i. Eligible securities

Under the final rule, a money market fund board (or its delegate) will be required to determine minimal credit risk by applying certain credit quality factors. Because the application of these factors may differ among fund boards and their advisers, the possible range of securities available for investment may differ from that under the current rule. However, inclusion of the credit analysis factors in the rule, as opposed to the more subjective standard in the proposed rule, should limit this range by helping to make compliance more uniform across money market funds. The final rule also clarifies that, when making minimal credit risk determinations, the fund's board (or its delegate) should consider the contribution of the security to aggregate credit

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263 *See* 2014 Money Market Fund Adopting Release, *supra* note 6, at section IV.A.5.

264 *See* 2014 Money Market Fund Adopting Release, *supra* note 6, at n.202 and accompanying text.

risks and not just evaluate the security in isolation. In particular, a potential addition to the portfolio that has low risk by itself might increase portfolio risk to unacceptable levels if it is sufficiently correlated with the overall portfolio. For example, a security that has a very low probability of default might be inappropriate for the fund if that security is likely to default at the same time as other securities in the fund's portfolio.

In addition, we believe that fund managers are generally unlikely to increase exposure of their funds to riskier second tier securities in light of both current market practices and amendments to rule 2a-7 adopted in the 2014 Money Market Fund Adopting Release.[265] First, we anticipate that many money market funds, particularly those that are themselves rated, are likely to retain their current investment policies, which incorporate NRSRO ratings and would be permitted under the rule amendments. Indeed, we understand that many funds today have investment policies that are more restrictive than rule 2a-7 requires, including policies that, for example, limit investments to first tier securities.[266] As a result, we do not expect that these

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265 *See, e.g.,* 2010 Money Market Fund Adopting Release, *supra* note 84, at section II.A.1 (discussing tradeoff between risk and yield for second tier securities). We do not believe fund managers are likely to invest in securities rated below the second highest short-term rating category of an NRSRO (or comparable unrated securities) because those securities would not satisfy the standard for eligible securities that the security present minimal credit risks to the fund. See discussion *infra* section V.2.ii.

266 As of February 2014, 179 money market funds, representing approximately 59% of all money market fund assets (88% of all institutional money market fund assets) were themselves rated by credit rating agencies, and approximately 98% of rated money market funds were rated in the top credit quality category by an NRSRO. For a money market fund to receive this top rating, credit rating agencies generally require the fund to limit its portfolio securities to first tier securities. *See, e.g.*, FitchRatings, Global Money Market Fund Rating Criteria (Mar. 26, 2013),*a vailable at* http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=704145 (registration required) (stating that its "AAAmmf" top rating requires that a money market fund have 100% of its portfolio securities rated first tier ("F1+" or "F1")); Standard & Poor's, Methodology: Principal Stability Fund Ratings (Jun. 8, 2011), *available at* https://www.sbafla.com/prime/portals/8/RiskMan_Oversight/FundProfile/201106_SPPrincipalStabilityFundRatingsMethodology.pdf (stating that "[i]n order for a fund to be eligible for an investment-grade rating, all investments should carry a Standard & Poor's short-term rating of 'A-1+' or 'A-1' (or SP-1+ or SP-1), or Standard & Poor's will consider all of the investments to be

money market funds will change current policies and procedures they have adopted that limit their investments to those assigned the highest NRSRO ratings. We also noted above that according to Form N-MFP filings from April 30, 2015, fund assets in second tier securities represented 0.14 percent of total money market fund assets and that 18 funds (out of a total of 537) currently hold the maximum amount of second tier securities permissible under current rule 2a-7. We do not anticipate that money market funds representing the significant majority of assets under management are likely to increase substantially their investments in riskier securities as a result of our rule because these funds do not currently invest in second tier securities to the extent permitted now.

Second, as discussed above, the 2014 amendments to rule 2a-7 should reduce the potential that funds will invest in riskier securities. Under the 2014 reforms, money market funds other than government money market funds are allowed to impose fees and gates, while institutional prime money market funds will be required to transact at a floating NAV.[267] We believe that those reforms may encourage non-government funds to more closely monitor fund liquidity and hold more liquid securities to increase the level of daily and weekly liquid assets in the fund to lessen the likelihood of needing to impose a fee or gate. These newly adopted money market fund reforms also require each fund to disclose daily its market value rounded to four decimal points (or an equivalent level of accuracy for a fund using a share price other than $1.0000[268]) and to depict historical information about its daily NAV for the previous six months. These disclosures may increase informational efficiency by allowing investors to see variations

of equivalent credit quality").

267 Rule 2a-7(a)(14) defines a government money market fund as a money market fund that invests 99.5% or more of its total assets in cash, government securities, and/or repurchase agreements that are collateralized fully.

268 Rule 2a-7(h)(10)(iii).

in share value that are not apparent in the current share price and compare the volatility of share values among funds over time. As a result, to the extent that institutional investors continue to value price stability and can see these variations in share value, we believe that institutional prime funds will endeavor to reduce NAV fluctuations.

Third, under the final rule funds are permitted to refer to credit ratings while making their minimal credit risk determinations. A credit rating in the top short-term credit quality category by an NRSRO might help support the fund's determination that the security is an eligible security, while a credit rating in a lower category might not support the same determination. Thus, fund managers may have to perform additional credit research and analysis on the issuers of second tier securities in order to determine whether the investment is permitted under the adopted amendments. We believe that many fund managers may not wish to invest in the additional resources necessary to make this assessment with respect to second tier securities unless the fund believes that the expected risk-adjusted return of doing so would be greater than the expected costs. Thus, the demand for securities rated second tier will likely be lower.

The final rule would eliminate the current limitations on fund investments in second tier securities.[269] As a result, funds may increase their holdings of second tier securities despite the considerations discussed above. Commenters on the 2014 Proposing Release were mixed in their opinions as to whether the proposed changes would have this effect. Some believed that the standard proposed would appropriately limit funds' purchases of riskier securities,[270] while others thought that it would not.[271] The Commission believes that the changes to the proposed standard

269 *See supra* note 30 and accompanying text and note 62.

270 *See, e.g.,* Invesco Comment Letter; MFDF Comment Letter.

271 *See, e.g.,* BlackRock Comment Letter; CFA Comment Letter; Vanguard Comment Letter.

made in this final rule should reduce the likelihood of increased credit risk because funds will have to perform a rigorous analysis using the codified factors and consider a security's potential addition to the aggregate risk of the portfolio. We also believe that, to the extent money market funds increase investments in riskier securities, institutional prime funds are more likely than stable-NAV funds to do so because stable-NAV funds will need to maintain stability to avoid falling below $1 per share. Although some shareholders may continue to value price stability more than yield from institutional prime funds, if enough shareholders value yield more than price stability, institutional prime funds will be incentivized to increase their investments in second tier securities. Allocative efficiency may improve if such preferences result in relatively riskier securities moving from the portfolios of stable NAV funds to the portfolios of institutional prime funds, allowing money market fund shareholders to choose funds that better match their preferences for risk and return. We do not, however, know whether institutional prime funds with floating NAVs, which will have to compete with other money market funds, including stable-NAV government funds, will focus on maintaining comparatively stable NAVs or on generating comparatively high yields.

If we were to assume that money market funds increase their relative holdings of second tier securities with the adoption of the amendments, the effects on competition and capital formation would depend, in part, on whether the increased demand for second tier investments comes from new assets that investors bring to money market funds, which are then disproportionately invested in second tier securities, or whether the increased second tier investments would come from a shift of existing money market fund assets from first tier securities to second tier securities. If the former, the effects on competition between issuers of first and second tier securities might be small, and capital formation might improve in the second tier market as the size of the new investment increases. If the latter, an increase in capital formation from issuers of second tier securities may result in a corresponding decrease in capital formation from issuers of first tier securities, which, in turn, may lead to increased competition between issuers of first and second tier securities. We are unable to estimate these effects because we do not know how shareholders and funds will respond to the elimination of the current limitation on fund investments in second tier securities and no commenters provided any estimates.

The amendments to Form N-MFP, which are discussed in more detail below, may make it easier for fund shareholders and other third parties to monitor the level of credit risk borne by funds that use credit ratings. As a result, this increased transparency may reduce the likelihood that fund boards (or managers) increase significantly fund investments in second tier securities. We are requiring each money market fund to disclose on Form N-MFP those NRSRO ratings the fund's board (or its delegate) has considered, if any, in determining whether a security presents minimal credit risks.[272] The disclosure to investors of these ratings may have the effect of reducing the demand for funds that assume a level of risk that is different from that which is desired by their shareholders.

As discussed above, the vast majority of money market funds held no second tier securities on April 30, 2015, and few funds held the maximum permissible 3 percent. We therefore believe that a reduction or even elimination of second tier securities from the money market fund industry's aggregate portfolio will not likely have a material effect on issuers of

[272] Because the fund may only choose to consider one or two ratings, the specific rating or ratings disclosed by a fund on Form N-MFP may not always be indicative of the overall universe of ratings for that security. However, investors who wish to have a larger sample may choose to subscribe to other ratings themselves.

either first or second tier securities. However, removing second tier securities from the portfolios of individual money market funds may negatively affect yields in certain funds, especially during periods when second tier securities offer substantially higher yields than the yields offered by first tier securities.

We believe that most money market funds are not likely to change their current investment policies in response to the adopted amendments. Nevertheless, we recognize that some fund boards might choose not to consider NRSRO ratings in their credit assessments or as noted above, fewer securities may be rated. If, as a result, the demand for NRSRO ratings were significantly reduced, NRSROs might invest less in producing quality ratings. The importance attached to NRSRO ratings currently as a result of the history of their use in regulatory requirements may impart franchise value to the NRSRO rating business. By eliminating references to NRSRO ratings in federal regulations, Section 939A of the Dodd-Frank Act could reduce these franchise values and reduce NRSROs' incentives to produce credible and reliable ratings. If the quality and accuracy of NRSRO ratings were adversely affected, yet the ratings continued to be used by enough other parties, the capital allocation process and economic efficiency might be impaired as investors make investment decisions using lower-quality information.

Conversely, the removal of ratings requirements in Commission rules may enhance incentives for NRSROs to produce credible and reliable ratings, in order to remain competitive, maintain revenue, and protect franchise value. In addition, certain industry commenters on the 2014 Proposing Release expressed support for the continued use of ratings as a tool in determining creditworthiness.[273] Thus, we believe that a large majority of institutional money

[273] *See* IDC Comment Letter; Invesco Comment Letter; MFDF Comment Letter.

market funds will continue to consider credit ratings in their evaluation of securities, at least as a screening measure, and will continue to be rated themselves. To the extent that funds continue to use ratings, which we believe most will, investors would be able to determine the ratings, and the extent to which funds are considering those ratings, of fund portfolio securities from the disclosures required under the amendments to Form N-MFP. Consequently, we believe it is unlikely that the capital allocation process and economic efficiency will be materially impaired.

The Proposing Release provided the credit analysis factors as guidance, rather than in rule text, and required that the fund make a finding that the issuer of a security had an "exceptionally strong capacity" to meet its short-term financial obligations.[274] Because the final rule is largely codifying the analysis that the staff believes money market fund managers currently take into account, as discussed above,[275] the economic analysis for this final rule is similar to that of the proposed rule. In this adopting release, we have incorporated into the rule credit analysis factors, as well as providing asset-specific factors as guidance. As we noted in the discussion above, based on staff observations in examinations and prior staff guidance, we believe that most money market fund managers currently take these factors into account, as appropriate, when they determine that a portfolio security presents minimal credit risks. Moreover, the factors listed in the rule are to be considered "to the extent appropriate"[276] and are not intended to rigidly define the parameters of an appropriate credit quality assessment; that is for the fund's board and its adviser to determine with respect to each particular security and the fund's overall risk profile. Thus, we do not anticipate that the rule's inclusion of factors that a

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274 *See* proposed rule 2a-7(a)(11).

275 *See supra* section IV.A.1.

276 Rule 2a-7(a)(11).

fund manager should consider will significantly change the process for evaluating credit quality or that consideration of the factors listed in the rule and discussed in the release will significantly affect the holdings in money market fund portfolios. For these reasons, we continue to believe that the factors will not have a material effect on efficiency, competition, or capital formation. Funds may, however, consider whether their policies and procedures for credit quality assessment should be revised in light of the factors as codified, and, as a result, may need to update them.

Finally, we note that Commission staff engages in ongoing monitoring of money market fund risks and operations, through review of Form N-MFP filings, examinations, and other outreach efforts, and provides regular updates to the Commission about relevant issues. As part of these ongoing monitoring efforts, the staff also will undertake to study and report to the Commission no later than 3 years following the adoption of these amendments to rule 2a-7 and Form N-MFP the impact of these amendments on capital formation and investor protection. The study will include, but not be limited to, a review of any changes in the risk profile of money market fund portfolio security investments during the period studied and whether any additional measures, including further investor protections, may be necessary.

ii. Conditional Demand Feature

The final rule provides the same credit quality standard for securities with a conditional demand feature as for other portfolio securities. The fund's board (or its delegate) must determine that a security with a conditional demand feature presents minimal credit risks to the fund. We do not believe that fund managers will likely interpret this standard in a manner that results in funds increasing the risk profiles of their underlying securities. First, as discussed above, we do not believe that securities that are rated by NRSROs in the third-highest category for long-term ratings (or comparable unrated securities) would satisfy the standard that underlying securities present minimal credit risks to the fund. We also note that funds currently can invest exclusively in underlying securities rated in the second-highest category if the instrument meets the other conditions for eligibility.[277] We estimate that most underlying securities held by money market funds (77 percent) are rated in the second-highest long-term category, and a smaller portion (23 percent) are rated in the highest long-term category.[278] For these reasons, we do not currently anticipate that funds are likely to increase the portion of their underlying securities that are rated in the second-highest long-term category as a result of the adopted amendments since these funds do not currently invest in these securities to the extent permitted under existing rules.

For the reasons explained above, and because the minimal credit risk standard is largely the same as what we understand that many funds apply now, and also the same as will be required for all eligible portfolio securities, we believe that our rule will result in only small changes to the practices of funds with respect to investments in securities with conditional demand features. In addition, the elimination of the "very strong capacity" standard presented in the proposal should result in little or no change to this analysis, as discussed above.[279] Thus, we continue to believe that the conditional demand feature provision will result in little or no effect on efficiency, competition, or capital formation for either funds or issuers.

As discussed above, we believe that the amendments to rule 2a-7 will cause money market fund complexes to incur certain costs in reviewing and updating their policies and

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277 Current rule 2a-7(d)(2)(iv).

278 *See supra* note 258 and accompanying text.

279 *See supra* section IV.A.1.

procedures. Specifically, each complex is likely to review the amendments to the credit quality standards in rule 2a-7 and, as it determines appropriate in light of the amendments, revise its policies and procedures to incorporate the amended credit quality evaluation method to be used in determining the eligibility of a money market fund's portfolio securities, including securities that are subject to a conditional demand feature.

iii. Ongoing Monitoring of Minimal Credit Risk

The Commission is adopting the ongoing monitoring provision as proposed. As discussed above, we believe that the requirement that each money market fund adopt written policies and procedures for ongoing monitoring of minimal credit risks for each portfolio security essentially codifies the current practices of fund managers.[280] Although based on staff experience we believe that most, if not all, money market funds currently monitor portfolio securities for minimal credit risk on an ongoing basis (as rule 2a-7 requires[281]), we note that money market funds are not currently required to maintain written policies and procedures that specifically address monitoring. We believe that to the extent that some money market funds may not have written procedures to regularly monitor minimal credit risks, our provision to require such procedures is designed to ensure that funds are better positioned to identify quickly potential risks of credit impairment that could impact portfolio security prices. The costs associated with the minimal credit risk monitoring requirement, as discussed above, will vary based on the extent to which funds' existing procedures need to be transcribed and reviewed.[282] We continue to believe that the requirement for written procedures in the final rule will not materially affect efficiency, competition, or capital formation because we expect no material

280 *See supra* section II.C.

281 *See id.*

282 *See supra* note 226 and accompanying text.

changes in how funds invest.

iv. Stress Testing

The Commission is adopting the stress testing provision as proposed. As discussed above, the amendments are designed to retain similar standards for stress testing as under current rule 2a-7. Specifically, the amendments will remove the current reference to ratings downgrades in the rule 2a-7 stress testing requirement, and instead require funds to test for an event indicating or evidencing credit deterioration of particular portfolio security positions, with a downgrade or default provided as examples of such an event. Consequently, we recognize that a money market fund could use its current policies and procedures for stress testing, including testing for a downgrade, to comply with the amendments. We believe that funds will do so because a downgrade by a relevant NRSRO may impact the price of a portfolio security.[283] Commenters on the stress testing provision of the Proposing Release were uniformly supportive of this approach,[284] and one specifically stated that the amendments would not significantly change the substance of current stress tests.[285] We believe this provision thus provides a clear benefit by reducing any perceived endorsement of NRSRO ratings. Because we believe that funds will not change their stress testing policies and procedures in response to these amendments, we also believe there will be little or no costs associated with them.[286] Thus we do not anticipate that these amendments are likely to affect efficiency, competition, or capital formation.

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283 *See* Comment Letter of Investment Company Institute (Apr. 25, 2011) on the 2011 Proposing Release.

284 *See* Barnard Comment Letter; BlackRock Comment Letter; ICI Comment Letter; Vanguard Comment Letter; CFA Institute Comment Letter; MFDF Comment Letter.

285 *See* MFDF Comment Letter.

286 *See supra* note 236 and accompanying text.

v. Policies and Procedures

As discussed above, money market funds have written policies and procedures for complying with rule 2a-7, including policies and procedures for determining and reassessing minimal credit risk and for stress testing the portfolio.[287] Although our final rule should not require changes to these policies and procedures for most money market funds, we anticipate that funds will likely review them and may revise them in consideration of the uniform credit quality standard provided in the rule. We also anticipate that after such a review, many fund boards and advisers will retain investment policies that reference NRSRO ratings.[288] Although we cannot predict the number of funds that will review and revise their policies and procedures or the extent to which funds may do so, we estimate that each fund will incur, at a minimum, the collection of information costs discussed in the Paperwork Reduction Act section for a total average one-time cost of approximately $2,838 per fund complex.[289] These minimum costs assume that a fund will review its policies and procedures in consideration of the amendments and make minor changes to conform with the revised rule text, but will not change significantly the policies and procedures relating to the fund's credit quality assessments, monitoring for minimal credit risk or stress testing, which currently include consideration of NRSRO ratings.

As noted above, we believe that while funds currently monitor for minimal credit risks on

287 *See* rule 38a-1(a); rule 2a-7.

288 *See supra* note 213 and accompanying text. We also note that most commenters on the 2011 proposal supported permitting funds to continue to use ratings, and some asked us to clarify that ratings continue to be a permissible factor for boards or their delegates to consider in making credit quality determinations. *See, e.g.*,2 011 Comment Letter of BlackRock Inc. (Apr. 25, 2011) ("2011 BlackRock Comment Letter"); Comment Letter of the Independent Directors' Council (Apr. 25, 2011). Commenters on the 2014 proposal continued to stress the usefulness of credit ratings. *See* IDC Comment Letter; Invesco Comment Letter; MFDF Comment Letter. Our amendments to Form N-MFP, discussed above, reflect our clarification that ratings continue to be a permissible tool to use in making credit quality determinations.

289 *See supra* note 218.

an ongoing basis, we assume that funds do not have written policies and procedures to address monitoring.[290] We estimate the average one-time costs to adopt those written policies will be $3,619 per fund.[291] Because we anticipate that our rule is not likely to change these fund policies significantly, we believe it is not likely to have a significant impact on efficiency, competition, or capital formation.

3. Alternatives

The Commission chose not to adopt certain credit quality standards and requirements from the Proposing Release. First, the proposed rule would have required that a portfolio security not only present minimal credit risks, but also that its issuer has an "exceptionally strong capacity" to meet its short-term financial obligations.[292] As many commenters suggested,[293] we now believe that this determination could create an unclear standard for determining eligible securities that might change the current credit quality profile of money market funds, possibly creating risk profiles in money market funds that are even more stringent than the current rule provides for, as the discussion above details.[294] We believe that the rulemaking goal associated with this aspect of the proposal of ensuring that only very high quality securities are purchased by money market funds is more effectively carried out instead by the second change we have made from the proposed rule, the codification of the general credit analysis factors.[295]

The Proposing Release provided two lists of credit analysis factors for use in determining

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290 *See supra* notes 116 and 226 and accompanying text.

291 *See supra* note 228.

292 Proposed rule 2a-7(a)(11).

293 *See, e.g.,* Dreyfus Comment Letter; NYC Bar Comment Letter; Schwab Comment Letter.

294 *See supra* section II.A.

295 Rule 2a-7(a)(11).

whether a security presented only minimal credit risks to a fund.[296] The first was a list of general factors for use with any security, and the second was an asset-specific list. The final rule incorporates the list of general factors into the rule text, and we discuss in this release the asset-specific list as guidance.[297] As discussed above,[298] we believe that codifying the general factors will help provide a uniform and objective check on credit risk that can be verified by our examiners. We also believe that incorporating these factors into the rule text will further promote effective and uniform application of the risk standard. These two changes together, elimination of the "exceptionally strong capacity" language and codification of the factors, should help to ensure that the rule will maintain the current risk characteristics of money market funds and thus is not likely to have a significant effect on efficiency, competition, or capital formation.

In addition to the changes to the primary risk standard, the final rule also changed the risk standard for securities with conditional demand features.[299] The proposed rule would have required that the issuer of the underlying security or the provider of a conditional demand feature have a "very strong" capacity to meet its financial obligations.[300] As with the proposed "exceptionally strong capacity" standard, some commenters felt that this standard could be interpreted very differently by different funds.[301] In order to reduce confusion and preserve a

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296 Proposing Release, *supra* note 3, at 47991-47993.

297 The general factors have also been amended based on comments received, with one new factor added. *See* rule 2a-7(a)(11). We chose not to codify the asset-specific factors. *See supra* section II.A.2.

298 *See supra* section II.A.2.

299 *See* rule 2a-7(d)(2)(iii).

300 *See* proposed rule 2a-7(d)(2)(iii).

301 *See, e.g.,* Dreyfus Comment Letter; Fidelity Comment Letter. Some commenters also felt that the need to apply two different standards would add to compliance costs without providing benefits

similar degree of credit quality to that currently present in fund portfolios, the Commission determined instead to require that the issuer of the underlying security and the provider of the conditional demand feature meet the same "minimal credit risks" standard.

In developing this final rule, we also considered changes consistent with the amendments we proposed in 2011. The 2011 proposal would have required fund boards first to determine whether securities are eligible securities based on minimal credit risks, and second to distinguish between first and second tier securities based on subjective standards similar to those the ratings agencies have developed to describe their ratings. However,we were persuaded by the concerns some commenters expressed on the 2011 proposal,[302] and did not adopt these alternatives. In particular, as several commenters noted, a two-tier approach could be confusing without reference to objective standards, and fund advisers are likely to make many of the same considerations in evaluating first and second tier securities.[303] In addition, we believe that the adopted single standard will better reflect the risk limitation in the current rule. The 2011 proposal described the standard for second tier securities in language similar to the descriptions NRSROs use for second tier securities, which fund managers might interpret as permitting funds to invest in riskier second tier securities to a greater extent than under our final rule, which is designed to limit investments to very high quality second tier securities. Such increased investments in riskier second tier securities would have had the potential to increase the risk profile of money market funds.

The two industry commenters on the 2014 proposal who discussed the elimination of the

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in improving credit quality. *See, e.g.,* Dreyfus Comment Letter; ICI Comment Letter; IDC Comment Letter.

302 *See* Proposing Release, *supra* note 3, at 47988-47989.

303 *See id.*

first and second tier distinction supported it.[304] However, two other commenters expressed concern that removal of the distinction and the limit on second tier securities could lead to funds purchasing more risky securities.[305] As discussed above,[306] we believe that the codification of the credit analysis factors in the final rule, combined with market discipline and staff oversight of required N-MFP disclosures, should reduce this possibility.

The two-tier approach discussed above could have had different effects on competition and capital formation than the effects on competition and capital formation stemming from the adopted approach, as a result of ensuing increased or decreased investments in second tier securities. However, we are unable to estimate the relative effects on competition or capital formation because we do not know how shareholders and funds would respond to this approach as compared to the final rule, and no commenters provided any estimates.

With respect to replacing the reference to ratings in determining the eligibility of underlying securities (*i.e.,* those that are subject to a conditional demand feature), we considered a qualitative standard that NRSROs use to articulate long-term securities in the highest rating category. We note generally that few issuers or guarantors have received long-term ratings in the highest category.[307] Moreover, issuers assigned a short-term credit rating in the top category by an NRSRO may have received a long-term rating in the second-highest (or lower) category.[308]

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304 *See* Fidelity Comment Letter; MFDF Comment Letter.

305 *See* Better Markets Comment Letter; CFA Comment Letter.

306 *See supra* section II.A.2.

307 *See* Vipal Monga & Mike Cherney, *CFO Journal: Lose your Triple-A Rating? Who Cares?,* WALL ST. J. (Apr. 29, 2014) (noting the decline in companies with triple A long-term ratings).

308 *See* Moody's Investors Service, Rating Symbols and Definitions, Apr. 2014, https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004, at 6 (showing the linkage between short-term and long-term ratings when such long-term ratings exist and indicating that long-term ratings of "A3" or higher are compatible with the highest short-term rating of "P-1"); Standard &Poor's, About Credit Ratings (2012),

Because of the limited NRSRO assignments of the highest long-term ratings to issuers, managers might have interpreted this alternative to preclude fund investments in a security subject to a conditional demand feature (that is itself an eligible security) if the underlying security's issuer or guarantor is rated in the second-highest category. Such an interpretation could significantly deviate from the credit quality standards in the current rule, which was not our intent. It also would likely reduce money market fund investments in these securities.

In choosing to eliminate the current reference to ratings downgrades in the monitoring standard of rule 2a-7, we considered the rule 2a-7 amendments that we proposed in 2011.[309] These proposed amendments would have required that, in the event the money market fund adviser (or any person to whom the board has delegated portfolio management responsibilities) becomes aware of any credible information about a portfolio security or an issuer of a portfolio security that suggests that the security is no longer a first tier security or a second tier security, as the case may be, the board or its delegate would have to promptly reassess whether the security continues to present minimal credit risks.[310] Most of those who commented on this proposed amendment objected to it as an inefficient method of notifying funds if a portfolio security is potentially impaired. We were persuaded by these commenters' concerns.[311]

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http://www.standardandpoors.com/aboutcreditratings/RatingsManual_PrintGuide.html (each short-term rating corresponds to a band of long-term ratings. "For instance, the A-1 short-term rating generally corresponds to the long-term ratings of 'A+,' 'A,' and 'A-'."); FitchRatings, Ratings Definitions (2014), https://www.fitchratings.com/jsp/general/RatingsDefinitions.faces?context=5&detail=507&context_ln=5&detail_ln=500 (indicating the relationship between short-term and long-term ratings with a table and acknowledging that "lower relative short-term default risk, perhaps through factors that lend the issuer's profile temporary support, may coexist with higher medium-or longer term default risk").

309 *See* 2011 Proposing Release, *supra* note 4, at section II.A.3.

310 *Id.*

311 *See* 2014 Proposing Release, *supra* note 3, at section II.A.3.

Finally, we also considered removing the current reference to ratings downgrades in the stress testing provisions of rule 2a-7 and replacing this reference with the requirement that money market funds stress test their portfolios for an adverse change in the ability of a portfolio security issuer to meet its short-term credit obligations. We had proposed this alternative in 2011, and commenters on the 2011 proposal who addressed this issue uniformly advocated against removing the reference to a downgrade in the stress testing conditions.[312] We believe that the 2011 proposed standard, as compared to the standard we are adopting today, was less clear and that it would lead to more burdensome monitoring and greater inefficiencies in developing hypothetical events for stress testing. In light of these commenters' concerns, we thus decided to adopt stress testing provisions in rule 2a-7 that would permit funds to continue to test their portfolios against a potential downgrade or default, as discussed in more detail above.[313] As also discussed above, commenters uniformly supported this provision.[314]

Form N-MFP

The final rule's amendments to Form N-MFP will require money market funds to disclose NRSRO ratings that they use in their evaluations of portfolio securities. Specifically, a fund will have to disclose for each portfolio security any NRSRO rating that the fund's board of directors (or its delegate) considered in making its minimal credit risk determination, as well as the name of the agency providing the rating. NRSRO ratings provide one indicator of credit risk of a fund's portfolio securities and, as discussed above, we anticipate that they will continue to be considered by many money market fund managers in performing credit quality assessments.

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312 We had proposed this alternative in 2011 and received comments on it at that time. *See id,* section II.A.4.

313 *See supra* section V.A.2.iv.

314 *See supra* notes 284-285 and accompanying text.

We believe this ratings information will be useful to the Commission, to investors, and to various third parties as they monitor and evaluate the risks that fund managers take in both stable-NAV and institutional prime funds.

1. Economic Baseline

Under the economic baseline outlined above, money market funds are required to disclose in Form N-MFP the credit ratings for each portfolio security.[315] More specifically, funds are currently required to identify whether a portfolio security is a first or second tier security or is unrated, and to identify the "designated NRSROs" for each security (and for each demand feature, guarantee, or other credit enhancement). This disclosure requirement was not changed by the 2014 Money Market Fund Adopting Release.

As noted above, based on Form N-MFP filings from April 30, 2015, the Commission estimates that 98.26 percent of aggregate money market fund assets are invested in first tier securities, 0.14 percent of aggregate money market fund assets are invested in second tier securities, and 1.6 percent of aggregate money market fund assets are invested in unrated securities. Among the 537 funds that filed that month, 412 funds reported that they held only first tier securities, 477 funds reported that they held no second tier securities, and 447 funds reported that they held no unrated securities.

2. Economic Analysis

We anticipate that our amendments are likely to have two primary benefits. First, they should reduce perceived government endorsement of NRSROs, particularly when considered together with other amendments the Commission has adopted that remove credit ratings

[315] Although some money market funds voluntarily disclose security credit ratings, money market funds often rely on a staff no-action letter in not disclosing security credit ratings and "designated NRSROs." *See supra* note 142 and accompanying text.

references in today's rule and other rules and forms under the federal securities laws. Second, they will provide transparency on whether or not specific funds use credit ratings when making investment decisions, and might make it easier, if ratings are used, for shareholders and other interested parties to also use those ratings as part of their own risk assessments.

We anticipate that our amendments are likely to have two primary costs. First, they may impose administrative costs on funds that need to re-program their Form N-MFP filing software.[316] Second, because only funds that choose to consider credit ratings in assessing minimal credit risk will be permitted to disclose NRSRO ratings on Form N-MFP, our final rule may reduce transparency into one measure of the credit risk associated with securities purchased by funds that do not choose to consider credit ratings. This loss of transparency could create additional servicing costs for such funds if shareholders demanded new communications regarding the credit quality of the portfolio,[317] though this problem may be mitigated by the fact that sophisticated shareholders will often be aware of the ratings and other measures of credit risk, even if they are not disclosed on Form N-MFP.

The net effect of the amendments to Form N-MFP is that funds will not be required or permitted to disclose credit ratings if credit ratings are not considered in determining whether a security is eligible for the portfolio. However, as discussed above, we believe that our amendments will not result in any material changes for the majority of funds because they will, we believe, continue to refer to credit ratings. We believe, therefore, that the amendments'

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316 *See supra* notes 243-244 and accompanying text (discussion of re-programming costs in PRA analysis).

317 *See* Comment Letter of the Dreyfus Corporation (Apr. 25, 2011) ("2011 Dreyfus Comment Letter") (opposing the elimination of credit ratings disclosures in Form N-MFP because of the potential that the fund would bear increased shareholder servicing costs to provide additional communications regarding the credit quality of the portfolio).

effects on efficiency, competition, and capital formation will likely be negligible. To the extent that money market funds continue to consider NRSRO ratings in making their minimal credit risk determinations, the amendments to Form N-MFP may reduce the potential that fund managers will increase significantly fund investments in riskier second tier securities; a fund will be required to disclose ratings considered in those credit determinations, and the ratings will reflect that increased risk. As a result, the disclosure to investors of these risk indicators may have the effect of penalizing funds that assume more risk.

Although this final rule reflects a change from the proposal by not requiring disclosure of every rating that a fund subscribes to, we believe that it will have a negligible impact on the overall costs and benefits of these amendments to Form N-MFP. Just as in the proposed rule, funds will still have to report the ratings they considered, and adjust their compliance programs to ensure such reporting. The extra reporting that would have been required under the proposed rule would likely only have caused a very small burden on funds because funds would incur the same reprogramming costs under either approach.

3. Alternatives

In the 2014 Proposing Release, the Commission presented an alternative to the now adopted amendments to Form N-MFP that would have required greater disclosure of credit ratings. Specifically, a fund would have had to disclose not only the ratings that it considered in evaluating a security and the name of the NRSRO providing the rating, but also each rating assigned by any NRSRO if the fund or its adviser subscribed to that NRSRO's services, and the name of that NRSRO. Several commenters on the proposed rule objected strongly to this requirement, stating that it would be costly, onerous and that mere subscription to an NRSRO's services was not a good indication that a particular rating was part of the evaluation of a particular security.[318] In developing this final rule, we were persuaded by these commenters and now believe that requiring this level of disclosure is unnecessary. In addition, as noted by commenters, requiring disclosure based on subscription might have increased costs and therefore created a financial disincentive to the use of ratings subscriptions by funds. As a result, this alternative might have decreased the amount of information used by fund managers to monitor risk in the market. For all of these reasons, we believe that the alternative chosen in the final rule is less likely than the other alternatives to impair efficiency, competition, and capital formation.

In developing this final rule, we also considered the 2011 proposal to completely eliminate the following two form items: the item that requires a fund to identify whether a portfolio security is a first tier security, a second tier security, or an unrated security; and the item that requires the fund to identify the "requisite NRSROs" for each security (and for each demand feature, guarantee, or other credit enhancement). Although we have eliminated the terminology "requisite NRSRO", we did not adopt this alternative because we now believe that completely eliminating such disclosure requirements masks not only the credit ratings but also information on whether or not the fund uses credit ratings when making its investment decisions.

We also considered not removing the current disclosure requirement as recommended by several commenters to the 2011 Proposing Release.[319] We elected not to leave the current disclosure requirements as is, but instead to adopt the required disclosure of NRSRO ratings only in certain circumstances, with the final rule narrowing those circumstances to situations where the fund actually uses the rating in its evaluation of credit quality. We believe these final

318 *See, e.g.,* SIFMA Comment Letter; BlackRock Comment Letter.

319 *See* 2011 BlackRock Comment Letter; 2011 Dreyfus Comment Letter; Comment Letter of Federated Investors, Inc. (Apr. 25, 2011); Comment Letter of the Securities Industry and Financial Markets Association (Apr. 18, 2011).

amendments are more in keeping with Congressional intent underlying Section 939A of the Dodd-Frank Act to reduce perceived government endorsement of credit ratings.

B. Exclusion from the Issuer Diversification Requirement

1. Economic Baseline

As discussed above, most money market fund portfolio securities that are subject to a guarantee by a non-controlled person are currently subject to a 10 percent diversification requirement on guarantors but no diversification requirement on issuers, while non-government securities with guarantors that do not qualify as non-controlled persons are generally subject to both a 5 percent diversification requirement with respect to issuers and a 10 percent diversification requirement with respect to guarantors.[320] In July 2014, we adopted amendments to rule 2a-7 that deem sponsors of asset-backed securities to be guarantors of the asset-backed security (unless the fund's board rebuts the presumption).[321] As a result, under rule 2a-7's definition of a guarantee issued by a non-controlled person, both non-asset-backed securities and asset-backed securities subject to such a guarantee (including asset-backed securities with a presumed sponsor guarantee) are excluded from the rule's issuer diversification requirement. That is, non-asset-backed securities and asset-backed securities subject to a guarantee by a non-controlled person are subject to a 10 percent diversification requirement on guarantors, but they are not subject to a 5 percent issuer diversification requirement on the issuer.[322] This forms the

[320] We note that single state funds may invest up to 25 percent of fund assets in securities of any single issuer, and tax-exempt funds may have as much as 15 percent of the value of portfolio securities invested in securities subject to guarantees or demand features issued by a single provider that is a non-controlled person. Rule 2a-7(d)(3)(i)(B); rule 2a-7(d)(3)(iii)(B).

[321] We also adopted an amendment to rule 2a-7's diversification provisions to provide that money market funds limit their exposure to affiliated groups, rather than to discrete issuers. *See* rule 2a-7(d)(3)(ii)(F).

[322] *See* current rule 2a-7(a)(18) (definition of guarantee); current rule 2a-7(a)(19) (definition of

economic baseline for the new diversification amendments that we are adopting today.

2. Economic Analysis

We believe that a small number of money market funds rely on the issuer diversification exclusion for securities subject to a guarantee by a non-controlled person. In the Proposing Release, staff's analysis of February 2014 Form N-MFP data showed that only 8 out of 559 money market funds held securities with a guarantee by a non-controlled person that exceeded the 5 percent diversification requirement for issuers. We stated in the Proposing Release that we believed that these funds in February 2014 relied on the exclusion from the 5 percent issuer diversification requirement with respect to issuers of securities that are subject to a guarantee issued by a non-controlled person.

In response to commenters, staff supplemented its analysis using October 2014 and April 2015 Form N-MFP data to review the number of funds that exceeded the 5 percent diversification limit.[323] Staff found, as discussed above, that as of October 2014 and April 2015, only 0.0482 percent and 0.0624 percent, respectively, of total money market fund assets were above the 5 percent issuer diversification threshold. As noted above, Commission staff found that only tax-exempt money market funds appeared to be relying on the 5 percent issuer diversification exclusion in October 2014 and April 2015. For October 2014 and April 2015, staff found that only 0.1 percent and 0.5 percent, respectively, of national tax-exempt money market fund assets were exposed to issuers above the 5 percent threshold.

Commission staff also separately analyzed the number of single state money market

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guarantee issued by a non-controlled person); current rule 2a-7(d)(3)(i) (issuer diversification).

323 *See supra* note 191 and accompanying text.

funds that appear to be relying on the issuer diversification exclusion.[324] Because single state funds have a 25 percent issuer diversification basket, staff analyzed issuer exposure above this 25 percent limit, which would suggest that the fund may be relying on the 5 percent issuer diversification exclusion in order to obtain additional issuer exposure. In their analysis, staff recognized that a single state money market fund could be relying on the issuer diversification exclusion even when a fund's exposure to a single issuer is below 25 percent. For example, using the 25 percent issuer basket, a single state fund technically could have a 10 percent exposure to Issuer A and a 15 percent exposure to Issuer B, while having an additional 7 percent exposure to Issuer B using the 5 percent issuer diversification exclusion. In this scenario the total amount of exposure to Issuer B is less than 25 percent, but the money market fund is nonetheless relying on the issuer diversification exclusion. Staff analysis suggests that for October 2014, 44 single state money market funds out of 97 total single state money market funds were potentially relying on the 5 percent issuer diversification exclusion, and for April 2015, 38 single state money market funds out of 90 total single state money market funds were potentially relying on the 5 percent issuer diversification exclusion. However, for October 2014 and April 2015, staff found that only 1.7 percent and 1.3 percent, respectively, of single state money market fund assets were above the 5 percent issuer diversification threshold (while taking into account the 25 percent issuer diversification basket). Therefore, while a number of single state money market funds may be affected by the amended rule, a very small portion of their assets will be affected.

We recognize that changes in fund assets could mask which funds rely on the issuer

[324] As noted above, rule 2a-7 currently permits a single state fund to invest up to 25 percent of its assets in any single issuer. *See supra* note 161 and accompanying text.

diversification exclusion at acquisition: a fund might be above the 5 percent limit today solely due to a decline in fund assets after acquisition, and a fund might be below the 5 percent limit today solely due to an increase in fund assets after acquisition.[325] Whatever the cause, a money market fund that has invested more than 5 percent of its assets in an issuer of securities subject to a guarantee issued by a non-controlled person in reliance on the exclusion under current rule 2a-7 would, when those investments mature, have to reinvest the proceeds over 5 percent elsewhere. Based on the additional analysis of Form N-MFP filings, we believe that a small percentage of all money market funds (including a higher proportion of single state funds) would have to make changes to their portfolios to bring them into compliance with the amendments. These changes may or may not require the funds to invest in alternative securities, and the alternative securities may or may not be inferior because they offer, for example, lower yields, lower liquidity, or lower credit quality.

In response to commenters' suggestion that the Commission consider a broader sample of data, as discussed above, and to assess the amendment's effect on yield, our staff examined whether the 7-day gross yields of funds that use the 5 percent issuer diversification exclusion were higher than the 7-day gross yields for funds that do not. Our staff found: (i) for national tax-exempt money market funds in October 2014, the average yield for funds using the 5 percent issuer diversification exclusion was 0.10 percent as compared to the average yield for funds that did not use the 5 percent issuer diversification exclusion of 0.08 percent; (ii) for national tax-exempt money market funds in April 2015, the average yield for funds using the 5 percent issuer

[325] All of rule 2a-7's diversification limits are applied at the time of acquisition. For example, a fund may not invest in a particular issuer if, after acquisition, the fund's aggregate investments in the issuer would exceed 5 percent of fund assets. But if the fund's aggregate exposure after making the investment was less than 5 percent, the fund would not be required to later sell the securities if the fund's assets decreased and the fund's investment in the issuer came to represent more than 5 percent of the fund's assets.

diversification exclusion was 0.12 percent as compared to the average yield for funds that did not use the 5 percent issuer exclusion of 0.11 percent; (iii) for single state money market funds in October 2014, the average yield for funds using the 5 percent issuer diversification exclusion was 0.10 percent as compared to the average yield for funds that did not use the 5 percent issuer exclusion of 0.08 percent; and (iv) for single state money market funds in April 2015, the average yield for funds using the 5 percent issuer diversification exclusion was 0.12 percent as compared to the average yield for funds that did not use the 5 percent issuer exclusion of 0.07 percent. Although we do not believe the above differences in yield are material, we do recognize that funds that appear to be relying on the exclusion have, on average, a higher yield than money market funds that do not rely on the exclusion. In addition, we acknowledge that the current low-interest rate environment may cause the yield spread in each comparison above to be less than if we were measuring the yield spreads in a higher interest rate environment.

It appears that the elimination of the exclusion would affect the 63 money market funds out of a total of 542 money market funds (or approximately 11.6 percent of all money market funds) that exceeded the 5 percent issuer diversification limit as of April 2015, and would affect the 0.0624 percent of total money market fund assets that were above the 5 percent issuer diversification threshold, such that when those investments mature, the affected funds would have to reinvest the proceeds over 5 percent elsewhere. Because of the minimal amount of money market fund assets that would be affected by our amendment, we believe that the potential lower yields, less liquidity or increased risks associated with the amendment will be small for the affected funds.[326]

[326] Consider, for example, how reducing a position from 7 percent to 5 percent might affect fund yields. The effect could be as small as 0 percent if the 2 percent of assets are reinvested in securities that offer the same yield as the original 7 percent of assets. On the other hand, the

A couple commenters expressed concern regarding the amendment's impact on the supply of available securities for all money market funds.[327] One of these commenters suggested that imposing further diversification limits could artificially lower the supply of available issuers.[328] The second commenter suggested that the amendment would unnecessarily restrict the amount of asset-backed securities, and particularly asset-backed commercial paper, available for purchase by money market funds.[329] In addition, a couple of commenters argued that the proposed amendment would cause certain issuers to experience decreased demand and increased financing costs.[330] Another commenter argued that removing the issuer diversification exclusion may increase the number of guarantors held in a fund's portfolio, some of which may present marginally greater credit risks.[331] This commenter further argued that repealing the exclusion to increase diversification may actually diminish the percentage of the portfolio subject to credit enhancement as well as the overall credit quality of the guarantors.[332]

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portfolio change could decrease fund yields by as much as approximately 29 percent if all of the portfolio yield came from the 7 percent security. We believe that funds will choose alternative securities that have similar yields as the securities replaced.

327 As discussed above, some commenters also voiced supply concerns specifically with respect to tax-exempt money market funds.

328 *See* BlackRock Comment Letter. This commenter suggested that many changes to the money market fund market may occur as a result of both the 2014 money market fund amendments and the 2014 proposed amendments relating to NRSRO ratings removal and suggested that the Commission wait to see the effects of those amendments before adopting additional diversification amendments.

329 *See* SFIG Comment Letter. SFIG stated that, as of June 30, 2014, money market funds held over $89 billion of asset-backed commercial paper, representing approximately 36 percent of the overall asset-backed commercial paper market. SFIG also argued that the creditworthiness of any single obligor of an asset-backed security would be less significant if that security was guaranteed and suggested that an obligor of an asset-backed security only be treated as an issuer of that security if its obligations constitute 20 percent of the obligations of that security rather than apply the 10 percent obligor provision under rule 2a-7(d)(3)(B).

330 *See* Fidelity Comment Letter; SIFMA Comment Letter.

331 *See* ICI Comment Letter.

332 *See id.*

We recognize that the removal of the issuer diversification exclusion and tightening of issuer diversification requirements for securities subject to a guarantee by a non-controlled person may impact issuers of these securities and the fund's risk profile. We also recognize that the amendment may occasionally prevent some issuers from selling securities to a money market fund that would otherwise invest in the issuer's securities above the 5 percent diversification requirement, but we believe, as discussed below, that the effect on such issuers would be negligible. In addition, while we recognize that removing the exclusion may cause some money market funds to invest in securities with higher credit risk, we note that a money market fund's portfolio securities must meet certain credit quality requirements, such as posing minimal credit risks, as discussed above.[333] We therefore continue to believe that the substantial risk limiting provisions of rule 2a-7 would mitigate the potential that these money market funds would significantly increase their investments in securities with higher credit risk. We also continue to believe that eliminating this exclusion would more appropriately limit money market fund risk exposures by limiting the concentration of exposure that a money market fund could have otherwise had to a particular issuer. We assume that all funds will incur costs associated with updating their systems to reflect the amendment, as well as the associated compliance costs, if their systems already incorporate this issuer diversification exclusion. We requested comment on operational costs that funds would incur in connection with the amendment. No commenters specifically addressed operational costs associated with the amendment. Accordingly, we continue to believe that these costs will be small for all funds because we believe that all funds currently have the ability to monitor issuer diversification to comply with rule 2a-7's limits on issuer concentration.

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[333] *See* rule 2a-7(d)(2) (portfolio quality); *see supra* section II.A.

Our diversification amendment offers two primary benefits. First, by requiring greater issuer diversification for those funds that rely on the exclusion, the amendment will reduce concentration risk in those funds and may make it easier for funds to maintain or generate liquidity during periods when they impose fees and/or gates. Second, the amendment simplifies rule 2a-7's diversification requirements by eliminating the exclusion for securities with a guarantee issued by a non-controlled person, which should lower certain compliance and operational costs to the extent that funds no longer have to keep track of the securities that have such guarantees and would be eligible for the exclusion.

Because we believe that the universe of affected funds and issuers is small, we continue to believe that our amendment will have only negligible effects on efficiency, competition, and capital formation. Although we recognize that this amendment may constrain more funds (and issuers) in the future that otherwise would have less issuer diversification, we estimate, based on our staff's analysis of data from April 2015, that it will affect 63 funds, or approximately 11.6 percent of all money market funds today. Based on our staff's analysis we also estimate that, as of April 2015, our amendment will affect the 0.0624 percent of total money market fund assets that were above the 5 percent issuer diversification threshold. Based on staff analysis of Form N-MFP data and the amount of high quality securities available to tax-exempt money market funds, we continue to believe that the affected funds will find comparable alternative securities for the amount that exceeds 5 percent, and we believe that the affected issuers, to the extent applicable, will find other investors willing to buy the amount that exceeds the 5 percent for a comparable price.

3. Alternatives

As an alternative to eliminating the exclusion from issuer diversification for securities with a guarantee issued by a non-controlled person, at the proposal stage we considered requiring money market funds to be more diversified by lowering a fund's permitted exposure to any guarantor or provider of a demand feature from 10 percent to 5 percent of total assets. We discussed potential benefits and costs of this alternative approach, and we requested comment on it in the 2013 Money Market Fund Proposing Release.[334] As discussed in more detail above, we decided that the current requirements for diversification of guarantors and providers of demand features together with the issuer diversification requirement if applied generally to all securities, as under the adopted amendment, appropriately address our concerns relating to money market fund risk exposures.[335] We also believe that the potential costs of this alternative approach would likely be more significant than the costs of our adopted amendment. As of the end of April 2015, we estimate that approximately 110 (of 214) prime money market funds had total exposure to a single entity (including directly issued, asset-backed commercial paper sponsorship, and provision of guarantees and demand features) in excess of 5 percent. Under the alternative, any fund that had exposure to an entity greater than 5 percent when those assets matured would have to reinvest the proceeds of the securities creating that exposure in different securities or securities with a different guarantor. Those changes may or may not require those funds to invest in alternative securities, and those securities might present greater risk if they offered lower yields, lower liquidity, or lower credit quality. The alternative approach would appear to affect many more funds than would the amendment we are adopting today. As a result, we continue to

334 *See* 2013 Money Market Fund Proposing Release, *supra* note 16, at section III.J.4. We received no comments on this alternative approach. We also requested comment in 2009 on whether to reduce rule 2a-7's current diversification limits. *See* 2009 Money Market Fund Proposing Release, *supra* note 160, at section II.D. Most commenters opposed these reforms because, among other reasons, the reductions could increase risks to funds by requiring the funds to invest in relatively lower quality securities. *See id.* at n.909.

335 *See supra* text preceding and accompanying note 182.

believe that a better approach to achieving our reform goal would be to restrict risk exposures to all non-government issuers of securities subject to a guarantee in the same way, and to require money market funds (other than tax-exempt and single state funds as described above) that invest in non-government securities subject to a guarantee to comply with the 5 percent issuer diversification requirement and the 10 percent diversification requirement on guarantors.

4. Technical Amendments

As discussed above, we are making technical amendments to certain diversification provisions in rule 2a-7. Due to the nature of these amendments, we believe that the amendments will have no effect on efficiency, competition, or capital formation.

VI. REGULATORY FLEXIBILITY ACT CERTIFICATION

The Commission certified, pursuant to section 605(b) of the Regulatory Flexibility Act of 1980[336] that the proposed amendments to rule 2a-7 and form N-MFP under the Investment Company Act, if adopted, would not have a significant economic impact on a substantial number of small entities.[337] We included this certification in Section VI of the Proposing Release. Although we encouraged written comments regarding this certification, no commenters responded to this request.

STATUTORY AUTHORITY

The Commission is adopting amendments to rule 2a-7 under the authority set forth in sections 6(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-37(a)] and Section 939A of the Dodd-Frank Act. The Commission is adopting amendments to Form

336 5 U.S.C. 603(b).

337 Under the Investment Company Act, an investment company is considered a small business or small organization if, together with other investment companies in the same group of related investment companies, it has net assets of $50 million or less as of the end of its most recent fiscal year. *See* 17 CFR 270.0–10.

N-MFP under the authority set forth in sections 8(b), 30(b), 31(a) and 38(a) of the Investment Company Act [15 U.S.C. 80a-8(b), 80a-29(b), 80a-30(a) and 80a-37(a)] and Section 939A of the Dodd-Frank Act.

List of Subjects in 17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF RULE AND FORM AMENDMENTS

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

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

1. The authority citation for part 270 continues to read as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39, and Pub. L. No. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

2. Section 270.2a-7 is amended by:

a. In paragraph (a)(5), removing the words "and (D)";

b. Removing paragraph (a)(11);

c. Redesignating paragraphs (a)(12) and (a)(13) as (a)(11) and (a)(12);

d. Revising newly designated paragraph (a)(11);

e.Re moving paragraph (a)(14);

f. Redesignating paragraphs (a)(15) through (a)(21) as (a)(13) through (a)(19);

g. In newly designated paragraph (a)(16)(ii), removing the references "(a)(12)(iii)" and "(d)(2)(iii)" and adding in their places "(a)(11)" and "(d)(2)(ii)", respectively.

h. Removing paragraph (a)(22);

i. Redesignating paragraph (a)(23) as paragraph (a)(20);

j. Removing paragraph (a)(24);

k. Redesignating paragraph (a)(25) as paragraph (a)(21);

l. Removing paragraph (a)(26);

m.Re designating paragraphs (a)(27) through (a)(31) as paragraphs (a)(22) through (a)(26);

n. Removing paragraph (a)(32);

o. Redesignating paragraphs (a)(33) and (a)(34) as paragraphs (a)(27) and (a)(28);

p.I n paragraph (c)(2)(i) removing the reference to "(c)(i)(A)" and adding in its place "(c)(2)(i)(A)".

q. Revising paragraph (d)(2);

r. Revising paragraph (d)(3)(i);

s.I n paragraph (d)(3)(iii), removing the words "paragraphs (d)(3)(iii) and (d)(3)(iv)" and adding in their place "paragraphs (d)(3)(i), (d)(3)(iii) and (d)(3)(iv)";

t.I n paragraph (d)(3)(iii)(A), removing the words "paragraphs (d)(3)(iii)(B) and (d)(3)(iii)(C)" and adding in their place "paragraphs (d)(3)(i) and (d)(3)(iii)(B)";

u. Removing paragraph (d)(3)(iii)(C);

v. Revising paragraph (f);

w. Revising paragraph (g)(3);

x. In paragraph (g)(8)(i)(B), at the beginning of the paragraph removing the word "A" and adding in its place "An event indicating or evidencing credit deterioration, such as a";

y.Re vising paragraph (h)(3); and

z. Revising paragraph (j).

The revisions read as follows:

§ 270.2a-7 Money market funds.

(a) * * *

(11) *Eligible security* means a security:

(i) With a remaining maturity of 397 calendar days or less that the fund's board of directors determines presents minimal credit risks to the fund, which determination must include an analysis of the capacity of the security's issuer or guarantor (including for this paragraph the provider of a conditional demand feature, when applicable) to meet its financial obligations, and such analysis must include, to the extent appropriate, consideration of the following factors with respect to the security's issuer or guarantor:

(A) Financial condition;

(B) Sources of liquidity;

(C) Ability to react to future market-wide and issuer- or guarantor-specific events, including ability to repay debt in a highly adverse situation; and

(D) Strength of the issuer or guarantor's industry within the economy and relative to economic trends, and issuer or guarantor's competitive position within its industry.

(ii) That is issued by a registered investment company that is a money market fund; or

(iii) That is a government security.

NOTE to paragraph (a)(11): For a discussion of additional factors that may be relevant in evaluating certain specific asset types see Investment Company Act Release No. IC-31828 (9/16/15).

*   *   *   *   *

(d) * * *

(2) *Portfolio quality.*

(i) *General.* The money market fund must limit its portfolio investments to those United States dollar-denominated securities that at the time of acquisition are eligible securities.

(ii) *Securities subject to guarantees*. A security that is subject to a guarantee may be determined to be an eligible security based solely on whether the guarantee is an eligible security, provided however, that the issuer of the guarantee, or another institution, has undertaken to promptly notify the holder of the security in the event the guarantee is substituted with another guarantee (if such substitution is permissible under the terms of the guarantee).

(iii) *Securities subject to conditional demand features.* A security that is subject to a conditional demand feature ("underlying security") may be determined to be an eligible security only if:

(A) The conditional demand feature is an eligible security;

(B) The underlying security or any guarantee of such security is an eligible security, except that the underlying security or guarantee may have a remaining maturity of more than 397 calendar days.

(C) At the time of the acquisition of the underlying security, the money market fund's board of directors has determined that there is minimal risk that the circumstances that would result in the conditional demand feature not being exercisable will occur; and

(1) The conditions limiting exercise either can be monitored readily by the fund or relate to the taxability, under federal, state or local law, of the interest payments on the security; or

(2) The terms of the conditional demand feature require that the fund will receive notice of the occurrence of the condition and the opportunity to exercise the demand feature in accordance with its terms; and

(D) The issuer of the conditional demand feature, or another institution, has undertaken to promptly notify the holder of the security in the event the conditional demand feature is substituted with another conditional demand feature (if such substitution is permissible under the terms of the conditional demand feature).

(3) * * *

(i) *Issuer diversification.* The money market fund must be diversified with respect to issuers of securities acquired by the fund as provided in paragraphs (d)(3)(i) and (d)(3)(ii) of this section, other than with respect to government securities.

(A) *Taxable and national funds.* Immediately after the acquisition of any security, a money market fund other than a single state fund must not have invested more than:

(1) Five percent of its total assets in securities issued by the issuer of the security, provided, however, that with respect to paragraph (d)(3)(i)(A) of this section, such a fund may invest up to twenty-five percent of its total assets in the securities of a single issuer for a period of up to three business days after the acquisition thereof; provided, further, that the fund may not invest in the securities of more than one issuer in accordance with the foregoing proviso in this paragraph at any time; and

(2) Ten percent of its total assets in securities issued by or subject to demand features or guarantees from the institution that issued the demand feature or guarantee, provided, however, that a tax exempt fund need only comply with this paragraph with respect to eighty-five percent of its total assets, subject to paragraph (d)(3)(iii) of this section.

(B) *Single state funds.* Immediately after the acquisition of any security, a single state fund must not have invested:

(1) With respect to seventy-five percent of its total assets, more than five percent of its total assets in securities issued by the issuer of the security; and

(2) With respect to seventy-five percent of its total assets, more than ten percent of its total assets in securities issued by or subject to demand features or guarantees from the

institution that issued the demand feature or guarantee, subject to paragraph (d)(3)(iii) of this section.

* * * * *

(f) *Defaults and other events.*

(1) *Adverse events.* Upon the occurrence of any of the events specified in paragraphs (f)(1)(i) through (iii) of this section with respect to a portfolio security, the money market fund shall dispose of such security as soon as practicable consistent with achieving an orderly disposition of the security, by sale, exercise of any demand feature or otherwise, absent a finding by the board of directors that disposal of the portfolio security would not be in the best interests of the money market fund (which determination may take into account, among other factors, market conditions that could affect the orderly disposition of the portfolio security):

(i) The default with respect to a portfolio security (other than an immaterial default unrelated to the financial condition of the issuer);

(ii) A portfolio security ceases to be an eligible security (*e.g.,* no longer presents minimal credit risks); or

(iii) An event of insolvency occurs with respect to the issuer of a portfolio security or the provider of any demand feature or guarantee.

(2) *Notice to the Commission.* The money market fund must notify the Commission of the occurrence of certain material events, as specified in Form N-CR (§ 274.222 of this chapter).

(3) *Defaults for purposes of paragraphs (f)(1) and (2) of this section.* For purposes of paragraphs (f)(1) and (2) of this section, an instrument subject to a demand feature or guarantee shall not be deemed to be in default (and an event of insolvency with respect to the security shall not be deemed to have occurred) if:

(i) In the case of an instrument subject to a demand feature, the demand feature has been exercised and the fund has recovered either the principal amount or the amortized cost of the instrument, plus accrued interest;

(ii) The provider of the guarantee is continuing, without protest, to make payments as due on the instrument; or

(iii) The provider of a guarantee with respect to an asset-backed security pursuant to paragraph (a)(16)(ii) of this section is continuing, without protest, to provide credit, liquidity or other support as necessary to permit the asset-backed security to make payments as due.

(g) * * *

(3) *Ongoing Review of Credit Risks.* The written procedures must require the adviser to provide ongoing review of whether each security (other than a government security) continues to present minimal credit risks. The review must:

(i) Include an assessment of each security's credit quality, including the capacity of the issuer or guarantor (including conditional demand feature provider, when applicable) to meet its financial obligations; and

(ii) Be based on, among other things, financial data of the issuer of the portfolio security or provider of the guarantee or demand feature, as the case may be, and in the case of a security subject to a conditional demand feature, the issuer of the security whose financial condition must be monitored under paragraph (d)(2)(iii) of this section, whether such data is publicly available or provided under the terms of the security's governing documents.

*   *   *   *   *

(h) * * *

(3) *Credit risk analysis.* For a period of not less than three years from the date that the

credit risks of a portfolio security were most recently reviewed, a written record must be maintained and preserved in an easily accessible place of the determination that a portfolio security is an eligible security, including the determination that it presents minimal credit risks at the time the fund acquires the security, or at such later times (or upon such events) that the board of directors determines that the investment adviser must reassess whether the security presents minimal credit risks.

*   *   *   *   *

(j) *Delegation.* The money market fund's board of directors may delegate to the fund's investment adviser or officers the responsibility to make any determination required to be made by the board of directors under this section other than the determinations required by paragraphs (c)(1) (board findings), (c)(2)(i) and (ii) (determinations related to liquidity fees and temporary suspensions of redemptions), (f)(1) (adverse events), (g)(1) and (g)(2) (amortized cost and penny rounding procedures), and (g)(8) (stress testing procedures) of this section.

(1) *Written guidelines.* The board of directors must establish and periodically review written guidelines (including guidelines for determining whether securities present minimal credit risks as required in paragraphs (d)(2) and (g)(3) of this section) and procedures under which the delegate makes such determinations.

(2) *Oversight.* The board of directors must take any measures reasonably necessary (through periodic reviews of fund investments and the delegate's procedures in connection with investment decisions and prompt review of the adviser's actions in the event of the default of a security or event of insolvency with respect to the issuer of the security or any guarantee or demand feature to which it is subject that requires notification of the Commission under paragraph (f)(2) of this section by reference to Form N-CR (§ 274.222 of this chapter)) to assure that the guidelines and procedures are being followed.

*   *   *   *   *

3. Section 270.12d3-1(d)(7)(v) is amended by removing the reference to "270.2a-7(a)(18)" and adding in its place the phrase "270.2a-7(a)(16)";

4. Section 270.31a-1(b)(1) is amended by removing the phrase "(as defined in § 270.2a-7(a)(9) or § 270.2a-7(a)(18) respectively)" and adding in its place the phrase "(as defined in § 270.2a-7(a)(9) or "§ 270.2a-7(a)(16) respectively)".

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

5. The authority citation for part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, 80a-29, and Pub. L. No. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

*   *   *   *   *

6. Form N-MFP (referenced in § 274.201) is amended by:

a. Revising Item C.9;

b. Revising Item C.10;

c. Removing Items C.14.b and C.14.c;

d. Redesignating Items C.14.d through C.14.f as Items C.14.b through C.14 d;

e. Adding new Item C.14.e;

f. Removing Items C.15.b and C.15.c;

g. Redesignating Item C.15.d as Item C.15.b;

h. Adding new Item C.15.c;

i. Removing Items C.16.c and C.16.d;

j. Redesignating Item C.16.e as Item C.16.c; and

k. Adding new Item C.16.d.

l. Revising the definition of "Money Market Fund" in General Instructions—E. Definitions.

The additions and revisions read as follows:

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

FORM N-MFP

*   *   *   *   *

Item C.9   Is the security an Eligible Security? [Y/N]

Item C.10   Security rating(s) considered. Provide each rating assigned by any NRSRO that the fund's board of directors (or its delegate) considered in determining that the security presents minimal credit risks (together with the name of the assigning NRSRO). If none, leave blank.

*   *   *   *   *

Item C.14   *   *   *

e. Rating(s) considered. Provide each rating assigned to the demand feature(s) or demand feature provider(s) by any NRSRO that the board of directors (or its delegate) considered in evaluating the quality, maturity or liquidity of the security (together with the name of the assigning NRSRO). If none, leave blank.

*   *   *   *   *

Item C.15   *   *   *

c. Rating(s) considered. Provide each rating assigned to the guarantee(s) or guarantor(s) by any NRSRO that the board of directors (or its delegate) considered in evaluating the quality, maturity or liquidity of the security (together with the name of the assigning NRSRO). If none, leave blank.

Item C.16 * * *

d. Rating(s) considered. Provide each rating assigned to the enhancement(s) or enhancement provider(s) by any NRSRO that the board of directors (or its delegate) considered in evaluating the quality, maturity or liquidity of the security (together with the name of the assigning NRSRO). If none, leave blank.

* * * * *

E. Definitions * * *

"Money Market Fund" means a registered open-end management investment company, or series thereof, that is regulated as a money market fund pursuant to rule 2a-7 (17 CFR 270.2a-7) under the Investment Company Act of 1940.

* * * * *

7. Form N-1A (referenced in § 274.11A) is amended by revising the definition of "Money Market Fund" in General Instructions—A. Definitions.

The revision reads as follows:

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

FORM N-1A

* * * * *

"Money Market Fund" means a registered open-end management investment company, or series thereof, that is regulated as a money market fund pursuant to rule 2a-7 (17 CFR 270.2a-7) under the Investment Company Act of 1940.

By the Commission

Dated: 9/16/15

Brent J. Fields
Secretary

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75938 / September 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16816

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b), and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Rudolfo DeLaSierra ("DeLaSierra" 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 Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

This proceeding arises out of securities lending practices at Penson Financial Services, Inc. ("Penson"), a former registered broker-dealer, that resulted in its systematic violations of Rule 204 of Regulation SHO.[2] From October 2008 through November 2011, DeLaSierra and other individuals in the Securities Lending Department implemented procedures that they knew, or were reckless in not knowing, did not comply with Rule 204 of Regulation SHO. In so doing, DeLaSierra willfully aided and abetted and caused Penson's violations.

Respondent

1. DeLaSierra, 39, of Dallas, Texas, was a Vice President of Penson from at least October 2008 until June 2012. In that position, DeLaSierra was responsible for securities lending activities at Penson. DeLaSierra was associated with Penson between March 2000 and August 2012. DeLaSierra holds Series 7, 63, and 24 licenses.

Other Relevant Entity

2. Penson was a registered broker-dealer incorporated in North Carolina with a principal place of business in Dallas, Texas. From at least 2010 to 2012, Penson was the second-largest clearing firm in the United States as measured by the number of correspondent broker-dealers for which it cleared. Penson was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide Inc. ("PWI"). Penson filed a Form BDW, which became effective in October 2012, and then declared bankruptcy in January 2013. A bankruptcy plan implementing Penson's liquidation was approved in July 2013.

Background

3. In September 2008, the Commission implemented Rule 204T of Regulation SHO, which required, among other things, clearing firms such as Penson to close out Continuous Net Settlement ("CNS") failures to deliver in all sales of equity securities that they cleared. In July 2009, the Commission made those requirements permanent in adopting Rule 204 of Regulation

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

[2] Rule 204 was initially implemented as a temporary rule, Rule 204T. Generally, Rule 204T and Rule 204 will be collectively referred to as Rule 204.

SHO. The Commission adopted Rule 204 of Regulation SHO to address, among other things, abusive "naked" short selling and failures to deliver.

4. Rule 204(a) requires participants of a registered clearing agency (generally, clearing firms) to deliver equity securities to a registered clearing agency when delivery is due, i.e., by settlement date, or close out fails to deliver resulting from long or short sales within certain timeframes. Settlement date is generally three days after the trade date ("T+3"). For short sales, if the clearing firm has a failure-to-deliver position at the clearing agency, it must close out the CNS failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours (i.e., market open) on the settlement day following the settlement date ("T+4"). For long sales, if the clearing firm has a failure-to-deliver position at the clearing agency, it must close out the CNS failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on the third day following the settlement date ("T+6").

Penson Violated Rule 204 of Regulation SHO

5. At all relevant times, Penson was a clearing firm and a member of the National Securities Clearing Corporation ("NSCC"), a clearing agency registered with the Commission that clears and settles the majority of United States transactions in equities. From October 2008 through November 2011, Penson systematically failed to close out CNS failures to deliver resulting from certain long sales by market open T+6. The relevant long sales originated with securities held in customer margin accounts. Under the Commission's customer protection rule, Penson was permitted, subject to certain conditions and limitations, to re-hypothecate margin securities to third parties.[3] Penson re-hypothecated margin securities according to the terms of the Master Securities Lending Agreement ("MSLA") developed by the Securities Industry and Financial Markets Association ("SIFMA"). The Securities Lending Department generated revenue and helped to finance Penson's operations by loaning out shares held in customer margin accounts.[4]

6. When a margin customer sold the hypothecated securities that were out on loan, Penson issued account-level recalls to the borrowers on T+3, i.e., three business days after execution of the margin customer's sale order. If the borrowers did not return the shares by the close of business T+3 and Penson did not otherwise have enough shares of the relevant security to meet its CNS delivery obligations, Penson incurred a CNS failure to deliver in the relevant

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[3] Re-hypothecation involves a broker-dealer's use of customer margin securities as collateral for its own securities lending activities.

[4] The circumstances in which margin customers sold securities that were on loan will be referred to as "long sales of loaned securities." This proceeding focuses solely on Penson's close-out practices and neither this proceeding nor the related, settled proceedings (*Michael H. Johnson*, Exch. Act Rel. No. 72186 (May 19, 2014) and *Lindsey Alan Wetzig*, Exch. Act Rel. No. 72187 (May 29, 2014), should be interpreted as finding that the sale transactions were properly marked as "long" sales under Rule 200 of Regulation SHO.

security. When the open stock loan continued to cause a CNS failure to deliver as of market open T+6, it was Penson's procedure not to purchase or borrow shares by market open sufficient to close out its failure to deliver position. Instead, Penson systematically violated Rule 204(a) by allowing its CNS failure to deliver position to persist beyond market open T+6.

The Securities Lending Department Adopted Procedures for Long Sales of Loaned Securities that Violated Rule 204(a)

7. At all relevant times, the Securities Lending Department was included on the organizational charts of PWI, the parent company, rather than within Penson, which was then a registered broker-dealer. However, the policies and procedures of Penson treated the Securities Lending Department as part of the broker-dealer and the employees of the Securities Lending Department as associated persons of the broker-dealer. Securities Lending Department personnel had direct access to Penson's account with NSCC and conducted all securities lending activity on behalf of Penson. The Securities Lending Department had primary responsibility at Penson for effecting Rule 204(a) close-outs of Penson's CNS failures to deliver resulting from long sales of loaned securities.

8. In September 2008, the Securities Lending Department initially attempted to comply with Rule 204 for long sales of loaned securities by (1) continuing to use its existing systems that were programmed to issue recall notices to borrowing counterparties on T+3; and (2) attempting to buy in the counterparties at market open T+6 if they had not yet returned the borrowed shares. However, this approach did not result in compliance because the counterparties refused to accept the buy ins. Under the MSLA applicable to the loans, the borrowing counterparties had three full business days from the T+3, account-level recall – i.e., until close of business T+6 – to return the shares. Because the MSLA provided for three full business days for the borrowing counterparties to return the shares, those counterparties often resisted Penson's attempted market open T+6 buy ins.

9. DeLaSierra notified his supervisor, the head of the Securities Lending Department, about the counterparty resistance to market open T+6 buy ins. After discussing the matter with the compliance department, DeLaSierra's supervisor decided to continue issuing recall notices on T+3 and to have DeLaSierra and other employees do their best to convince counterparties to return the loaned securities before market open T+6. However, if the counterparties did not return the loaned securities by market open T+6, Penson would not fulfill its Rule 204 obligations by purchasing or borrowing securities. Under these procedures, Penson would sometimes allow the relevant CNS failures to deliver to persist beyond close-of-business on T+6. DeLaSierra discussed these issues with his supervisor and, after hearing his supervisor discuss the counterparty resistance with Penson's Chief Compliance Officer, agreed to follow these procedures.

10. DeLaSierra knew or was reckless in not knowing that these procedures would cause Penson to violate Rule 204. Nevertheless, from October 2008 until November 2011, DeLaSierra and other employees of the Securities Lending Department followed the procedures. As a result, Penson violated Rule 204 at least 1,500 times.

Violations

As a result of the conduct described above, DeLaSierra willfully aided and abetted and caused Penson's violations of Rules 204(a) of Regulation SHO, which requires registered participants of clearing agencies to close out CNS failures to deliver resulting from long sales by market open T+6 and to close out CNS failures to deliver resulting from short sales by market open T+4.

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) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent DeLaSierra shall cease and desist from committing or causing any violations and any future violations of Rule 204(a) of Regulation SHO.

B. Respondent DeLaSierra is censured.

C. Respondent acknowledges that the Commission is not imposing a civil penalty based upon his cooperation in a Commission investigation and related enforcement proceeding. 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.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75935; File No. PCAOB-2015-01)

September 17, 2015

Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules to Implement the Reorganization of PCAOB Auditing Standards and Related Changes to PCAOB Rules and Attestation, Quality Control, and Ethics and Independence Standards

I. Introduction

On June 17, 2015, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 107(b)[1] of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and Section 19(b)[2] of the Securities Exchange Act of 1934 (the "Exchange Act"), proposed rules to adopt amendments to implement the reorganization of PCAOB auditing standards and related changes to PCAOB rules and attestation, quality control, and ethics and independence standards (collectively, the "Proposed Rules" or "Proposed Reorganization").[3] The Proposed Rules were published for comment in the Federal Register on June 25, 2015.[4] At the time the notice was issued, the Commission designated a longer period to act on the Proposed Rules, until September 23, 2015.[5] The Commission received four comment letters in response to the

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[1] 15 U.S.C. 7217(b).

[2] 15 U.S.C. 78s(b).

[3] The Board originally proposed in March 2013 ("Original Proposal") what became the Proposed Rules. See PCAOB Release No. 2013-002 (March, 26, 2013). The Board also issued a supplemental request for comment in May 2014 ("Supplemental Request"). See PCAOB Release No. 2014-001 (May 7, 2014).

[4] See Release No. 34-75251 (June 19, 2015), 80 FR 36602 (June 25, 2015).

[5] Ibid.

notice.[6] This order approves the Proposed Rules.

II. Description of the Proposed Rules

In April 2003, the Board adopted, on an interim, transitional basis, generally accepted auditing standards ("GAAS") that were in existence on April 16, 2003. When the Board adopted those auditing standards, it continued to use the topical organization and reference numbers ("AU sections") in the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants' ("AICPA") then-existing codification of its standards. Auditing standards issued by the Board ("AS standards") have not been codified or otherwise organized by topic, and are numbered in sequential order based upon when they were issued. As a result, the Board's auditing standards are organized using two separate numbering systems: (1) the numbering system used by the ASB when the Board adopted the interim standards; and (2) the numbering system used by the Board for the standards it has issued.

1. Proposed Reorganization

Under the Proposed Reorganization, the individual standards will be grouped into the following topical categories:

- General Auditing Standards (AS 1000s)—standards on broad auditing principles, concepts, activities, and communications;
- Audit Procedures (AS 2000s)—standards for planning and performing audit procedures and for obtaining audit evidence;
- Auditor Reporting (AS 3000s)—standards for auditors' reports;

[6] See Comment letters from Suzanne H. Shatto, June 27, 2015, Deloitte & Touche LLP, July 8, 2015, Michael McMurtry, July 28, 2015, and Stephen G. Wills, August 17, 2015, available at http://www.sec.gov/comments/pcaob-2015-01/pcaob201501.shtml.

- Matters Related to Filings Under Federal Securities Laws (AS 4000s)—standards on certain auditor responsibilities relating to U.S. Securities and Exchange Commission filings for securities offerings and reviews of interim financial information; and
- Other Matters Associated with Audits (AS 6000s)—standards for other work performed in conjunction with an audit of an issuer or of a broker or dealer.

Within each category are subcategories to further organize similar topics, such as standards related to auditor communications in the "General Auditing Standards" category. The integrated reference system uses an "AS" prefix to identify the auditing standard and each standard is assigned a unique section number, based on a four-digit numbering system.

2. Changes to PCAOB Standards and Rules

The amendments to PCAOB standards and rules include changes rescinding certain interim auditing standards that the Board believes are no longer necessary, eliminating inoperative language in auditing standards, references, and interpretations, and eliminating inoperative references to AICPA standards or rules.

a. Changes to the PCAOB Standards

The amendments primarily update section numbers, update cross-references among standards using the numbering system in the adopted reorganization, and change the titles of certain standards. Other amendments rescind certain interim standards and remove or update certain terms and phrases in the standards.

Interim Standards to be Rescinded

The following interim standards are being rescinded because they contain requirements that have been superseded or duplicated by other PCAOB standards, and as such, are considered unnecessary:

- AU sec. 150, Generally Accepted Auditing Standards
- AU sec. 201, Nature of the General Standards
- AU sec. 410, Adherence to Generally Accepted Accounting Principles
- AU sec. 532, Restricting the Use of an Auditor's Report
- AU sec. 901, Public Warehouses—Controls and Auditing Procedures for Goods Held.

Interpretive Publications

Almost all[7] of the AICPA auditing interpretations are being retained and presented separately from the auditing standards. The Proposed Reorganization retains the existing requirement for the auditor to be aware of and consider the applicable auditing interpretations.

The Proposed Reorganization retains the majority[8] of the appendices to the interim auditing standards and to continue presenting those appendices together with their related auditing standards in the same manner that appendices to PCAOB-issued standards are presented. Additionally, the Proposed Reorganization removes references to AICPA Audit and Accounting Guides and AICPA auditing Statements of Position because the guides referenced in PCAOB standards are outdated.[9]

Other Changes to PCAOB Standards

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[7] The Proposed Reorganization will rescind two auditing interpretations related to AU sec. 410 and AU sec. 534 and interpretation 16 of AU sec. 508 because they are either duplicative or unrelated to the preparation or issuance of any audit report for an issuer, broker, or dealer, and thus unnecessary.

[8] The Proposed Reorganization will delete duplicative and thus unnecessary appendices that contain paragraphs .86 and .87 of AU sec. 316.

[9] AICPA Audit and Accounting Guides and auditing Statements of Position referenced in PCAOB standards are the editions of those publications as in existence on April 16, 2003.

The Proposed Reorganization includes amendments to replace references to GAAS throughout the auditing standards with references to the standards of the PCAOB or PCAOB auditing standards, and accordingly, to supersede Auditing Standard No. 1 ("AS 1"), References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board.[10] The Proposed Reorganization also includes amendments to preserve the requirement from AS 1 for the auditor's report to include the city and state, (or city and country), of the auditor. Finally, as AS 1 applied to the PCAOB's attestation standards, amendments to update references to PCAOB standards and to include the city and state (or city and country) have been applied to the attestation standards.

As a result of these changes, the amendments also include updates to the illustrative auditor's reports included throughout the auditing standards. In addition to illustrating the two changes described above, the updates to the reports include changing the title to "Report of Independent Registered Public Accounting Firm."[11]

b. Changes to PCAOB Rules

The Proposed Reorganization amends PCAOB Rule 3200T to remove (1) the reference to AU sec. 150, which, as discussed above, is rescinded, and (2) terms such as "interim auditing standards" and "generally accepted auditing standards." These terms are no longer relevant under the Proposed Reorganization. Additionally, the Proposed Reorganization makes the rule

[10] In 2004, the Commission published interpretive guidance to explain that references in Commission rules and staff guidance to GAAS or specific standards of GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission. See Release No. 34-49708, FR-73 (May 14, 2004).

[11] In the Board's final rule release, it notes that the amendments would not preclude an unregistered firm that applies PCAOB standards, when appropriate, from omitting "Registered" from the title of the report. See PCAOB Release No. 2015-002 at fn. 26 (March 31, 2015).

permanent, rather than temporary, and therefore removes the word "Interim" from its title.

3. Applicability and Effective Date

The PCAOB has proposed application of its Proposed Rules to audits of all issuers, including audits of emerging growth companies ("EGCs"),[12] as discussed in Section IV. below. The Proposed Rules also would apply to audits of SEC-registered brokers and dealers.[13]

The Proposed Rules would be effective as of December 15, 2016. However, auditors and others are not precluded from using and referencing the standards as reorganized pursuant to the Proposed Rules before the effective date because the amendments do not substantively change the standards' requirements.[14]

III. Comment Letters

As noted above, the Commission received four comment letters concerning the Proposed Rules. Three commenters expressed support for the Proposed Rules,[15] and the other commenter provided suggestions discussed further below.[16]

One commenter stated that the new organizational structure will improve the usability of the PCAOB's auditing standards, including helping users navigate the standards more easily.[17] Another commenter suggested adopting a similar structure used by the ASB and IAASB and

[12] The term "emerging growth company" is defined in Section 3(a)(80) of the Exchange Act. 15 U.S.C. 78c(a)(80).

[13] On July 30, 2013, the Commission adopted amendments to Rule 17a-5 under the Exchange Act to require, among other things, that audits of brokers' and dealers' financial statements be performed in accordance with the standards of the PCAOB for fiscal years ending on or after June 1, 2014. 17 CFR 240.17a-5. See *Broker–Dealer Reports*, Release No. 34–70073, (July 30, 2013), 78 FR 51910 (August 21, 2013), available at http://www.sec.gov/rules/final/2013/34-70073.pdf.

[14] See PCAOB Release No. 2015-002 at 21.

[15] See Shatto Letter, Deloitte Letter and McMurtry Letter.

[16] See Wills Letter.

[17] See Deloitte Letter.

reorganizing the PCAOB's attestation, quality control, and ethics and independence standards. This same commenter expressed concern regarding the rescission of AU sec. 532 and removal of references to non-authoritative other guidance in the Proposed Reorganization.[18] Finally, one commenter suggested enhancements to improve the usability of the Proposed Reorganization, including a suggestion to embed PCAOB standards in the FASB's Accounting Standards Codification.[19] The PCAOB addressed many of these comments in its Original Proposal, Supplemental Request, and final rule release. The Commission does not find the PCAOB's responses to be unreasonable. The comment on embedding PCAOB standards in the FASB's Accounting Standards Codification is outside the scope of the Proposed Rules.

IV. The PCAOB's EGC Request

Section 103(a)(3)(C) of the Sarbanes-Oxley Act provides that any additional rules adopted by the PCAOB subsequent to April 5, 2012 do not apply to the audits of EGCs, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.[20] Having considered those factors, and as explained further herein, the Commission finds that applying the Proposed Rules to audits of EGCs is necessary or appropriate in the public interest.

In proposing application of the Proposed Rules to audits of all issuers, including EGCs, the PCAOB requested that the Commission make the determination required by Section 103(a)(3)(C). To assist the Commission in making its determination, the PCAOB prepared and

[18] See McMurtry Letter.

[19] See Wills Letter.

[20] Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as amended by Section 104 of the JOBS Act.

submitted to the Commission its own EGC analysis. The PCAOB's EGC analysis includes discussions of characteristics of self-identified EGCs and economic considerations pertaining to audits of EGCs, including efficiency, competition, and capital formation. In its analysis, the Board states the reorganization of PCAOB auditing standards would involve amendments that do not impose additional requirements on auditors or change substantively the requirements of PCAOB standards. Thus, the reorganization, including the amendments, is not expected to affect the manner in which audits are performed and reported under PCAOB standards, including audits of EGCs. Additionally, reorganizing the PCAOB standards into a single, integrated organizational structure should make it easier for auditors and others to navigate, use, and apply the standards.

The PCAOB's EGC analysis was included in the Commission's public notice soliciting comment on the Proposed Rules. Based on the analysis submitted, we believe the information in the record is sufficient for the Commission to make the requested EGC determination in relation to the Proposed Rules.

V. Conclusion

The Commission has carefully reviewed and considered the Proposed Rules and the information submitted therewith by the PCAOB, including the PCAOB's EGC analysis, and the comment letters received. In connection with the PCAOB's filing and the Commission's review,

A. The Commission finds that the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors; and

B. Separately, the Commission finds that the application of the Proposed Rules to

EGC audits is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Sarbanes-Oxley Act and Section 19(b)(2) of the Exchange Act, that the Proposed Rules (File No. PCAOB-2015-01) be and hereby are approved.

By the Commission.

Brent J. Fields
Secretary

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75939 / September 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16817

In the Matter of

BRIAN DAVID HALL

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b), and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Brian David Hall ("Hall" 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 Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

This proceeding arises out of securities lending practices at Penson Financial Services, Inc. ("Penson"), a former registered broker-dealer, that resulted in its systematic violations of Rule 204 of Regulation SHO.[2] From October 2008 through November 2011, Hall and other individuals in the Securities Lending Department implemented procedures that they knew, or were reckless in not knowing, did not comply with Rule 204 of Regulation SHO. In so doing, Hall willfully aided and abetted and caused Penson's violations.

Respondent

1. Hall, 40, of Pantego, Texas, was a Vice President of Penson from at least October 2008 until June 2012. In that position, Hall was responsible for securities lending activities at Penson. Hall was associated with Penson between June 2001 and June 2012. Hall holds Series 7 and 63 licenses.

Other Relevant Entity

2. Penson was a registered broker-dealer incorporated in North Carolina with a principal place of business in Dallas, Texas. From at least 2010 to 2012, Penson was the second-largest clearing firm in the United States as measured by the number of correspondent broker-dealers for which it cleared. Penson was a wholly-owned subsidiary of SAI Holdings, Inc., which in turn was a wholly-owned subsidiary of Penson Worldwide Inc. ("PWI"). Penson filed a Form BDW, which became effective in October 2012, and then declared bankruptcy in January 2013. A bankruptcy plan implementing Penson's liquidation was approved in July 2013.

Background

3. In September 2008, the Commission implemented Rule 204T of Regulation SHO, which required, among other things, clearing firms such as Penson to close out Continuous Net Settlement ("CNS") failures to deliver in all sales of equity securities that they cleared. In July 2009, the Commission made those requirements permanent in adopting Rule 204 of Regulation

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

[2] Rule 204 was initially implemented as a temporary rule, Rule 204T. Generally, Rule 204T and Rule 204 will be collectively referred to as Rule 204.

SHO. The Commission adopted Rule 204 of Regulation SHO to address, among other things, abusive "naked" short selling and failures to deliver.[3]

4. Rule 204(a) requires participants of a registered clearing agency (generally, clearing firms) to deliver equity securities to a registered clearing agency when delivery is due, i.e., by settlement date, or close out fails to deliver resulting from long or short sales within certain timeframes. Settlement date is generally three days after the trade date ("T+3"). For short sales, if the clearing firm has a failure-to-deliver position at the clearing agency, it must close out the CNS failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours (i.e., market open) on the settlement day following the settlement date ("T+4"). For long sales, if the clearing firm has a failure-to-deliver position at the clearing agency, it must close out the CNS failure-to-deliver position by purchasing or borrowing securities of like kind and quantity by no later than the beginning of regular trading hours on the third day following the settlement date ("T+6").

Penson Violated Rule 204 of Regulation SHO

5. At all relevant times, Penson was a clearing firm and a member of the National Securities Clearing Corporation ("NSCC"), a clearing agency registered with the Commission that clears and settles the majority of United States transactions in equities. From October 2008 through November 2011, Penson systematically failed to close out CNS failures to deliver resulting from certain long sales by market open T+6. The relevant long sales originated with securities held in customer margin accounts. Under the Commission's customer protection rule, Penson was permitted, subject to certain conditions and limitations, to re-hypothecate margin securities to third parties.[4] Penson re-hypothecated margin securities according to the terms of the Master Securities Lending Agreement ("MSLA") developed by the Securities Industry and Financial Markets Association ("SIFMA"). The Securities Lending Department generated revenue and helped to finance Penson's operations by loaning out shares held in customer margin accounts.[5]

6. When a margin customer sold the hypothecated securities that were out on loan, Penson issued account-level recalls to the borrowers on T+3, i.e., three business days after execution of the margin customer's sale order. If the borrowers did not return the shares by the

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[3] Rule 204T and Rule 204 will be collectively referred to as Rule 204.

[4] Re-hypothecation involves a broker-dealer's use of customer margin securities as collateral for its own securities lending activities.

[5] The circumstances in which margin customers sold securities that were on loan will be referred to as "long sales of loaned securities." This proceeding focuses solely on Penson's close-out practices and neither this proceeding nor the related, settled proceedings (*Michael H. Johnson,* Exch. Act Rel. No. 72186 (May 19, 2014) and *Lindsey Alan Wetzig,* Exch. Act Rel. No. 72187 (May 29, 2014)) should be interpreted as finding that the sale transactions were properly marked as "long" sales under Rule 200 of Regulation SHO.

close of business T+3 and Penson did not otherwise have enough shares of the relevant security to meet its CNS delivery obligations, Penson incurred a CNS failure to deliver in the relevant security. When the open stock loan continued to cause a CNS failure to deliver as of market open T+6, it was Penson's procedure not to purchase or borrow shares by market open sufficient to close out its failure to deliver position. Instead, Penson systematically violated Rule 204(a) by allowing its CNS failure to deliver position to persist beyond market open T+6.

The Securities Lending Department Adopted Procedures for Long Sales of Loaned Securities that Violated Rule 204(a)

7. At all relevant times, the Securities Lending Department was included on the organizational charts of PWI, the parent company, rather than within Penson, which was then a registered broker-dealer. However, the policies and procedures of Penson treated the Securities Lending Department as part of the broker-dealer and the employees of the Securities Lending Department as associated persons of the broker-dealer. Securities Lending Department personnel had direct access to Penson's account with NSCC and conducted all securities lending activity on behalf of Penson. The Securities Lending Department had primary responsibility at Penson for effecting Rule 204(a) close-outs of Penson's CNS failures to deliver resulting from long sales of loaned securities.

8. In September 2008, the Securities Lending Department initially attempted to comply with Rule 204 for long sales of loaned securities by (1) continuing to use its existing systems that were programmed to issue recall notices to borrowing counterparties on T+3; and (2) attempting to buy in the counterparties at market open T+6 if they had not yet returned the borrowed shares. . However, this approach did not result in compliance because the counterparties refused to accept the buy ins. Under the MSLA applicable to the loans, the borrowing counterparties had three full business days from the T+3, account-level recall – i.e., until close of business T+6 – to return the shares. Because the MSLA provided for three full business days for the borrowing counterparties to return the shares, those counterparties often resisted Penson's attempted market open T+6 buy ins.

9. After discussing the matter with the compliance department, Hall's supervisor decided to continue issuing recall notices on T+3 and to have Securities Lending personnel do their best to convince counterparties to return the loaned securities before market open T+6. However, if the counterparties did not return the loaned securities by market open T+6, Penson would not fulfill its Rule 204 obligations by purchasing or borrowing securities. Under these procedures, Penson would sometimes allow the relevant CNS failures to deliver to persist beyond close-of-business on T+6. Hall discussed these issues with his supervisor and agreed with these procedures.

10. Hall knew or was reckless in not knowing that these procedures would cause Penson to violate Rule 204. Nevertheless, from October 2008 until November 2011, Hall and other employees of the Securities Lending Department followed the procedures. As a result, Penson violated Rule 204 at least 1,500 times.

11. Hall played a significant role in bringing the violations to the attention of regulators. Penson failed to disclose the non-compliant procedures over the course of more than two years even though examiners from the Commission's Office of Compliance Inspections and Examinations and the Financial Industry Regulatory Authority ("FINRA") were continuously reviewing Penson's Rule 204 practices from November 2008 through the end of 2010. Penson finally disclosed the non-compliant procedures to FINRA in a March 2011 letter responding to FINRA examination findings. Early drafts of the letter prepared by Penson personnel other than Hall did not disclose the non-compliant procedures. Mid-way through the drafting process, Hall took over responsibility for drafting the relevant portion of Penson's response, and drafted the language disclosing Penson's non-compliant procedures.

Violations

As a result of the conduct described above, Hall willfully aided and abetted and caused Penson's violations of Rules 204(a) of Regulation SHO, which requires registered participants of clearing agencies to close out CNS failures to deliver resulting from long sales by market open T+6 and to close out CNS failures to deliver resulting from short sales by market open T+4.

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) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Hall shall cease and desist from committing or causing any violations and any future violations of Rule 204(a) of Regulation SHO.

B. Respondent Hall is censured.

C. Respondent acknowledges that the Commission is not imposing a civil penalty based upon his cooperation in a Commission investigation and related enforcement proceeding. 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.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Dissents as to the
Municipal Advisor
and NRSRO Bars

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75940 / September 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16818

In the Matter of

TIMOTHY J. MCGEE,

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 Timothy J. McGee ("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) 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. McGee, age 51, lives in Wayne, Pennsylvania. From April 27, 1988 to March 22, 2012, McGee was a registered representative with Ameriprise Financial Services, Inc., a registered broker-dealer. McGee held Series 7 and 63 licenses and was a Certified Financial Planner.

2. On November 15, 2012, a jury found McGee guilty of one count of securities fraud, in violation of 15 U.S.C. §§ 78j(b) and 78(ff), and Securities and Exchange Commission ("SEC") Rules 10b-5 and 10b5-2(b)(2), based on his July 2008 insider trading in the stock of Philadelphia Consolidated Holding Company ("PHLY"); and one count of perjury, in violation of 18 U.S.C. § 1621, based on his false testimony before the Commission. *United States v. McGee*, Crim. No. 12-236 (E.D. Pa. 2012). McGee was sentenced to six months imprisonment and ordered to pay a $100,000 fine. His conviction was subsequently affirmed. *United States v. McGee*, 763 F.3d 304 (3d Cir. 2014).

3. On July 15, 2015, a Judgment Order was entered by consent against McGee, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled *Securities and Exchange Commission v. Timothy J. McGee, et al.*, Civil Action Number 12-CV-01296 (TJS), in the United States District Court for the Eastern District of Pennsylvania.

4. The Commission's amended complaint alleged that McGee engaged in unlawful insider trading by purchasing the common stock of PHLY in advance of the company's July 23, 2008 public announcement of its sale to Tokio Marine Holdings, Inc., after he misappropriated material nonpublic information from a senior executive of PHLY with whom he had a relationship of trust and confidence. The amended complaint alleged further that McGee purchased a substantial amount of PHLY stock for himself, ultimately earning over $292,000 in ill-gotten gains. The amended complaint also alleged that McGee tipped his good friend and colleague, Michael W. Zirinsky, about the PHLY acquisition. Zirinsky bought PHLY stock for himself and on behalf of numerous family members.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, that Respondent McGee be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and pursuant to Section 15(b)(6) of the Exchange Act Respondent McGee 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

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9915 / September 17, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75944 / September 17, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3698 / September 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16820

In the Matter of **TERRY L. JOHNSON, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

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"), Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e)(1)(ii) and (iii) of the

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

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

Commission's Rules of Practice against Respondent Terry L. Johnson, CPA ("Johnson" or "Respondent").[2]

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 Making Findings And Imposing Remedial Sanctions Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rules 102(e) of the Commission's Rules of Practice and a Cease-and-Desist Order, as set forth below.

III.

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

A. <u>SUMMARY</u>

1. Respondent, Terry L. Johnson, a Casselberry, Florida-based certified public accountant, who performed highly deficient and fraudulent audits and quarterly reviews of the financial statements of at least eight issuer clients and issued audit reports containing materially false statements on these annual financial statements. These audit reports were included in the issuers' filings under the Exchange Act or in registration statements under the Securities Act. Specifically, Johnson issued audit reports with unqualified opinions on the December 31, 2012 and 2013 fiscal year-end financial statements included in the Form 10-K annual reports of six clients, including Boreal Water Collection, Inc., Monster Arts, Inc., Primco Management, Inc.,

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

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

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's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Puissant Industries, Inc., UMED Holdings, Inc., and Valley High Mining Company, and for inclusion in Form S-1 registration statements of two clients, including ADM Endeavors, Inc. and Legendary Ventures Inc. (collectively the "Eight Issuers").

2. Johnson's numerous audit deficiencies included, among other things, the failure to obtain engagement quality reviews, properly plan audits, obtain sufficient appropriate audit evidence, and maintain audit documentation. Johnson's audits were so deficient that they amounted to no audits at all and could not be relied upon as having afforded him with a reasonable basis for his opinions regarding the financial statements that he audited. Moreover, Johnson falsely stated in audit reports that he conducted his audits "in accordance with the standards of the Public Company Accounting Oversight Board [PCAOB]," when, in fact, his conduct of the audits did not conform with and violated numerous PCAOB auditing standards.

3. Johnson also created, or caused to be created, back-dated, artificial audit documentation for certain audit clients, which he produced to the Commission staff in response to document subpoenas as a contemporaneous work paper[4]. In reality, the work papers did not exist at the time of the actual audits, but were created after Johnson was requested to produce work papers in connection with the Commission staff's investigation.

B. RESPONDENT

4. **Terry L. Johnson**, age 56, a resident of Casselberry, Florida operates a self-named sole-proprietorship accounting firm in Casselberry, Florida. Johnson is a Florida-licensed CPA. Johnson's accounting firm, "Terry L. Johnson, CPA, had its PCAOB registration withdrawn as of July 7, 2015.[5] Johnson audited and issued audit reports, purportedly in accordance with PCAOB standards, for the December 31, 2012 and 2013 year-end financial statements of the Eight Issuers.

C. RELEVANT ENTITIES

5. **ADM Endeavors, Inc. ("ADM")** is a Nevada corporation with its principal place of business in Bismarck, North Dakota. ADM has common stock registered pursuant to Section 12(g) of the Exchange Act and files periodic reports with the Commission pursuant to Section 13 of the Exchange Act. ADM has filed a Form S-1 registration statement, which became effective on May 14, 2015.

6. **Boreal Water Collection, Inc. ("Boreal")** is a Nevada corporation with its principal place of business in Kiamesha Lake, New York. Boreal has common stock registered

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[4] The term "work paper" is used in this memorandum interchangeably with, and has the same meaning as, the term "audit documentation."

[5] On December 17, 2013, Johnson's accounting firm became a PCAOB-registered firm. On May 14, 2015, Johnson requested the withdrawal of his firm's PCAOB registration.

pursuant to Section 12(g) of the Exchange Act and files periodic reports with the Commission pursuant to Section 13 of the Exchange Act. Boreal's common stock trades on OTC Link.

7. **Legendary Ventures, Inc. ("Legendary")** is a Nevada corporation with its principal place of business in Mississauga, Ontario, Canada. Legendary has filed a Form S-1 registration statement that is currently being reviewed by the Division of Corporation Finance.

8. **Monster Arts, Inc. ("Monster")** is a Nevada corporation with its principal place of business in San Clemente, California. Monster's common stock is registered pursuant to Section 12(g) and files periodic reports with the Commission pursuant to Section 13 of the Exchange Act. Monster is delinquent in its Exchange Act reporting obligations, having failed to file its Form 10-K for the fiscal year ended December 31, 2014 and Form 10-Q for the quarter ending March 31, 2015. Monster's common stock trades on OTC Link.

9. **Primco Management, Inc. ("Primco")** is a Delaware corporation with its principal place of business in Seattle, Washington. Primco has common stock registered pursuant to Section 12(g) of the Exchange Act and files periodic reports with the Commission pursuant to Section 13 of the Exchange Act. Primco is delinquent in its Exchange Act reporting obligations, having failed to file its Form 10-Q for the quarter ending March 31, 2015. Primco's common stock trades on OTC Link.

10. **Puissant Industries, Inc. ("Puissant")** is a Florida corporation with its principal place of business in London, Kentucky. Puissant filed periodic reports with the Commission pursuant to Section 13 and 15(d) of the Exchange Act through December 31, 2014. On December 31, 2014, Puissant filed a Form 15 to terminate or suspend its duty to file reports with the Commission. Puissant's common stock trades on OTC Link.

11. **UMED Holdings, Inc. ("UMED")** is a Texas corporation with its principal place of business in Fort Worth, Texas. UMED has common stock registered pursuant to Section 12(g) of the Exchange Act and files periodic reports with the Commission pursuant to Section 13 of the Exchange Act. UMED's common stock trades on OTC Link.

12. **Valley High Mining Company ("Valley High")** is a Nevada corporation with its principal place of business in Silverdale, Washington. Valley High has common stock registered pursuant to Section 12(g) of the Exchange Act and files periodic reports with the Commission pursuant to Section 13 of the Exchange Act. Valley High's common stock trades on OTC Link.

D. FACTS

13. Johnson was first registered with the PCAOB on December 17, 2013. Within two months of becoming registered, Johnson acquired eighteen new issuer audit clients. The vast majority of these audit clients were previously audited by an auditor who was censured and barred from being an associated person of a registered public accounting firm by the PCAOB in March 2014. Once the predecessor auditor's registration was revoked by the PCAOB, Johnson, who had previously worked for the predecessor auditor, became the new auditor for audit clients of the predecessor auditor. Out of the eighteen audit clients, at least two were previously audited

by a second predecessor auditor, who was also previously sanctioned by the PCAOB in November 2013. Johnson had no prior experience in serving as an engagement partner for Commission registrants prior to the numerous engagements that he picked up after the predecessor auditors were barred by the PCAOB.

14. For the audits of the Eight Issuers, Johnson falsely stated that he had conducted his audits in accordance with the standards of the PCAOB. Johnson's audits were grossly deficient, evidencing numerous and repeated violations of auditing standards and, among other things, lacked audit planning, engagement quality reviews, audit documentation, and sufficient appropriate audit evidence.

1. <u>Failure to Obtain Engagement Quality Reviews</u>

15. PCAOB Auditing Standard No. 7, Engagement Quality Review, requires an engagement quality review ("EQR") and concurring approval of issuance for each audit engagement and each engagement to review interim financial information. Auditing Standard No. 7, ¶ 1. To maintain objectivity, the engagement quality reviewer should not make decisions on behalf of the engagement team or assume any of the responsibilities of the engagement team. Auditing Standard No. 7, ¶ 7. Johnson repeatedly failed to comply with PCAOB Auditing Standard No. 7.

16. Auditing Standard No. 7 allows firms, including sole practitioners such as Johnson, to engage qualified individuals from outside the firm to serve as the engagement quality reviewer. Auditing Standard No. 7, ¶ 3. Johnson knew that each of his audit engagements required an EQR, but failed to obtain an EQR for the December 31, 2012 and 2013 audits of the financial statements of the Eight Issuers.

17. Johnson also failed to obtain engagement quality reviews of the March 31 and June 30, 2014 quarterly reviews of ADM, Boreal Water, Monster, Primco, Puissant, UMED and Valley High; the March 31, 2014 quarterly review of Legendary.

2. <u>Lack of Audit Work Papers</u>

18. Johnson repeatedly violated PCAOB Auditing Standard No. 3, *Audit Documentation*, which requires that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement (a) to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached, and (b) to determine who performed the work and the date such work was completed. Auditing Standard No. 3, ¶ 6, *Audit Documentation*. If, after the documentation completion date, an auditor becomes aware, as a result of a lack of documentation or otherwise, that audit procedures may not have been performed, evidence may not have been obtained, or appropriate conclusions may not have been reached, the auditor must determine, and if so demonstrate that, sufficient procedures were performed, sufficient evidence was obtained, and appropriate conclusions were reached with respect to the relevant financial statement assertions. To accomplish this, the auditor must have persuasive other evidence, and oral explanations alone does not constitute persuasive other evidence. Auditing Standard No. 3, ¶ 9, *Audit Documentation*.

19. Johnson's audit work papers related to the December 31, 2012 and 2013 year-end audits of the Eight Issuers were grossly deficient. The audits consistently failed to include evidence of the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions.

a. <u>2012 Audits</u>

20. Johnson was engaged to perform a re-audit of the December 31, 2012 year-end financial statements of six audit clients, including, ADM, Boreal, Legendary, Monster, Puissant, and UMED, as a result of the PCAOB revoking the registration of the predecessor auditor. Johnson was required to take full responsibility for the 2012 audits and perform his own audit work that provided a basis for his opinion on the financial statements.[6] Johnson, however, relied on the predecessor auditor's audit work to afford a basis for his 2012 audit opinions, without performing an independent audit.

21. Johnson's re-audits of the December 31, 2012 financial statements amounted to no audits at all, and the information he obtained from any review of the predecessor auditor's work papers was insufficient to afford a basis for expressing an opinion on the financial statements. Significant categories of work papers were either completely absent from the audit file or consisted of a schedule prepared by the client that detailed the particular account balance, but contained no other documentation from Johnson such as the procedures performed, evidence obtained, or conclusions reached. For example, virtually no work papers existed for the Boreal and Puissant audits. The majority of work papers for the Monster audit only contained a notation from Johnson indicating that he "traced to w/p in prior auditor file, reviewed procedures."

22. Johnson's 2012 audits of Primco and Valley High (which were not audited by the predecessor auditor), were lacking in work paper documentation, evidence obtained, or evidence that he performed audit procedures to reach conclusions with respect to the relevant financial statement assertions.

b. <u>2013 Audits</u>

23. Johnson's audit work papers related to the December 31, 2013 year-end audits of the Eight Issuers were grossly deficient. The audits failed to include evidence of the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions. For example, for all Eight Issuers, Johnson's files contained no work papers related to significant categories of financial statement line items and transactions including cost of sales, operating expenses, and equity transactions.

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[6] If the successor auditor accepts the re-audit engagement, he or she may consider the information obtained from inquiries of the predecessor auditor and review of the predecessor auditor's report and working papers in planning the re-audit. However, the information obtained from those inquiries and any review of the predecessor auditor's report and working papers is not sufficient to afford a basis for expressing an opinion. The nature, timing, and extent of the audit work performed and the conclusions reached in the re-audit are solely the responsibility of the successor auditor performing the re-audit. AU 315 ¶ 15, *Communication Between Predecessor and Successor Auditors*. The successor auditor should plan and perform the re-audit in accordance with PCAOB standards. AU 315 ¶ 16.

c. **Financial Statements and Other Information**

24. In his audits of the December 31, 2012 and 2013 year-end financial statements of the Eight Issuers, Johnson failed to include work papers that demonstrated that he reconciled underlying accounting records to the issuers' financial statements.[7] No documentation existed evidencing procedures performed to obtain audit evidence for the financial statement footnotes or reconciling the footnotes to supporting documentation. Further, no documentation existed within the audit files evidencing that Johnson read and considered any of the other information in the annual audit reports of Boreal, Monster, Primco, Puissant, UMED and Valley High that were filed with the Commission.[8]

25. For the audit of Primco, for example, Johnson had no copy of the issuer's Form 10-K (or subsequent amended 10-Ks) in his work papers. Primco subsequently restated its Form 10-K because it later came to Johnson's attention that the issuer "inadvertently" included among other things, approximately $1,496,000 in assets on the balance sheet that should not have been recorded in the company's books and records. Significantly, as a result of the restatement, certain amounts reflected in Primco's original tax footnote should have changed in the restated filing but were not. Johnson, however, did not review the tax footnote.

26. In other instances, for the audits of Puissant, UMED and Valley High, Johnson had a copy of the Commission filing in his work papers which contained no notations or any other evidence that he reviewed the financial statements contained within those filings. Further, for the audits of Monster and Boreal, for example, the work papers included a printout of the issuers' filings with a header containing the SEC EDGAR internet address, demonstrating that that the filings were printed from the SEC EDGAR website and inserted in the work papers <u>after</u> they were filed with the Commission. Therefore, no evidence existed in the work papers indicating that Johnson reviewed the financial statements or read and considered the other information contained in those documents before they were filed with the Commission.

27. Two other clients, ADM and Legendary, had filed a series of amended Form S-1s with the Commission. The work papers do not contain evidence that Johnson reviewed the financial statements contained within these filings in order to reconcile them with the underlying accounting records. The ADM work papers merely contained a copy of the last amended Form S-1, but no copies of the previous three amended Form S-1s that included his opinions. The Legendary work papers contained a copy of the first Form S-1 filed, but none of the subsequent

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[7] The auditor's substantive procedures must include reconciling the financial statements with the underlying accounting records. AS No. 13 ¶ 41, *The Auditor's Responses to the Risks of Material Misstatement.*

[8] Other information in a document may be relevant to an audit performed by an independent auditor or to the continuing propriety of his report. The auditor's responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no obligation to perform any procedures to corroborate other information contained in a document. However, he should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. AU 550 ¶ 04, *Other Information in Documents Containing Audited Financial Statements.*

amended Form S-1 filings. Legendary's second amended Form S-1 contained a restatement of previously issued financial statements and the inclusion of the financial statements of an additional interim period, but a copy of which was not included in the work papers.

3. <u>Inappropriate Addition of Documents to Work Papers</u>

28. PCAOB Auditing Standard No. 3, *Audit Documentation* requires that prior to the report release date, the auditor must have completed all necessary auditing procedures and obtained sufficient evidence to support the representations in the auditor's report. A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (*documentation completion date)*. Auditing Standard No. 3, ¶ 15, *Audit Documentation*. Circumstances may require additions to audit documentation after the report release date. Audit documentation must not be deleted or discarded after the documentation completion date; however, information may be added. Any documentation added must indicate the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it. Auditing Standard No. 3, ¶ 16, *Audit Documentation*. Johnson repeatedly failed to comply with PCAOB Auditing Standard No. 3.

29. Johnson failed to document the addition of several documents to the work papers after the documentation completion date for the Puissant and Primco engagements, as required by Auditing Standard No. 3, *Audit Documentation*. To the contrary, Johnson, after receiving a request for work papers by Commission staff, engaged in a scheme with several of his audit clients to draft back-dated, fraudulent work papers and create the appearance of having proper contemporaneous work papers.

30. For the Puissant audit, the report release date for Johnson's audit of the company's December 31, 2013 year-end financial statements was April 14, 2014.[9] In a September 23, 2014 email from Johnson to the CEO of Puissant, following the staff's request for documents, Johnson sent a "management inquiries" work paper and a "SAS 99 fraud questionnaire" work paper—critical parts of an audit—and asked "can you get these back to me as soon as possible." Puissant's CEO, on that same day, responded "signed documents..." and attached completed copies of the "management inquiries" and "SAS 99 fraud questionnaire" work papers. Johnson sent another email to Puissant's CEO on September 23, 2014 in which he attached a management representation letter and asked the CEO "can you copy this on to your letter head and sign and date April 12, 2014."

31. For the Primco audit, the report release date for Johnson's audit of Primco's December 31, 2013 year-end financial statements was April 15, 2014.[10] In another September 23, 2014 email from Johnson to the CEO of Primco, Johnson wrote, "Could you please fill out these and get back to me today. I need these for my audit files." Attached to this email were

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[9] No report release date is documented in the work papers. In fact, April 14, 2014 represents the date Puissant's Form 10-K was filed with the Commission. Johnson's audit opinion is also dated April 14, 2014.

[10] No report release date is documented in the work papers. April 15, 2014 represents the date Primco's Form 10-K was filed with the Commission.

blank copies of two documents, a "management inquiries" work paper and a "SAS 99 fraud questionnaire" work paper, which were to be completed by Primco's CEO. In another instance, Primco's CFO and Johnson worked together to create or alter Johnson's work papers in connection with responding to the Commission staff's document requests. An email dated September 17, 2014 from Primco's CFO to its CEO states "...over the last 10 days we have been in Florida helping Terry [Johnson] with the pcaob review, one of the accounts picked was the 12312013 primco file...so we have been working on this and several other accounts they want to see...unfortunately when the SEC calls everything else comes to a halt..."

4. <u>Lack of Sufficient Appropriate Audit Evidence</u>

32. Johnson repeatedly violated PCAOB Auditing Standard No. 15, *Audit Evidence*, which requires that the auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion. Auditing Standard No. 15, ¶ 4, *Audit Evidence*. Sufficiency is the measure of the quantity of audit evidence. Appropriateness is the measure of the quality of audit evidence, *i.e.,* its relevance and reliability. To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based. Auditing Standard No. 15, ¶ 5-6, *Audit Evidence*. Johnson repeatedly failed to comply with Auditing Standard No. 15.

33. In those instances which Johnson prepared audit work papers, they were perfunctory and did not contain sufficient and appropriate audit evidence to provide a reasonable basis for his opinions. The lack of sufficient and appropriate audit evidence is pervasive throughout the audits for the Eight Issuers.

a. <u>Valley High – "Mineral Rights"</u>

34. For the audit of Valley High, Johnson prepared a work paper related to "mineral rights," the company's principal asset, representing 80% and 98% of its total assets at December 31, 2013 and 2012, respectively. The mineral rights represented monies paid by Valley High to a newly formed joint venture that was going to operate and develop mineral properties in Peru. In 2013, the joint venture was terminated because Valley High could not access the mining property. Johnson included a note on the relevant work paper stating that "per agreement all payments made by VHMC [Valley High] will be returned one year after y/e 12/31/13." Johnson, however, failed to obtain any evidence on whether the monies paid by Valley High and included on the balance sheet would be recovered or returned. Further, once the joint venture was terminated, the amounts due to Valley High should have been classified as a receivable due to Valley High. However, Johnson knew that the amount was still misclassified as "mineral rights" in Valley High's December 31, 2013 financial statements.

35. In an email dated September 10, 2014 from Johnson to the CEO of Valley High, Johnson stated "Also, I need backup for the mineral rights property at 12/31/13..." and "the mineral rights should have been written off at 12/31/13."[11] This email was sent approximately

[11] The email was sent by Johnson to his client shortly after Johnson received the first document request from the Commission staff on August 26, 2014.

six months after Valley High's December 31, 2013 Form 10-K was filed with the Commission. Johnson knew that, by September, Valley High believed that it would not recover the monies and, thus, would have to write-off the amount in the third quarter of 2014. Valley High's September 30, 2014 Form 10-Q, the company's most recent filing, however, still included the non-existent asset on its balance sheet.

b. UMED Audit - "Tea Farm"

36. In 2012, UMED acquired a tea bush farm located in Hawaii for consideration of 5.5 million restricted shares and $278,000 in cash. At December 31, 2012 and 2013, UMED valued the tea bushes at $750,000, and this item constituted the second largest asset recorded on the books and records of the company. Notwithstanding its significance, only two work papers addressed this transaction, including: (1) a "property, plant and equipment" work paper, which listed the tea bushes as a single line item and included the notation, "traced to original agreement," next to this line item; and (2) an undated two sentence memo which stated "Traveled to Wood Valley to observe existence of ranch. Attached find pictures of the farm as well as documents that were found online regarding the farm." The audit evidence Johnson obtained with respect to financial statement assertions associated with this asset was wholly inadequate and do not indicate that Johnson did any inspection of or confirmation of the existence of the tea farm, its tea bushes, facilities and equipment.

c. Multiple Issuers -- Derivative Liability

37. For the Monster, Primco and Valley High engagements, Johnson failed to obtain "sufficient appropriate" evidence concerning the recording of "derivative liabilities," which generally arise when certain features of convertible debt are required to be accounted for separately as a derivative financial instrument. Johnson performed no analyses to determine whether the issuers' convertible notes, including the potential for recording a related derivative liability, were appropriately accounted for under Generally Accepted Accounting Principles ("GAAP"). Nor did Johnson obtain evidence to determine whether the derivative liabilities were valued correctly or should have even been recorded in the first place.

38. Monster, for example, recorded an implausibly large derivative liability in the amount of $21,876,947 on its December 31, 2013 balance sheet that pertained to only $261,000 in outstanding convertible notes. The derivative liability work papers contained implausible assumptions, including, for example, a risk-free rate, used to calculate the derivative liability.[12] During the relevant time, the risk-free rate would have been less than 1%, but the rate documented in the work papers and used in calculating the liability was 10%. Had Johnson reviewed the company's footnotes, he would have noted the company disclosed that it was using risk-free rates of less than 1% in its calculations for valuing stock options. Johnson testified that he did not understand the risk-free rate assumption used to value the derivative. Thus, the audit evidence Johnson obtained with respect to financial statement assertions associated with these liabilities was completely deficient.

[12] The risk-free rate generally represents the discount rate on short term U.S. Government Treasury Bills.

d. Multiple Issuers – Revenue

39. Johnson consistently failed to obtain sufficient appropriate audit evidence with respect to his audits of the revenue reported by various issuers. In the Monster 2013 year-end audit, for example, Johnson did not test revenue because it was "under materiality" even though it was above the materiality threshold Johnson had calculated for that audit and was in fact material.[13]

40. For the UMED audit, revenue "testing" consisted of Johnson including a notation next to the revenue balance on the income statement simply stating that revenue recorded was the result of the purchase of another entity. The only procedure Johnson performed with respect to revenue was to trace a sample of individual sales transactions to an "invoice," "contract" or "customer file." The work papers did not provide any information pertaining to how the sample was determined or the basis for selecting items to "test." In addition, the work papers did not provide any details concerning the invoice, contract or file that was examined. Johnson did not obtain sufficient appropriate evidence pertaining to whether fundamental revenue recognition criteria had been met. Further, Johnson did not test whether the sales were realized or recorded in the appropriate period.

41. For all Eight Issuers, Johnson glossed over the audit testing of revenue and failed to obtain sufficient appropriate evidence that reported sales did in fact occur. The grossly deficient audits of revenue combined with the non-existent audits of cost of sales and operating expenses, resulted in essentially "non-audits" of the Eight Issuers income statements. Accordingly, based on the foregoing, Johnson failed to comply with PCAOB Auditing Standard No. 15 for the audits of the Eight Issuers.

5. Failure to Properly Plan Audits

42. Johnson repeatedly violated PCAOB Auditing Standard No. 9, *Audit Planning*, which requires that planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan, which includes, in particular, planned risk assessment procedures and planned responses to the risks of material misstatement. Auditing Standard No. 9, ¶ 5, *Audit Planning*. The auditor should develop and document an audit plan that includes a description of: the planned nature, timing, and extent of the risk assessment procedures; the planned nature, timing, and extent of tests of controls and substantive procedures; and other planned audit procedures required to be performed so that the engagement complies with PCAOB standards. Auditing Standard No. 9, ¶ 10, *Audit Planning*. The purpose and objective of planning the audit are the same for an initial audit or a recurring audit engagement. However, for an initial audit, the auditor should determine the additional planning activities necessary to establish an appropriate audit strategy and audit plan, including determining the audit procedures necessary to obtain sufficient appropriate audit evidence regarding the opening balances. Auditing Standard No. 9, ¶ 19, *Audit Planning*. Johnson's audits of the financial statements of the Eight Issuers violated PCAOB Auditing Standard No. 9.

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[13] 2013 revenues amounted to $32,568. The materiality threshold Johnson had calculated for this audit was $25,000.

43. The work papers for the Eight Issuers contained the same types of forms, checklists and questionnaires that amounted to nothing more than superficial planning work papers for each audit. The veneer of the audit planning work performed is demonstrated by the fact that the audit planning work papers for four of the issuers contained basic erroneous information that related to other issuers. For example, some of the planning forms contained the names of other clients, names of employees from other issuers and/or references to fiscal years Johnson did not audit. The evidence indicates that Johnson just copied planning documents from one client to another without taking the time to change or delete incorrect information.

44. Johnson further failed to establish a materiality level for the 2012 year-end audits.[14]

45. With the exception of audit clients, Boreal and Primco, Johnson did not meet any employee of the Eight Issuers or visit their offices.

46. The "SAS 99 audit planning & risk assessment" work paper for the issuers was not completed properly.[15] Given that Johnson's clients were microcap issuers and seven were issued a "going concern" audit opinion, various risk factors were mostly present at each of the Eight Issuers. The following are examples of such factors that Johnson, inexplicably, indicated were not present: (1) recurring operating losses; (2) recurring negative cash flows; (3) need to refinance or obtain additional financing; (4) marginal ability to meet debt obligations; and (5) management's net worth threatened. Johnson acknowledged his audit failure in this area, testifying, "Yeah, they [risk factors] were present. That [the SAS 99 audit planning & risk assessment] should have been checked yes."

47. Further, the planning work papers did not include documentation concerning the planned nature, timing, and extent of substantive procedures and other planned audit procedures required to be performed so that the engagement complies with PCAOB standards. In addition, the work papers did not contain any planning documents concerning the audit procedures necessary to obtain sufficient appropriate audit evidence regarding the opening balances. In fact, Johnson's audit files contained no audit programs for any account balances.

6. <u>Deficient Interim Reviews</u>

48. The objective of a review of interim financial information pursuant to AU § 722, *Interim Financial Information*, is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with GAAP. A review consists principally of performing

[14] To plan the nature, timing, and extent of audit procedures, the auditor should establish a materiality level for the financial statements as a whole that is appropriate in light of the particular circumstances. AS No. 11, ¶ 6, *Consideration of Materiality in Planning and Performing an Audit.*

[15] This work paper contained a list of factors that might create incentives or pressures for management to commit fraud. In order to help assess the risk of misstatement due to fraud, the auditor indicates whether each stated factor is present at the issuer.

analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate (a) tests of accounting records through inspection, observation, or confirmation; (b) tests of controls to evaluate their effectiveness; (c) obtaining corroborating evidence in response to inquiries; or (d) performing certain other procedures ordinarily performed in an audit. AU § 722.07. Johnson's review of the interim financial information of the Eight Issuers did not meet the standards required of a reviewing accountant by AU § 722.07, *Interim Financial Information.*

49. The accountant should apply analytical procedures to the interim financial information to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Analytical procedures, for the purposes of this section, should include, among other things, comparing the quarterly interim financial information with comparable information for the immediately preceding interim period and the quarterly and year-to-date interim financial information with the corresponding period(s) in the previous year, giving consideration to knowledge about changes in the entity's business and specific transactions. AU §722.16, *Interim Financial Information.* The auditor should also obtain evidence that the interim financial information agrees or reconciles with the accounting records. AU §722.18, *Interim Financial Information.*

50. In each quarterly review work paper file for the Eight Issuers, Johnson included a half page to one page work paper which constituted his "analytical procedures" for that period. In all the quarterly review work papers produced to the staff, no balance sheet accounts were subject to analytical procedures. The analytical procedures applied to the interim income statement line items were perfunctory and contained no meaningful analysis of variances in account balances from one period to another.

51. For example, in one review, Johnson notes that an increase in revenue was due to "increased outputs." In another review, Johnson notes that an income statement line item, "Contract Labor", decreased because of "less contract labor."

52. In many instances, material variances were not investigated. Further, the analytical procedures pertaining to the income statement accounts did not contain comparisons of the current interim financial information to the immediately preceding interim period. Because this comparison was not completed, Johnson did not identify that Primco's revenue for the three month period ended March 30, 2014 and June 30, 2014 did not equal the revenue for the six months ended June 30, 2014. This error is contained in Primco's June 30, 2014 Form 10-Q. Finally, in each quarterly review, Johnson failed to obtain evidence that the interim financial information agreed or reconciled with the accounting records.

7. **<u>Failure to Apply Procedures to Required Supplementary Information</u>**

53. Accounting Standards Codification No. 932, *Extractive Activities – Oil and Gas* (formerly FASB Statement No. 69, *Disclosures About Oil and Gas Producing Activities),* requires publicly traded entities that have significant oil and gas producing activities to include, with complete sets of annual financial statements, supplementary disclosures of proved oil and

gas reserve quantities, changes in reserve quantities, a standardized measure of discounted future net cash flows relating to reserve quantities, and changes in the standardized measure.

54. Required supplementary information differs from other types of information outside the basic financial statements because the FASB considers the information an essential part of the financial reporting of certain entities and because authoritative guidelines for the measurement and presentation of the information have been established. Accordingly, the auditor should apply certain limited procedures to required supplementary information and should report deficiencies in, or the omission of, such information. AU § 558.06, *Required Supplementary Information.*

55. Johnson violated AU § 558 by failing to apply certain limited procedures to required supplementary information with respect to his audits of the December 31, 2012 and 2013 year-end financial statements of Puissant. Johnson failed to undertake any procedures with respect to the "Supplemental Disclosures about Oil and Gas Producing Activities" contained in Puissant's Form 10-K. Johnson claimed to have reviewed a report from the engineer hired by Puissant to help prepare the supplemental disclosures. However, this report was not in the work papers and no other evidence exists suggesting Johnson reviewed the report. Among other things, Johnson should have inquired whether the person who estimated the issuer's reserve information had appropriate qualifications and make certain other comparisons and inquiries related to information contained in the supplemental disclosures. Further, Johnson's work papers did not include a copy of the engineer's report and there is no evidence that Johnson reviewed this report.

56. Based on the foregoing, Johnson did not meet the standards required of an audit by AU § 558, *Required Supplementary Information.*

8. <u>Subsequent Events</u>

57. An independent auditor's report ordinarily is issued in connection with historical financial statements that purport to present financial position at a stated date and results of operations and cash flows for a period ended on that date. However, events or transactions sometimes occur subsequent to the balance-sheet date, but prior to the issuance of the financial statements, which have a material effect on the financial statements and therefore require adjustment or disclosure in the statements. These occurrences hereinafter are referred to as "subsequent events." AU § 560.01, *Subsequent Events.* Subsequent events require consideration by management and evaluation by the independent auditor. AU § 560.02, *Subsequent Events.* The independent auditor should perform other auditing procedures with respect to the period after the balance sheet date for the purpose of ascertaining the occurrence of subsequent events that may require adjustment or disclosure essential to a fair presentation of the financial statements in conformity with generally accepted accounting principles. AU § 560.12, *Subsequent Events.*

58. In connection with the Valley High 2013 audit, Johnson became aware before his audit report was released, that a balance sheet entry for "Note receivable" in the amount of $75,000 was uncollectible as of the date of the balance sheet. Valley High's 2013 Form 10-K

was filed with the Commission on April 15, 2014. Johnson's work paper concerning the note receivable was dated March 31, 2014 and indicated that the "Client recorded a receivable for a payment for services not performed. Pursued matter. Amount written-off in Q1 2014. Passed adjust since not material to overall presentation in financial statements." The $75,000 note, however, was material. It was only one of two assets on the company's balance sheet and more than the $1,530 materiality threshold amount Johnson calculated for this audit. The note receivable, thus, should not have been recorded on Valley High's December 31, 2013 balance sheet or, at a minimum, the non-collectability of the note should have been disclosed.[16]

59. Accordingly, Johnson violated AU § 560.02 and § 560.12 by failing to properly evaluate the subsequent events to determine whether Valley High should adjust or disclose a non-collectible receivable on its December 31, 2013 balance sheet.

9. Lack of Due Professional Care

60. Due professional care is to be exercised in the planning and performance of the audit and the preparation of the report. AU § 230.01, *Due Professional Care in the Performance of Work*. This standard requires the independent auditor to plan and perform his or her work with due professional care. Due professional care imposes a responsibility upon each professional within an independent auditor's organization to observe the standards of field work and reporting. AU § 230.02. The matter of due professional care concerns what the independent auditor does and how well he or she does it. AU § 230.04. An auditor should possess "the degree of skill commonly possessed" by other auditors and should exercise it with "reasonable care and diligence" (that is, with due professional care). AU § 230.05.

61. Johnson violated AU § 230.01 as evidenced by his repeated audit deficiencies such as his failure to obtain engagement quality reviews, properly plan audits, obtain sufficient appropriate audit evidence, and maintain audit documentation.

10. Failure to Issue Accurate Audit Reports

62. PCAOB standards require that the auditor's standard report state that the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an audit performed in accordance with PCAOB standards. AU § 508.07, *Report on Audited Financial Statements*.

63. Regulation S-X, 17 CFR § 210 et seq., prescribes the qualifications of accountants and the contents of the accountants' reports that must be submitted with corporate financial statements. This regulation defines "audit," when used in regard to financial statements, to mean

[16] Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities ordinarily will require adjustment of the financial statements (see paragraph .03) because such events typically represent the culmination of conditions that existed over a relatively long period of time. AU § 560.07, *Subsequent Events*.

an examination of the financial statements by an independent accountant in accordance with generally accepted auditing standards ("GAAS"), as may be modified or supplemented by the Commission, for the purpose of expressing an opinion thereon.[17] 17 CFR § 210.1-02(d). "[R]eferences in Commission rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission." (See SEC Release No. 34-49708 (May 14, 2004)). Thus, an auditor violates Regulation S-X Rule 2-02(b)(1) if it issues a report stating that it had conducted its audit in accordance with PCAOB standards when it had not. See Andrew Sims, CPA, Rel. No.34-59584, AAER No. 2950 (Mar. 17, 2009) (settled action). Johnson failed to comply with PCAOB standards in every audit engagement examined by the staff.

64. The culmination of Johnson's numerous audit deficiencies rendered any representations that the audits were conducted in accordance with the PCAOB standards materially false and misleading because the audits were grossly out of compliance. Johnson made such representations in each of his audit reports for the Eight Issuers, falsely stating that his audits of the issuers' financial statements were conducted in accordance with the standards of the PCAOB.

E. VIOLATIONS

1. Johnson's Deficient Audits Amounted to Securities Fraud and Violations of Rule 2-02 of Regulation S-X

65. An auditor violates Section 10(b) and Rule 10b-5 thereunder by preparing or certifying a false audit report that he knew would be included in a Form 10-K. *McGann v. Ernst & Young*, 102 F.3d 390, 397 (9th Cir. 1996). Johnson violated the antifraud provisions by issuing audit reports that falsely stated that his audit were conducted in accordance with PCAOB standards. In fact, Johnson's auditing practices were so deficient that the audits amounted to no audits at all. *See, e.g., SEC v. Moore*, Lit. Rel. No. 21189A (Aug. 27, 2009) (auditor consented to an injunction against future violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder for failure to comply with PCAOB standards where his audits were assisted by high school graduates hired with little or no education or experience in accounting or auditing); *Norman Stumacher, CPA*, Rel. No. 34-58624 (Sept. 23, 2008) (auditor violated Exchange Act Section 10(b) and Rule 10b-5 thereunder when he falsely claimed his audits were conducted in accordance with GAAS, GAAP, and professional standards); *SEC v. Midgley*, Case No. 2:96-cv-00783 (D. Utah, March 3, 1997) (permanent injunction issued against auditor for violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder where he committed gross violations of GAAS).

66. In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S.Ct. 2296 (2011), the Supreme Court held that persons "with ultimate authority over the statement, including its content and whether and how to communicate it," may be held primarily liable for "making" a

17 These standards include the auditing standards adopted by the PCAOB following passage of the Sarbanes-Oxley Act of 2002.

misleading statement under Section 10(b) and Rule 10b-5(b) *Id.* at 2302. Accordingly, primary liability under Rule 10b-5(b) attaches to a person with "ultimate authority" over the fraudulent statements.

67. Johnson had ultimate authority over the audit opinions issued in his name, or in the firm's name. Johnson is the only person in his firm with the authority to sign the firm's audit reports or consent to its inclusion in public filings. Accordingly, under *Janus*, Johnson is the "maker" of the statements in the Johnson firm's audit reports. Thus, Johnson willfully violated Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, as the knowing "maker" of the materially false or misleading audit reports included in the Form 10-K filings of six of his audit clients.

68. Rule 2-02(b)(1) of Regulation S-X requires an accountant's reports to state "whether the audit was made in accordance with generally accepted auditing standards." "[R]eferences in Commission rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission." (*See SEC Release No. 34-49708 (May 14, 2004)).* Thus, Johnson also willfully violated Regulation S-X Rule 2-02(b)(1) when he issued his audit reports stating that he had conducted his audits in accordance with PCAOB standards, when he had not. *See In re Andrew Sims, CPA*, Rel. No. 34-59584, AAER No. 2950 (Mar. 17, 2009) (settled action).

69. Johnson's audit reports provided public investors with the false impression that Johnson's audits of the financial statements included in Form 10-K filings of six issuer clients (Boreal, Monster, Primco, Puissant, UMED, and Valley High) were in accordance with PCAOB standards and applicable rules of the Commission and, thus, reliable. For instance, an investor examining Valley High's December 31, 2013 financial statements, in the their Form 10-K filed with the Commission on April 15, 2014, might take comfort in Valley High's $75,000 note receivable as an asset that may ultimately provide some liquidity to a company that has no cash on its balance sheet.

70. An accounting firm acts "in connection with" securities trading when it produces an audit report that it knows its client will include in a Form 10-K. *McGann v. Ernst & Young, Id. at* 397. At the time Valley High filed its Form 10-K, Valley High's common stock was trading on OTC Link. Accordingly, its audited financial statements, which investors rely on, and Johnson's materially false certifications thereof, constituted material misstatements in connection with the purchase or sale of Valley High securities trading on OTC Link.

71. In addition, Johnson's materially false audit reports on the financial statements of Boreal Water, Monster, Primco, Puissant and UMED were in connection with the purchase and sale of securities of these issuers. Each of these issuers had equity securities trading on OTC Link or OTC BB at the time the issuers' respective Forms 10-K were publicly filed. Accordingly, Johnson willfully violated Section 10(b) of the Exchange Act, Rule 10b-5(b) thereunder, and Rule 2-02(b)(1) of Regulation S-X.

72. The Commission has charged auditors with violation of Section 17(a) of the Securities Act where the conduct of an audit was so deficient that it would be knowing or reckless to assert that the audit was performed in accordance with GAAS. *See, e.g., SEC v. Friehling*, Lit. Rel. No. 20959 (Mar. 18, 2009) (charged with violation of antifraud provisions, including Securities Act 17(a), for among other things, falsely stating in annual audit reports that he audited Bernard L. Madoff Investment Securities LLC's financial statements in conformity with GAAS when, in fact, he performed no meaningful audits); *SEC v. Savvides & Partners/PKF Cyprus, et al.*, Lit. Rel. No. 19622 (Mar. 22, 2006) (auditor failed to conduct basic audit procedures or maintain audit work papers). Further, the Commission has taken the broader view that the three subdivisions of Section 17(a) and Rule 10b-5 should be considered mutually supportive, rather than mutually exclusive. *See In re John P. Flannery*, 2014 WL 7145625 *12 & n.52, Rel. No. 3981 (Dec. 15, 2014) (Commission Opinion) (holding that primary liability under Rules 10b-5(a) and (c) and Section 17(a)(1) encompasses all "scienter-based, misstatement-related misconduct"). Establishing violations of Section 17(a)(1) of the Securities Act, and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, requires proof of scienter. The scienter of an officer acting on its behalf may be imputed to a corporation. *See, e.g., SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1096-97 nn.16-18 (2d Cir. 1972).

73. Johnson knowingly consented to the inclusion of his audit reports in Form S-1 registration statements of ADM and Legendary, filed pursuant to the Securities Act. Registration statements constitute offering documents disclosing material information, including financial information, concerning an offering of securities. Filed registration statements, even prior to effectiveness, are offering documents and may be used to "offer to sell" or "offer to buy" securities. Securities Act Section 5(c). Johnson's audit reports in ADM and Legendary Form S-1 registration statements were in an offer to sell securities. Johnson's audit reports were materially false, stating that the financial statements were audited in accordance with PCAOB standards, when they were not. Such false statements, knowingly made, in an offering of securities constitute a device, artifice or scheme to defraud, in violation of Section 17(a)(1). Accordingly, Johnson willfully violated Section 17(a)(1) of the Securities Act.

2. Johnson Willfully Aided and Abetted and Caused Violations of Exchange Act Section 13(a) and Rule 13a-1

74. In administrative proceedings, the Commission may impose sanctions upon any person that is, was, or would be a cause of a violation, due to an act or omission the person knew or should have known would contribute to such violation. In order to establish that a person caused a violation, the Commission has specifically ruled that a showing of negligence will suffice. *KPMG Peat Marwick LLP*, 289 F.3d 109 (D.C. Cir. 2002) (negligence is sufficient to establish 'causing' liability under Exchange Act 21C" where the underlying violation is non-scienter based); *see also Rita L. Schwartz*, Exch. Act Rel. No. 42684, 2000 SEC LEXIS 737 (Apr. 13, 2000) (settled case) ("the Commission must prove that the person knew or should have known that such person's inaction would contribute to the violation"). For willful aiding and abetting or causing liability, ""[a] finding of willfulness does not require an intent to violate, but merely an intent to do the act which constitutes a violation." *In the Matter of Anthony Fields CPA,* Initial Decision Release No. 474, 2012 WL 6042354, at *8 (Dec. 5, 2012).

75. An issuer violates Section 13(a) of the Exchange Act, and Exchange Act Rule 13a-1, when such issuer of registered securities files with the Commission factually inaccurate annual reports. *SEC v. IMC International,Inc.*, 384 F.Supp. 889, 893 (N.D. Texas), *aff'd mem.*, 505 F.2d 733 (5th Cir 1974), *cert. denied sub nom.* An issuer violates these provisions if its filings contains materially false or misleading information. *SEC v. Falstaff Brewing Corp.*, 629 F.2d 62, 72 (D.C. Cir. 1980). Scienter is not required for a violation of Section 13(a). *SEC v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998).

76. By not conducting his audits of the financial statements of the six aforementioned issuers in accordance with the PCAOB standards, Johnson willfully aided and abetted and caused those issuers to file annual reports with misleading financial statements, in violation of Section 13(a) and Rule 13a-1, in violation of Section 13(a) and Rule 13a-1.

4. Johnson Engaged in Improper Professional Conduct and May Be Barred From Practicing or Appearing Before the Commission

77. Johnson's, numerous and repeated violations of auditing standards and his issuances of audit reports that falsely stated that he conducted his audits in accordance with the standards of PCAOB, when he had not, constituted "improper professional conduct" within the meaning of Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice ("CRP"). Further, in Johnson willfully violating Securities Act Section 17(a) and Exchange Act Section 10(b) and Rule 10b-5(b) thereunder, he also engaged in conduct that falls within the meaning of Exchange Act Section 4C(a)(3) and CRP Rule 102(e)(1)(iii). Exchange Act Section 4C(a) and CRP Rule 102(e)(1) authorize the Commission to institute administrative proceedings to determine whether a person has engaged in "improper professional conduct" or has willfully violated, or willfully aided and abetted and caused violations of, any provisions of the securities laws and rules issued thereunder, and censure or temporarily or permanently deny that person of the privilege of appearing or practicing before the Commission.

78. With respect to persons licensed to practice as accountants, "improper professional conduct" includes, "intentional or knowing conduct, including reckless conduct that results in a violation of applicable professional standards." CRP Rule 102(e)(1)(iv)(A). In addition, under CRP Rule 102(e)(1)(iv)(B), negligent conduct can constitute "improper professional conduct" where the negligence involves:

(1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or

(2) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

79. "Unreasonable conduct" as used in CRP Rule 102(e)(1)(iv)(B), means ordinary negligence. *See In re Dohan & Co. CPA, et al.*, Int. Dec. Rel. No. 420, at p. 16 (June 27, 2011).

80. "The Commission defines recklessness under Rule 102(e) to be the same as recklessness under the antifraud provisions.... Thus, recklessness is 'an extreme departure from the standards of ordinary care, . . . 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." Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57164, 57167 (Oct. 26, 1998). It is "a lesser form of intent," "not merely a heightened form of ordinary negligence." Id. (internal citations and quotations omitted).

81. Johnson's false representations in his audit reports that he had conducted the audits in accordance with PCAOB standards, when he had not, constituted extreme departure from the standards of ordinary care and presented a danger of misleading the public about the fair presentation, in all material respects, of the financial statements he had audited. Johnson failed to engage in any meaningful audit procedures and violated numerous auditing standards in his audits of the financial statements of the Eight Issuers. His audits were so deficient that they amounted to no audits at all. Accordingly, Johnson engaged in reckless "improper professional conduct" as an accountant within the meaning of CRP Rule 102(e)(1)(iv)(A).

82. Johnson failed to perform any audit procedures on the valuation of "derivative liabilities" in the financial statements of Monster, Primco and Valley High. Johnson failed to obtain sufficient evidence that the "tea bushes" recorded as a $750,000 asset in UMED's financial statements, actually existed. These are but a few examples of Johnson's numerous violations of auditing standards through negligence, if not willful or reckless disregard of the standards. The repeated instances of negligent conduct resulting in violations of auditing standards constitute "improper professional conduct" within the meaning of CRP Rule 102(e)(iv)(B) and shows Johnson's lack of competence to practice before the Commission as an accountant.

83. Willful violations of Exchange Act Section 10(b) and Rule 10b-5(b) thereunder, Securities Act Section 17(a)(1) and Rule 2-02(b)(1) of Regulation S-X constitute conduct within the meaning of Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii).

84. Based on the foregoing, the Commission finds that Johnson willfully violated Section 10(b) of the Exchange Act, Rule 10b-5(b) thereunder, Section 17(a)(1) of the Securities Act, and Regulation S-X Rule 2-02(b)(1).

85. Based on the foregoing, the Commission finds that Johnson willfully aided and abetted and caused violations of Section 13(a) of the Exchange Act, Rule 13a-1 thereunder.

86. Based on the foregoing, the Commission finds that Johnson engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice and conduct within the meaning of Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Respondent Johnson shall cease-and-desist from committing or causing any violation and any future violations of Sections 10(b) and 13(a) of the Exchange Act, Rules 10b-5(b) and 13a-1 promulgated thereunder; Section 17(a)(1) of the Securities Act; and Regulation S-X Rule 2-02(b)(1).

B. Respondent Johnson is denied the privilege of appearing or practicing before the Commission as an accountant.

C. Respondent Johnson shall pay disgorgement of $96,000, plus prejudgment interest thereon of $3,662.

D. Respondent Johnson shall pay a civil money penalty of $50,000.

E. Respondent Johnson shall make the following payments required by Sections IV.C and IV.D, above, 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), as follows:

1. $20,000 on the day of entry of this Order;
2. $64,831 within 180 days of entry of this Order;
3. $64,831, within 360 days of entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments must be made in one of the following ways:

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

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

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

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

F. Payments by check or money order must be accompanied by a cover letter identifying Terry L. Johnson 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 simultaneously sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

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

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 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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Release No. 4197 / September 17, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31830 / September 17, 2015

Admin. Proc. File No. 3-15519

In the Matter of

TIMBERVEST, LLC,
JOEL BARTH SHAPIRO,
WALTER WILLIAM ANTHONY BODEN, III,
DONALD DAVID ZELL, JR., and
GORDON JONES II

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

Grounds for Remedial Action

Antifraud Violations

Registered investment adviser committed fraud by making material misrepresentations and omissions, and its principals aided, abetted, and caused the violations. *Held*, it is in the public interest that the registered investment adviser and its principals (collectively, Respondents) be ordered to cease and desist from further violations of the securities laws; that the principals be barred from associating with any investment adviser; and that Respondents be ordered to disgorge, jointly and severally, $403,500 plus prejudgment interest.

APPEARANCES

Stephen D. Councill and *Julia Blackburn Stone* of Rogers and Hardin, LLP, and *Nancy R. Grunberg* and *George Kostolarnpros* of McKenna Long & Aldridge LLP, for Respondents.

70 of 147

Andrew J. Ceresney, *M. Graham Loomis*, *Robert K. Gordon*, *Anthony J. Winter*, and *David S. Mendel*, for the Division of Enforcement.

Appeal filed:	September 10, 2014
Last brief received:	February 23, 2015
Oral Argument:	June 8, 2015

I. Introduction*

Respondents Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Boden, III, Donald David Zell, Jr., and Gordon Jones II appeal from an administrative law judge's initial decision finding that Timbervest, a registered investment adviser, violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940, and that Timbervest's four principals aided, abetted, and caused those violations.[1] The Division of Enforcement has also petitioned for review of certain aspects of the administrative law judge's initial decision regarding the liability determination as to Jones and Zell, and the imposition of an associational bar. Based on our independent, *de novo* review of the record, we find that Timbervest orchestrated a transaction to sell the property of one of its clients to another client at a below-market rate, to the detriment of the original client. We find that Timbervest violated the Advisers Act by failing to disclose its conflict of interest in this transaction. Additionally, we find that Timbervest violated the Advisers Act by causing its client to pay brokerage commissions that Timbervest did not disclose. We also find that Shapiro, Boden, Zell, and Jones aided, abetted, and caused Timbervest's misconduct.

For the reasons that we explain herein, the Respondents are ordered to cease and desist from further violations of the securities laws and to disgorge, jointly and severally, $403,500 plus prejudgment interest. Further, we find that it is in the public interest that the four individual Respondents be permanently barred from associating with any investment adviser.

Finally, we reject Respondents' challenges to the constitutionality of the Commission's administrative forum. Specifically, we find that: (1) Commission administrative law judges are not "inferior officers" covered by the Appointments Clause of the U.S. Constitution;[2] (2) the two layers of tenure protection that ALJs enjoy do not unconstitutionally impede the President's ability to "take Care that the Laws be faithfully executed";[3] and (3) the decision to file this

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* Unless the context indicates otherwise, any factual statements that are quoted in this decision are witness testimony from the hearing.

1 *In the Matter of Timbervest, LLC, et al.*, Initial Decision Release No. 658, 2014 WL 4090371 (Aug. 20, 2014).

2 *See* U.S. Const. art. II, § 2, cl. 2.

3 *Id.* art. II, § 3.

enforcement matter in the administrative forum as opposed to federal court did not violate Respondents' Fifth Amendment right to equal protection of the laws.

II. Background

A. Respondents

Respondent Timbervest is a registered investment adviser headquartered in Atlanta, Georgia.[4] Its clients include institutions that invest through various investment funds that are managed by Timbervest and that generally invest in the timber industry. Among other things, Timbervest manages the timberland owned by these funds and generally controls the acquisition and disposition of timberland on the funds' behalf. Throughout the period relevant to this case, Timbervest was owned and controlled by Respondents Shapiro, Boden, Zell, and Jones (collectively "the Timbervest partners"), each of whom served on Timbervest's investment committee, which made all decisions regarding the acquisition, disposition, and valuation of timberland property. As Shapiro testified, "all purchase and sale decisions need[ed] to be unanimously agreed to by the investment committee" before the transaction could be completed.

Shapiro, who joined Timbervest in 2002, was Timbervest's Chief Executive Officer. He had previously been affiliated with various broker-dealers and investment advisers, and has held several securities licenses including a Series-65 registered investment adviser license.

Boden began as a consultant to Timbervest in late 2002 and became its Chief Investment Officer in 2004. Throughout the relevant period, he was a licensed real estate salesperson in Georgia.

Zell worked as an investment manager in the pension group of BellSouth, which (through three BellSouth pension plans) wholly owned an investment vehicle (New Forestry, LLC) that Timbervest managed prior to and during the period of the violations. While at BellSouth, Zell had responsibility for overseeing the New Forestry investment and for dealing with Timbervest in its capacity as BellSouth's investment adviser. He joined Timbervest from BellSouth in 2003 and became Timbervest's Chief Financial Officer in March 2004.

Jones, who joined Timbervest in January 2004, was Timbervest's President, General Counsel, and Chief Compliance Officer. Before joining Timbervest, he practiced corporate law and commercial finance as a partner in an Atlanta law firm.

B. New Forestry and TVP-1

In January 2005, the four individual Respondents acquired 100 percent ownership of Timbervest.[5] Although they acquired Timbervest through a wholly owned holding company in

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4 Timbervest is a relatively small entity. During the relevant 2006-2007 period, there were only "15 people in the company."

5 In December 2013, Jones sold his interest in Timbervest to Shapiro, though he remains involved with the management of the company.

which they each owned 25 percent, they managed Timbervest together as though it were a partnership. As Boden testified, they "worked in close proximity for years," they "buil[t] the business together," "all four of [them] were intimately involved in what [they] were doing," and they "invested in our timberland funds on an equal prorated basis."

In acquiring Timbervest, Shapiro, Boden, Zell, and Jones collectively took on $1.7 million in loans to purchase a private equity firm's controlling interest. The four partners had to personally guarantee those loans, and as Jones testified, they "extended [themselves] in buying the company."

At that time, Timbervest's principal revenue source was from its investment advisory relationship with its client BellSouth, specifically the management fees that Timbervest received from managing BellSouth's New Forestry investment vehicle.[6] These management fees were calculated as a percentage of the value of BellSouth's assets held in the New Forestry portfolio. A few months after the partners took control of Timbervest, BellSouth directed the partners to begin a process of reducing New Forestry's portfolio by half—from approximately $471 million to $200-$250 million. At the same time, BellSouth "dramatically" and immediately lowered Timbervest's management fees for all portfolio assets in excess of $250 million.[7]

At around the same time, Timbervest was working to establish a series of new funds—the first of which was Timbervest Partners, LLC ("TVP-1"). TVP-1 had a particular structure that gave Timbervest a significant interest in the success of the fund's investments. Known as a "commingled fund," it was a "pooled vehicle in a limited liability format where [a Timbervest subsidiary] served as a general partner" and it was comprised "of investments made by either institutional investors, high net worth investors and the like that pool their capital into [the fund]." Each of the four Timbervest partners invested in this commingled fund.

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6 BellSouth exercised ultimate control over the New Forestry investment portfolio, including requiring Timbervest to report to BellSouth, unilaterally modifying BellSouth's compensation level for managing the portfolio, determining the character of the investments in New Forestry, and eventually terminating Timbervest's management of the New Forestry portfolio. Respondents recognized that BellSouth was the actual investment advisory client. For example, Boden testified that BellSouth was a "client" and that Timbervest "manage[d]" New Forestry for BellSouth "specifically according to their ... strategy that they espoused and the timeline that they wanted and it was a direct relationship." Similarly, Jones admitted during the hearing that "Timbervest had a fiduciary duty that it owed to BellSouth."

7 In an effort to incentivize Timbervest to implement the portfolio reduction, BellSouth provided that Timbervest could receive a one-time disposition fee of 3 percent of the gross sales price of any timberlands where the gross sales price was at least 90 percent of the fair market value of the property. As we will discuss later, this disposition fee is the subject of the Division's disgorgement requests.

C. The Sale and Repurchase of the Tenneco Core Property

Although it faced a decline in revenue from BellSouth, Timbervest stood to gain if it could make the new TVP-1 fund a success.[8] Timbervest soon engaged in a fraudulent transaction that involved both of those funds.

Toward the end of 2006, Timbervest sold a large parcel of timberland out of New Forestry. That parcel was known as "Tenneco Core." Timbervest "had discretion to sell any property in New Forestry's portfolio" without obtaining permission from BellSouth or anyone else. The buyer, Charles Wooddall, had known Boden since "the 90s" and had been actively buying and selling timberland since 1998. In a transaction that closed on October 17, 2006, Timbervest sold Tenneco Core on BellSouth's behalf to Wooddall's company, Chen Timber, for $13.45 million.

But Wooddall did not keep the property for long. Just six weeks later, on November 30, 2006, Boden sent Wooddall a written agreement to repurchase the property on behalf of Timbervest's new fund, TVP-1. The parties executed this transaction on December 15, 2006, and the sale closed on February 1, 2007. Timbervest paid $14.5 million to repurchase the property from Wooddall, and it valued the property on TVP-1's books at $15.7 million. BellSouth was never told about the sale-and-repurchase arrangement with Wooddall.

D. The Brokerage Commissions on the Tenneco Core and Kentucky Property Transactions

Timbervest's investment management agreement did not provide for real estate brokerage commissions to be paid to Timbervest or the other Respondents, nor did any other written agreement authorize such payments. But when Timbervest sold the Tenneco Core property to Wooddall, the sales contract included a 3 percent real estate commission to be paid to "Fairfax Realty Advisers LLC." Similarly, when Timbervest sold a BellSouth property in Kentucky in 2007, the contract for that sale required a 2.5 percent commission to be paid to "Westfield Realty Partners, LLC."

Although Fairfax Realty and Westfield Realty appeared to be bona fide real estate brokers, they were in fact—unbeknownst to BellSouth—shell companies that served to funnel the brokerage commissions back to the Timbervest partners. These companies had no assets, business plan, operating agreement, bank account, or employees, and they were not licensed real estate brokers. Rather, they were set up, at Boden's request, by Boden's personal attorney and "very good friend," Ralph Harrison. They were registered with the state of Georgia under Harrison's name, each using a different address at a private mailbox company (*e.g.*, the UPS Store).

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[8] Jones testified that, notwithstanding the efforts to establish the new funds, in 2006 and 2007 "most of Timbervest's revenues came from its relationship with New Forestry[.]" Tr. 1510.

After the Tenneco Core sale to Wooddall closed in 2006, Boden received a $470,450 check for the real estate commission made out to Fairfax Realty. He gave the check to Harrison, who deposited it in his IOLTA attorney trust account; Harrison, after deducting a 10 percent contingency fee for himself, then wrote a $423,000 check from the trust account to WAB, Inc., an entity owned and controlled by Boden; Boden then divided the $423,000 four ways, keeping a quarter for himself and paying approximately $105,000 to each of the three other Timbervest partners using cashier's checks. Essentially the same process was followed to funnel Westfield Realty's $684,486 commission back to Harrison and the four Timbervest partners.[9]

III. Discussion

We find that Timbervest, acting with scienter, violated Sections 206(1) and 206(2) of the Advisers Act by failing to disclose to BellSouth its secret sale-and-repurchase arrangement for the Tenneco Core property.[10] We find that Timbervest also violated Sections 206(1) and 206(2) with scienter by imposing undisclosed brokerage commissions on the Tenneco Core transaction and Kentucky property transactions. We further find that the four Timbervest partners aided, abetted, and caused Timbervest's violations.

A. Timbervest violated Sections 206(1) and 206(2) by failing to disclose its secret agreement to repurchase the Tenneco Core property.

To find that Timbervest violated either Section 206(1) or 206(2), we must find that it was an investment adviser (which is undisputed), that it made a material misstatement or omission (or engaged in some other fraudulent activity), and that in so doing, it acted with the requisite level of culpability. To be found culpable under Section 206(1), Timbervest's officers or employees[11] must have acted with scienter, which is defined as a "mental state embracing intent to deceive, manipulate, or defraud."[12] To find a violation of Section 206(2), we need not find that a

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9 On June 8, 2012, during the Commission's investigation, Timbervest reimbursed the $1,156,236 in commissions and approximately $96,315 in interest.

10 During the hearing before the administrative law judge, Respondents and the Division spent considerable time arguing whether, and to what extent, the Employee Retirement Security Act of 1974 (ERISA) applies here. Critically, neither party has claimed that ERISA somehow displaces the securities laws or conflicts with them in any respect relevant here. We find it unnecessary to address any of the ERISA-related issues in this decision.

11 *See Montford*, 2014 WL 1744130, at *14; *see also, e.g., Suez Equity Investors, L.P. v. Toronto Dominion Bank*, 250 F.3d 87, 100-01 (2d Cir. 2001).

12 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Scienter can be established by recklessness, *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990), which is "highly unreasonable" conduct that represents "an extreme departure from the standards of ordinary care, which presents a danger of misleading [investors] that is either known to the defendant or is so obvious that the actor must have been aware of it." *Steadman*, 967 F.2d at 641-42 (quotation omitted).

respondent acted with scienter—a finding of negligence is sufficient.[13] Circumstantial evidence is sufficient to prove a violation of the securities laws and to establish the requisite, culpable mental state in securities fraud cases.[14] A misstatement or omission is material if a reasonable investor would have considered the information important in making an investment decision.[15]

As BellSouth's investment adviser, Timbervest owed fiduciary obligations to its client. These fiduciary responsibilities include an "affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts.'"[16] These fiduciary responsibilities also include a "duty to disclose any potential conflicts of interest accurately and completely, and to recognize ... a potential conflict."[17] As Jones (himself an attorney) conceded during his testimony, "[a] conflict of interest may exist whenever the private interests of an employee, officer, or manager conflict in any way or even appear to conflict with the interests of ... its client[.]" The "standard of care to which an investment advisor must adhere" incorporates all of these fiduciary duties.[18] For that reason, an investment adviser who fails to disclose a conflict of interest acts, at a minimum, with "a reckless disregard for the well-established fiduciary duty he owe[s] his clients," and thus scienter.[19]

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13 *See Steadman*, 967 F.2d at 641 & n.3; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

14 *See, e.g.*, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983) (noting the sufficiency of circumstantial evidence, particularly in fraud cases); *Derek L. Dubois*, Securities Exchange Act Release No. 48322, 2003 WL 21946858, at *3 (August 13, 2003) (same); *see also Valicenti Advisory Servs., Inc. v. SEC*, 198 F.3d 62, 65 (2d Cir. 1999) ("Proof of scienter under the securities laws need not be direct, but may be a matter of inference from circumstantial evidence." (quotation marks omitted)); *Donald M. Bickerstaff*, Exchange Act Rel. No. 35607, 52 SEC 232, 1995 WL 237230, at *5 (Apr. 17, 1995) (finding witness's testimony to be "persuasive evidence" even though it was "circumstantial").

15 *See SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 231-32, 240 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

16 *Capital Gains Research*, 375 U.S. at 194; *SEC v. Blavin*, 760 F.2d 706, 711-12 (6th Cir. 1985).

17 *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003); *see also* 17 C.F.R. 275.206(3)-2(c) (investment advisers have a "duty with respect to the best price and execution for the particular transaction for the advisory client").

18 *Blavin*, 760 F.2d at 711; *see also Transamerica Mortg. Advisers, Inc. v. Lewis*, 444 U.S. 11, 17 (1979).

19 *Montford & Co., Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *19 (May 2, 2014).

We find that Timbervest violated Sections 206(1) and 206(2) by engaging in an undisclosed sale-and-repurchase of the Tenneco Core property that benefitted TVP-1 at BellSouth's expense. Notwithstanding its duty to BellSouth of utmost good faith and fair dealing and its duty of full and fair disclosure of all material facts, Timbervest was actually on both sides of this transaction, but it did not disclose that fact to BellSouth. Instead, Timbervest disguised its intent to repurchase the property by selling it to a middleman—Wooddall—who, unbeknownst to BellSouth, had secretly agreed to sell it back to Timbervest shortly thereafter.

Wooddall testified that Timbervest made a deal with him in which it was understood that Timbervest intended to buy the property back within six months: The "deal, in a nutshell, was they were selling [me] the land, they wanted to buy it back, they had to raise this fund to buy it back, and I wasn't obligated to sell it to them, but the gist of it was they needed six months to raise this fund to buy it back." Although Wooddall wanted Timbervest to sign a written agreement to repurchase the property, Boden "said they could not commit in writing." Wooddall eventually agreed to a verbal arrangement. Timbervest thus agreed to sell the property to Wooddall, while promising him that it would buy the property back for approximately $1 million more than Wooddall would pay for it. Wooddall testified that the repurchase price was negotiated in advance of the sale so that Wooddall would know his potential "upside" on the deal.[20]

Contrary to Wooddall's testimony, Boden claims that Timbervest "didn't offer or guarantee or promise any type of buy-back on [the] property." We find for the following reasons that the weight of the evidence supports Wooddall's account of the deal.

First, we are not persuaded by the testimony of the Timbervest partners, each of whom testified at the administrative hearing. Although Boden purports to remember vividly that the buy-back agreement "just didn't happen," the partners purport to have no memory of what motivated their subsequent decision to repurchase the Tenneco Core property.[21] Not one partner,

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20 Wooddall testified that he was technically "free to sell the property to anybody else" but did not do so because of the repurchase arrangement. That the arrangement was not legally binding does not change the fact that the arrangement constituted a material conflict of interest that should have been disclosed to BellSouth.

21 We do not credit Respondents' claim that too much time had passed for them to remember the motivation for the repurchase. During their testimony, Respondents had little difficulty recalling events that appear to be beneficial to the positions that they are advancing in this litigation. We are particularly struck by Boden's claimed inability to remember the details of the alleged decision to reacquire Tenneco Core because he demonstrated an ability to recall the intimate details of other business deals predating the Tenneco Core transaction. For example, in connection with a 2005 attempted sale of another BellSouth property (the Glawson tract), Boden testified:

> I picked up the paperwork, the option agreement from Mr. Harrison's office in Buckhead on the way to may meeting with Mr. Hailey [the potential purchaser]. I

for example, recalls why he decided to repurchase the Tenneco Core property. Boden conceded that the repurchase "was definitely an anomaly"—"it was the only time [Timbervest] bought a property back." Jones similarly admitted that the repurchase was "unusual" and that nothing else like it had occurred while he was at Timbervest. Yet, according to Boden, the repurchase was "just another deal in a long list of scores of deals, nothing jumped out at [him] and [he] do[es]n't recall anything special about it." The self-serving recollection that Timbervest did not promise a buy-back appears to be Boden's only significant memory of the deal. We do not find this credible.

Second, not only were the Timbervest partners unable to recall why they *actually* repurchased the property, but they could not even identify a persuasive reason why they innocently *might* have done so. Boden speculated that they might have repurchased the property because they saw that adjoining parcels of timberland (known collectively as the "Tenneco Non-Core property") were being sold at higher prices. But Timbervest was already aware of the higher value of those adjoining parcels before it agreed to sell BellSouth's property in October 2006.[22] Boden and Zell also speculated that the unusual repurchase may have been motivated by the fact that timber prices for pulpwood were "moving up." But, as Wooddall explained, "[i]t is better not to buy timberland during a spike in timber prices." Finally, Boden suggested that the fourth-quarter results for a general index of timberland prices may have motivated the repurchase. But those results would not have been available "in early November 2006" when Boden claims he first developed an interest in Timbervest repurchasing the property for the TVP-1 fund.[23]

> didn't proof it, I didn't look at it until I got there. I dropped the [purchase-and-sale agreement] and the option down and said, 'Here's, here's a potential deal, what do you think?' And he studied it, thought about it for a few days, and called me back to decline."

As yet another example, Boden testified as follows about the 2004 departure of a Timbervest associate:

> I know he was given a laptop computer, and I know he got a fee—or he paid us a fee—to take over contracts of some parcels of land I had negotiated for purchases earlier in the year with J.W. Irving Company out of Maine, it was about 130,000 acres in two tracts near the Allgash .... So he paid us, our company, an exit fee with us allowing him to take those over because they were a fit for him and what he was doing and were not really a fit for us.

22 An August 2006 "New Forestry Disposition Report" prepared by Timbervest for BellSouth estimated a $1,424 per acre sales price for the adjoining, Tenneco Non-Core parcels—only $37 per acre below the actual October-November sales prices of those properties.

23 It is possible that Boden may have observed in October and early November anecdotal evidence of the price movements that were subsequently reflected in the general index. But even supposing that, neither Boden nor the other Timbervest partners offered any explanation for why such anecdotal evidence of an overall increase in the value of timberland would lead them to

Third, the weight of the evidence persuades us that the reason Timbervest sold and repurchased the property was to benefit its new TVP-1 fund by acquiring the property at a discount to its fair market value. As explained above, Timbervest's reduced management fees from BellSouth and the opportunity to gain from the Timbervest partners' own investment in, and management of, the TVP-1 fund gave Timbervest a motive to benefit the new fund. The pricing of the sale-and-repurchase transaction suggests that this was the transaction's true purpose. The bank that loaned Chen Timber, Wooddall's company, the funds to acquire the property from Timbervest appraised it at $15.5 million in October 2006,[24] but Timbervest sold it that same month on behalf of BellSouth for just $13.45 million.[25] Once Timbervest repurchased the Tenneco Core property for TVP-1, it valued the property on TVP-1's books even higher than the appraisal value, at $15.7 million, and told TVP-1's own investors that the property was worth over $18.9 million. Notably, the price Timbervest paid to repurchase the property from Wooddall was just $14.5 million—well below the appraisal and Timbervest's own valuation.[26]

Fourth, Timbervest misled BellSouth about the true nature and value of the deal. Not only did Timbervest fail to disclose its intent to repurchase the Tenneco Core property from Wooddall, but it also made the property appear less valuable to BellSouth than it really was. In June 2005, an independent appraiser estimated the property's market value at $12.13 million. As Boden acknowledged, the market price for timberland began to "head-up" and "got hot in latter '05 and '6 and '7." Yet, despite the hot market, Timbervest *lowered* the valuation it provided BellSouth to just $12.04 million in September 2006—making it appear to BellSouth that the sale to Wooddall was a good deal. Before the sale, Timbervest (in an email sent by Jones to a BellSouth representative, ORG) also characterized Tenneco Core as having "challenging access issues."

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make the unusual decision to attempt to reacquire a property that they had *just* sold weeks earlier.

24 Although it appears from the record that the bank did not provide this appraisal to any of the parties to the transaction, we nevertheless believe that it is relevant because it tends to indicate that the Respondents substantially undervalued Tenneco Core when they sold it to Chen Timber.

25 Wooddall testified that he believed that he paid a "fair purchase price" that was not "an undervaluation of the property," but we place little weight on this opinion. Given that Wooddall was not looking to hold the property and that his principal interest was the pre-arranged, $1 million profit margin that Chen Timber stood to make when Timbervest repurchased the property, we find it unlikely that he was focused on whether the $13.45 million was an accurate reflection of the property's market value, and, in any event, it is irrelevant given Respondents' knowledge of the property's value.

26 Jones testified that the $14.5 million repurchase price "was a discount of what [Timbervest's] due diligence valuation yielded by a fairly substantial amount."

After the repurchase, Timbervest's tune abruptly changed. Rather than describing the property's access as "challenging," Timbervest told TVP-1's investors that it had "excellent" access. Further, in a February 2007 document prepared for TVP-1's investors, Timbervest highlighted numerous other positive details about the property, such as the fact that it was "situated for optimal recreational opportunities within a short drive of several large cities"—details that were omitted from the information provided only six months earlier to BellSouth when Timbervest was in the process of selling the property.[27] Consistent with Timbervest's sudden change in valuation and characterization of the property after repurchasing it, Timbervest also changed Tenneco Core's name to Gilliam Forest, making it more difficult for outsiders such as BellSouth or its agents to discover the repurchase.[28]

Fifth, record evidence demonstrating that Timbervest had previously attempted a similar scheme lends further support to our conclusion that Timbervest orchestrated a secret sale-and-repurchase. A year before the Tenneco Core transaction, Boden sought to sell and repurchase a different Tenneco Core property, the Glawson tract.[29] Boden solicited Reid Hailey, who owned a real estate business and had known Boden for about twelve years, to serve as the middleman for the sale-and-repurchase arrangement. According to Hailey's testimony, Boden offered to sell the Glawson tract to Hailey with a written option agreement that gave a shell company the right to subsequently purchase the property back. The shell company was formed and controlled by Boden's "very good friend" of "[o]ver 30 years" and personal attorney, Ralph Harrison.[30] Hailey decided he was not interested. But he provided Boden's draft option agreement to a third party who in turn sent the Timbervest partners a letter threatening to expose them for attempting to use

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27 Boden conceded during his testimony that "[t]here's definitely an issue" with the inconsistency.

28 Timbervest also misled BellSouth into believing that Timbervest did not initiate the original sale or the repurchase. In an April 7, 2006 email to ORG, Jones falsely represented that "the Tenneco property … [has] been designated for sale as a result of an *unsolicited* favorable offer received in July 2006." (Emphasis added). Timbervest continued to misrepresent its role in initiating the sale even after it occurred, falsely stating in a 2006 fourth quarter report to BellSouth that "in Q3 2006, an offer to purchase the unit [Tenneco Core] … was received from a private investment company[.]" Similarly, after the repurchase, an employee of an outside consulting firm that Timbervest utilized sent an email to Timbervest's director of land management, John Carter, expressing concern that , "literally, it's basically a fund swap transaction." In an attempt to avoid suspicion of wrongdoing, Carter wrote back falsely representing that "[t]he buyer [Chen Timber] was presented with a different opportunity elsewhere and approached us with the idea of buying the property back."

29 We discuss the Glawson tract in more detail below when determining the appropriate remedies and when rejecting Respondents' claims of prejudicial error. *See infra* Part IV(A).

30 Harrison testified that he and Boden had been "college roommates," that Harrison was "a groomsman at [Boden's] wedding," and that Harrison has "taken vacations together with [Boden] and his family."

the agreement to sell the property to "family and friends" "at less than fair market value, while creating the appearance of an arm's length transaction to a third party." This experience could potentially explain why Timbervest refused to provide Wooddall with a written agreement to repurchase the Tenneco Core property.[31]

In sum, we find that Timbervest, acting with scienter, made material omissions regarding the sale-and-repurchase arrangement in violation of its fiduciary obligations. Investment advisers have a "duty to disclose any potential conflicts of interest accurately and completely."[32] As Jones (an attorney) conceded during his testimony, an agreement for a direct sale of Tenneco Core to TVP-1 "would be a conflict of interest" that Timbervest would have been required to fully disclose. That conflict of interest and the resulting duty of full disclosure remain when a middleman is used as Timbervest did here. But Timbervest did not disclose to BellSouth the fact that Timbervest had already arranged to repurchase Tenneco Core from Wooddall at the time that BellSouth sold Wooddall the property. This secret arrangement—which Timbervest orchestrated—was highly material because it created a conflict of interest that effectively put Timbervest on both sides of the Tenneco Core transaction.[33] Moreover, Timbervest acted with scienter in failing to disclose the repurchase arrangement. Timbervest's intent to deceive is evident to us from Boden's negotiation of the secret agreement with Wooddall. Scienter is also evident from Timbervest's below-market valuation of the property before the sale, followed by the sudden, dramatic increase in Timbervest's valuation of the property after the repurchase.

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31 Respondents claim that the proposed Glawson transaction was never intended to be a sale-and-repurchase arrangement, but their arguments in support of this claim are unpersuasive. *First*, although Boden admits that he provided the draft option agreement to Hailey, he claims that he did so merely to show Hailey an example of a potential arrangement that a third party might enter into with Hailey that would help him "reduce [his] risk" on the transaction. But an option would not mitigate Hailey's downside risk, only limit his potential upside gain in the event the purchaser of the option were to exercise it. *Second*, Boden's attorney testified that he included his shell company in the option agreement he drafted for Boden merely as a "placeholder in the draft." We do not credit this explanation in light of attorney Harrison's use of four other shell companies for Boden, discussed below. *Third*, Respondents argue that Hailey's testimony should be rejected because he remarked to Boden's attorney that his testimony would be more favorable if Boden paid Hailey certain money owed to him. But Hailey explained that this comment was mere sarcasm. Based on our independent review of the record, we find Hailey's testimony to be more credible and less evasive than the contrary testimony of Boden and Harrison. Hailey's testimony is also supported by documentary evidence, including the draft option agreement.

32 *Vernazza v. SEC*, 327 F.3d 851, 860 (9th Cir. 2003); *see also Montford and Company, Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *19 (May 2, 2014) (explaining that failure to disclose a conflict of interest is "a reckless disregard for the well-established fiduciary duty [an investment adviser] owe[s] his clients").

33 *Cf. Vernazza*, 327 F.3d at 859 ("It is indisputable that potential conflicts of interest are 'material' facts with respect to clients and the Commission.").

And it is evident from Timbervest's decision to promptly change Tenneco Core's name and Timbervest's description of the property following the repurchase.

B. Timbervest violated Sections 206(1) and 206(2) by imposing the undisclosed brokerage commissions.

In addition to the secret sale-and-repurchase agreement, we find that Timbervest secretly imposed approximately $1.156 million in brokerage commissions on the Tenneco Core transaction and a second transaction involving a BellSouth property in Kentucky. As discussed above, shell companies were used to funnel the commissions from BellSouth to the four Timbervest partners.

Boden and Harrison maintain that the shell companies were not established to hide the fact that the four partners were receiving real-estate commissions. They instead offer an elaborate alternative explanation: Shortly after Boden joined Timbervest in 2002, they claim, Timbervest (through Shapiro) entered into an oral agreement with Boden under which Boden would receive a real estate commission on the sale of any of the eight largest southeastern properties in New Forestry's account sold over the next five years. Respondents claim that they disclosed this agreement in 2006 to a third-party representative that BellSouth had retained to assist with the New Forestry account. They further claim that Boden, with the help of Harrison, established the shell companies merely out of "concern that unknown brokers or other third parties might try to assert a claim to the commissions that [he] expected to receive." Finally, despite the fact that they were supposedly Boden's commissions, the Timbervest partners claim that they each received a quarter of the commissions because Boden generously decided to share his commissions with them after he received the money. As discussed below, we do not find Respondents' version of these events to be credible.

1. Respondents used shell companies to hide the brokerage commissions from BellSouth.

The weight of the evidence convinces us that the reason Boden and Harrison set up the shell companies was not to protect Boden's commissions from other brokers, but rather to hide the commissions from BellSouth.

As Harrison admitted during his testimony, the LLC "special entity" structure is "a common strategy to make [money] harder to follow" and to make it difficult for outsiders to determine "who owns or controls" the entity. The shell entities here appear to have been established with that common strategy in mind given that none of the entities' corporate documents reflect any ownership or control on the part of Boden or the other Timbervest partners. Harrison and Boden were careful to avoid any apparent link between the shell entities and Boden. Harrison testified, Boden "didn't have a documented legal right" to the money that went into the shell entities; according to Harrison, he and Boden just "had an understanding that it was [Boden's] money."

Boden's effort to hide the commissions from BellSouth is also apparent from the manner in which the shell entities were described in the contracts to sell the properties. The sales contract with Wooddall falsely stated that "Fairfax Realty Advisers LLC has acted as a brokerage agent on behalf of the *purchaser*" (*i.e.*, Chen Timber)—when Fairfax Realty in fact did nothing for the purchaser.[34] The sales contract for the Kentucky property also vaguely described the commission to Westfield Realty as a fee for "services rendered." Although the commissions were supposedly for services Boden provided exclusively to the *seller* in the transaction, the agreements obscured that fact—a fact that could have aroused suspicion and prompted BellSouth to investigate why it was being charged commissions.

Although Boden purports to have been concerned about other brokers claiming his commissions, we do not find this credible. Boden admitted that he was not aware of a single instance in which a real estate broker had filed a lawsuit against another broker for fees or commissions that the first broker had been promised by the seller or buyer of the property. Boden also admitted that he was unaware of "any specific claims by brokers to commissions from the sale" of the New Forestry properties for which he purportedly had a right to a commission. Neither Boden nor Harrison identifies any plausible theory upon which such a lawsuit could have been maintained against Boden.[35] We also believe that Boden likely would have reduced the terms of his oral agreement to writing if he were actually concerned about another broker's claim to his commissions in order to demonstrate his own purported right to those commissions.

Furthermore, the shell entity structure would not actually have accomplished the purpose Boden claimed for it. The entities likely would not have prevented a lawsuit from a broker seeking to obtain the commissions, nor would they have precluded a recovery if a lawsuit succeeded. Indeed, Harrison conceded that, in any lawsuit, he would likely have been required to disclose where the money ultimately went.

Finally, the manner in which the shell entities were established makes it difficult for us to believe Boden's explanation. Harrison testified that his friend Boden approached him "after a baseball game" to obtain his legal advice, and "based on [that] five-minute conversation," Harrison was "able to determine all the relevant facts [that he] needed to know in order to help Mr. Boden protect himself from liability." Harrison suggested to Boden that they "set up [the] LLC's as a special purpose entity," and Boden's response at the end of this five-minute

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[34] Boden admitted that the statement was incorrect, but attributed this to a mistake by Wooddall. Boden acknowledges that he personally reviewed the draft sales contract, including the incorrect language. We find it improbable that Boden overlooked the inaccuracy, given that he suggested a change to the very same portion of the contract.

[35] Although Boden also claims to have been concerned that Timbervest's former CEO might have entered into unknown arrangements with unspecified third-party brokers for commissions, we do not believe that any such concern motivated him here. Any such individuals could claim some share of the commissions only if they stepped forward to provide some service in connection with the sales transaction. Perhaps then Boden might have had some cause for concern, but in the absence of this occurring, we find it implausible that Boden's true motivation for approving the shell companies was to avoid losing his brokerage commissions to an unknown third-party broker.

conversation was, "'Fine, just handle it, I'll pay you 10 percent of whatever I get.'" Harrison testified that he and Boden had no further conversations "of substance" about the "arrangement or engagement." Although Harrison spent less than 20 hours setting up the shell entities for Boden, his 10 percent share of the eventual commissions amounted to $110,000—an inexplicably large contingency fee for minimal work, and for a type of legal work that Harrison acknowledged is not typically performed on a contingency basis.

2. Timbervest made a series of material omissions and misstatements relating to the brokerage commissions.

Respondents maintain that the commissions were disclosed to BellSouth during one phone call that took place in 2005. We find that the commissions were not in fact adequately disclosed on that phone call.

At the time of the call, BellSouth had recently hired ORG Portfolio Management, a registered investment adviser, to oversee Timbervest's management of the properties in BellSouth's New Forestry account. According to Shapiro, he called ORG's Edward Schwartz and told him that Timbervest had previously made an oral agreement with Boden in 2002 to pay Boden the real estate commissions. There is no dispute that Shapiro placed this phone call on behalf of Timbervest in his official capacity as the company's CEO. Shapiro does not recall the details of the conversation, but says that he "just remembers telling [Schwartz] the basic deal" and "mak[ing] him aware that Mr. Boden would be receiving a fee at some point if he sold some of these properties." Shapiro claims that, after the conversation, he "walked away thinking [the arrangement] was fine." Schwartz remembers the conversation differently. He recalls a "hypothetical" discussion that merely gauged his reaction to Timbervest "bringing someone in" and paying them "a brokerage commission for work they did prior to" joining Timbervest. He claims there was no mention of a fee or commission being paid to Boden. Rather than telling Shapiro that the arrangement was "fine," Schwartz recalls telling him that he had "concerns" and that he "would have to run it by legal counsel."

Although the recollections of Shapiro and Schwartz differ, we need not decide whose account of the phone call is correct because, even under Shapiro's account, the commissions were not adequately disclosed. We reach this conclusion for three independent reasons.

During the phone call, Shapiro omitted several material facts about the purported oral arrangement with Boden. He did not disclose the amount of the commissions, the properties covered, the time period of the arrangement, or the fact that the other Timbervest partners would be sharing the commissions. The last of these facts was particularly significant because it affected the incentives all of the partners had to approve the sale of BellSouth's property.[36]

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36 We do not find credible Boden's claim that, despite his supposed longstanding agreement with Timbervest entitling him to the commissions, he just decided to share the commissions equally with his partners after the two BellSouth properties were sold. The facts and circumstances surrounding the payments, including the size of the payments, make Boden's claims unbelievable in our view.

Neither Shapiro nor any of the other Respondents ever informed anyone at BellSouth that a Timbervest principal would be receiving brokerage commissions.[37] When BellSouth hired ORG, it sent a letter to Zell's attention instructing Timbervest that "ORG should be copied on all reporting and correspondence . . . *in addition to the existing reporting to BellSouth*," and Zell shared this letter with each of the other Timbervest partners. But Shapiro's only purported disclosure of the fees was a single phone call to Schwartz at ORG, and Schwartz was not even the lead ORG account representative overseeing BellSouth's New Forestry properties.[38] This one oral disclosure solely to a secondary account agent at ORG—along with the use of shell companies, the misrepresentation of the commissions in the sale agreements, and the failure to put any disclosure of the commissions in writing—convince us that Timbervest did not seek to fully disclose the commissions to BellSouth or obtain its consent.[39]

In any event, even giving Shapiro the benefit of the doubt that he made a full disclosure during his conversation with Schwartz about all of the material terms of Boden's alleged commission arrangement, we would still find that Shapiro made material omissions and misstatements. Specifically, the weight of the evidence convinces us that, contrary to Respondents' assertions, no five-year oral agreement to pay Boden real estate commissions was entered into when Boden joined Timbervest in 2002. We find that Timbervest violated its fiduciary obligations of good faith and full and fair disclosure of material facts by concocting the claims about the oral agreement at some point after BellSouth reduced Timbervest's management fees in 2005. Timbervest did so to defraud BellSouth into paying the commissions.

The following considerations lead us to conclude both that there was no oral agreement entered into in 2002 to pay Boden real estate commissions and that the claims about the agreement were intended to defraud BellSouth.

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37 Zell testified that "regardless of what anyone at Timbervest may have disclosed to Ed Schwartz at ORG, Timbervest never sought consent from BellSouth for the payment of fees to a Timbervest principal."

38 There was some testimony during the hearing that Shapiro eventually developed a bad relationship with the lead ORG account representative. In our view, this would not explain why Shapiro spoke with Schwartz, a secondary account representative, since at the time of the phone call ORG had been retained only weeks earlier by BellSouth.

39 Zell also claims that Shapiro advised him about Timbervest's commission agreement with Boden in late 2002, when Zell was still employed at BellSouth and just months before Zell left to go work at Timbervest. But we do not find this self-serving testimony persuasive in light of the overwhelming evidence demonstrating that no such agreement in fact existed, which we discuss below. And in any event, in 2002 Boden was not a principal at Timbervest so any disclosure at that time (had it actually occurred) would not have addressed the manifest conflict that arose once Boden became a partner and received the brokerage commissions.

- Despite supposedly entitling Boden to commissions for five years, the purported agreement was never put in writing. This is particularly surprising because of the amount of the potential commissions involved, the multi-year duration of the arrangement, and the fact that the arrangement involved a number of specific features that one would normally want to reduce to writing (*e.g.*, eight specific properties, a sliding-scale compensation scheme).

- This substantial commitment was supposedly made "within a couple of weeks of [Boden] showing up" at Timbervest, and it was supposedly offered by Shapiro, at a time when he was himself on a 90-day trial period at Timbervest, was not drawing a salary, and was "basically a consultant" tasked with "figur[ing] out if [Timbervest] was a profitable business."

- Further, while Shapiro claims to have promised Boden commissions to sell New Forestry's eight largest southeastern properties worth $144 million (including Tenneco Core and the property in Kentucky), BellSouth at that time in 2002 had asked Timbervest to sell only $30 to $60 million worth of property;[40] it is therefore doubtful that Shapiro would have entered into a commission arrangement for $144 million worth of New Property sales.[41]

- Notwithstanding the large number of real estate transactions that Boden claims that he participated in each year at Timbervest, Boden made no sales whatsoever under the oral agreement for the first four years that it supposedly existed. It was only in the last year of the oral arrangement—at a time when Boden and the other Timbervest partners had "extended" themselves in buying the company *and* BellSouth had dramatically reduced Timbervest's management fees—that Boden made his first sale under the purported agreement.[42]

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40 The requested $30 to $60 million reduction in 2002 was a separate request from the subsequent reduction that BellSouth ordered in April 2005 that would have brought the assets under management down to $250 million. Moreover, testimony during the hearing indicated that Shapiro's strategy for dealing with BellSouth's 2002 directive to sell $30 to $60 million worth of property was to delay acting on it to avoid losing the management fees, which we believe further calls into doubt any claim that Shapiro entered into a commissions arrangement with Boden in connection with the sale of BellSouth's properties.

41 Doing so also would have made little business sense to Timbervest at the time because its revenues came overwhelmingly from management fees calculated based on the total assets in BellSouth's New Forestry portfolio, and would have worsened Timbervest's financial position had the sales occurred by reducing the net assets under management upon which Timbervest's management fees were calculated.

42 We do not credit Respondents' claim that the purported brokerage commission arrangement was intended to serve as Boden's compensation for the work that he did after joining Timbervest. Boden testified that "I worked for 20 months under the advisery fee arrangement from like September 2002 to April 2004, without getting any money at all." Boden

- Additionally, Jerry Barag, Timbervest's former chief investment officer, testified that, during his time at Timbervest (from March 2003 through December 2004), he never heard anything about any such arrangement. We believe that, had such an agreement existed, Barag would have known about it because of his role as chief investment officer, and because Timbervest was a small operation with only a few employees working in close proximity where "everybody was involved in everything that was going on."

- Finally, Boden's testimony about the commission structure established by the oral arrangement inexplicably conflicted with how he implemented it in a contract for the sale of another property in BellSouth's New Forestry account, the Rocky Fork property (an agreement that was signed but that fell through before the sale closed).[43]

In sum, we find that Timbervest made a material omission when it failed to disclose to BellSouth that the four Timbervest partners would receive over $1 million in commissions. Even assuming some disclosure of the "basic deal" was made on the phone call to Schwartz, several material terms were omitted, as described above. Further, Timbervest made material misstatements when Shapiro (on behalf of Timbervest) told Schwartz about an agreement with Boden that did not exist, when Respondents used shell companies in the sales agreement to hide the identity of the true recipients of the commissions, and when Timbervest executed a sales agreement that falsely described one of the shell companies in the sale agreement as providing services to the buyer rather than the seller. These facts also convince us that Timbervest's misstatements and omissions were made with scienter.

C. The individual Respondents aided, abetted, and caused Timbervest's violations.

Our *de novo* review of the record leads us to conclude that Boden, Shapiro, Jones, and Zell—through their collective control of Timbervest—caused the fraud on BellSouth. We also find that the four Timbervest partners aided and abetted Timbervest's violations because they

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further testified that "my interest vested in that agreement, I earned those fees during that period of time[.]" But during his investigative testimony, Boden stated that "I think July of 2003 was when I first officially got an actual paycheck from [Timbervest]," and "[m]ost of what I did before that I didn't actually get paid for. It was [to] tell them how [Timbervest] could do things better[.]" We believe that Boden's investigative testimony is the more accurate reflection of his early compensation arrangement with Timbervest. In reaching that conclusion, we note that when his investigative testimony was given, the investigation "had a different focus" than the commission payments and thus we believe that Boden had no reason to misrepresent the facts about his compensation at that point. For the same reason, we do not credit Shapiro's hearing testimony that Boden had earned the commissions by "work[ing] for two years for free."

43 The 2 percent commission that Boden had written into the Rocky Fork sales contract was outside the range of the commission payments that Boden testified were provided for by the alleged 2002 agreement (4 percent to 2.5 percent).

had knowledge of the violations and their role in those violations, and they provided substantial assistance.[44]

As to the sale-and-repurchase agreement, we find that Boden plainly had knowledge of the misconduct and substantially assisted it because, among other considerations, he personally negotiated the agreement with Wooddall. We find that Shapiro, Jones, and Zell also had knowledge of the arrangement and substantially assisted it. Boden testified that he would "generally always discuss [any offer he was going to make] with one or more" of the Timbervest partners. Zell testified that he and Boden spoke internally about the repurchase, and Boden was "pretty confident" that he and Shapiro spoke about it as well. Further, as members of Timbervest's investment committee, each of the four Timbervest partners had to vote to approve both the sale and the repurchase.[45] At a minimum, we believe that the partners must have known about the arrangement when they voted to repurchase the property from Wooddall after having sold it to him only a short time before.[46] It is implausible that they would have voted to repurchase the property for $1 million more than the price at which they had just sold it weeks earlier without being fully aware that the repurchase was pre-arranged.[47] The partners' knowledge is further confirmed by the fact that not one of them could recall why they repurchased the property only weeks later, or even offer a plausible reason why they might have done so.

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[44] A person is liable for aiding and abetting a violation of Section 206 if there is "(a) wrongdoing by [the investment adviser]; (b) a general awareness or reckless disregard by [the person] of the wrongdoing and of his role in furthering it; and (c) [the person] substantially assisted the wrongdoing." *Abraham & Sons Capital, Inc.*, Exchange Act Release No. 44624, 2001 WL 865448, *7 (July 31, 2001). A person who aids and abets violations is also "necessarily a cause of those violations." *Id.* For both Section 206(1) and 206(2), it is sufficient to establish knowledge by showing recklessness when the alleged aider and abettor is a fiduciary or active participant. *See, e.g.*, *German v. SEC*, 334 F.3d 1183, 1195-96 (10th Cir. 2003); *Ross v. Bolton*, 904 F.2d 819, 824 (2d Cir. 1990).

[45] As Shapiro admitted during his testimony, "each of [the Timbervest] partners approved the sale by New Forestry of the property for 13.45 million dollars and the repurchase of the same property for 14-and-a-half million by [the TVP-1 fund]." Indeed, Shapiro admitted that "all purchase and sale decisions need to be unanimously agreed to by the investment committee to go forward."

[46] Zell testified that the "normal practice" would be for the investment committee to review a proposed sale or purchase arrangement "two or three times" "over a number of days or weeks." Boden testified that he "couldn't bind the company to any deal without everyone's involvement."

[47] Jones conceded during his testimony that the four Timbervest partners would have been aware of the "abbreviated timeline" and the $1 million price differential between the sale and repurchase of Tenneco Core.

As to the real estate commissions, Boden's knowledge and substantial assistance are apparent from the efforts he made to hide the commissions, including establishing shell companies, directing the payments through multiple accounts, and using cashier's checks to distribute the proceeds.[48] Shapiro's knowledge and substantial assistance are likewise apparent from his material misstatements and omissions on the phone call with Schwartz.

We also find that Jones and Zell had knowledge of Timbervest's violations in connection with the commissions, and substantially assisted the violations. Both Zell and Jones knew that the brokerage commission would be paid prior to giving their approval for the Tenneco Core sale. Zell testified that he knew "[a]t least a month, but I'm assuming it's at least two plus months" before the Tenneco Core transaction closed that the brokerage commission would be paid.[49] Jones similarly testified that he "was aware that a fee *was going to be paid* to Mr. Boden." (Emphasis added). Based on their testimony, we find that they were both aware of the commissions when, as members of Timbervest's investment committee, they gave their approval to the sale contract being executed. This constituted knowledge of the violations and substantial assistance.[50]

Additional considerations support our finding that Jones and Zell knowingly participated in planning and executing the scheme to secretly obtain and share the real estate commissions.

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48 *See generally Robert D. Tucker*, Exchange Act Rel. No. 68210, 2012 WL 5462896, at *11 n.56 (Nov. 9, 2012) (stating that "efforts to conceal violative conduct demonstrate scienter"); *Phillip J. Milligan*, Exchange Act Release No. 61790 (March 26, 2010) (attempts to conceal misconduct support a finding of scienter); *see also In re Nature's Sunshine Prods. Sec. Litig.*, 486 F. Supp.2d 1301, 1310 (D. Utah 2007) ("Evidence that a defendant has taken steps to cover-up a misdeed is strong proof of scienter"); *In re Connetics Corp. Sec. Litig.*, No. 07 Civ. 2940, 2008 WL 3842938, at *15 (N.D. Cal. Aug. 14, 2008) (strong inference of scienter based on efforts to conceal stock sales).

49 Zell also testified that he knew a month or two before the closing on the Kentucky property that the brokerage commissions would be paid.

50 Jones's opening brief appears to assert that Jones's involvement as a member of the investment committee would have ended months before the September 2006 sale. Jones's Opening Br. at 2 ("The Investment Committee would have most likely evaluated the sale by New Forestry in May or June 2006."). Notably, no record citation is provided for this assertion. Moreover, this assertion conflicts with Jones's own testimony in which he said "[t]he investment committee would approve a sale *prior to* the sale contract being executed." (Emphasis added). Further, Shapiro testified that "each of [his] partners approved the sale by New Forestry of the property for 13.45 million dollars[.]" Earlier versions of the sales agreement had provided for a lower sales price, so the partners could not have agreed to the sale much earlier than September 15, 2006 when the agreement was executed. In any event, Jones testified that he learned the actual amount of the brokerage commissions that were to be paid to Boden before the sales contract was signed, which supports the conclusion that his involvement with the sale had not ceased months earlier.

We find it implausible that Boden, after receiving the commissions (money that he had supposedly earned for work done years earlier), simply decided to give three-quarters of it—approximately $780,000—to the other partners.[51] In our view, the actual explanation for why Boden gave $260,000 each to Jones and Zell is that this money was their share of the ill-gotten gains from their participation in the fraud, including their approval of the Tenneco Core and Kentucky property transactions on which the brokerage commissions were paid.[52] We also find it relevant that Jones and Zell actively sought to cover up the fraud by, among other things, providing testimony—which we do not find credible—to support the claim that Shapiro and Boden entered into an oral arrangement for the commissions in 2002.[53] Their participation in the cover up of the fraud supports the inference that they actively and knowingly participated in the underlying misconduct.[54] We further find that, contrary to Zell's testimony, he knew that that Boden had used the Fairfax Realty shell entity to receive the commission payments.[55] We

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51 The quarter share that each of the Timbervest partners received was not an insubstantial sum of money to them given that it exceeded their $250,000 per-partner annual salary in 2006.

52 *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 325 (2007) (stating that "personal financial gain may weigh heavily in favor of a scienter inference"); *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 497 (7th Cir. 1986) ("If the plaintiff does not have direct evidence of scienter, the court should ask whether the fraud (or cover-up) was in the interest of the defendants."). *See generally United States v. Floyd*, 740 F.3d 22, 29 (1st Cir 2014), *cert denied sub nom, Dion v. United States*, 135 S. Ct. 124 (2014) ("Receipt of a share of a conspiracy's proceeds may be probative of the recipient's participation in the conspiracy.").

53 Specifically, Jones testified that he first learned of the arrangement in 2004 when he joined Timbervest and Zell testified that he first learned of the arrangement in 2002 while he was still working at BellSouth.

54 *See generally United States v. Fusaro*, 708 F.2d 17, 21 (1st Cir.1983) (explaining that "attempts to cover up the scheme as it unraveled" can "provide[] the basis for the inference that [the defendant] acted with the requisite intent and knowledge").

55 After the Tenneco Core closing, Zell authorized a $300 payment to Fairfax Realty, the shell company that received the Tenneco Core commissions. The check, which stated "commission" in the memo line, was the balance of the brokerage commission payments supposedly owed on the Tenneco Core transaction. Although Zell claims that he was simply given the check to sign by Timbervest's accounting personnel and that at the time did not realize what the check was for, we believe that Boden would have addressed the shortfall with Zell given Timbervest's small size (it was a 15-person operation at this time), Zell's central role in managing the BellSouth account, and the close, collaborative relationship among the Timbervest partners. At a minimum, upon seeing the check for a "commission" payment, we believe that Zell would have asked questions about the check before signing it and in so doing would have learned both that Boden had requested it and that Boden was using Fairfax Realty to receive the commission payments. For these reasons, we do not credit Zell's testimony that he only learned much later that Boden had used Fairfax Realty to receive the brokerage commission or his testimony that he did not know anything about the $300 check.

similarly find that Jones, as the General Counsel of Timbervest, must have been aware that the Tenneco Core and Kentucky property contracts misrepresented that the brokerage commissions would be paid to the shell entities.[56] The failure of Zell, a long-time manager of pension plan assets, and Jones, an experienced lawyer and Timbervest's compliance officer, to document either Boden's purported commission arrangement, the commission payments, or BellSouth's consent further supports the inference that they knew that the brokerage commissions had not in fact been approved by BellSouth.[57] At a minimum, we find that Zell and Jones recklessly disregarded the risk that BellSouth would be deceived.[58]

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56 Jones testified that his direct report, Carolyn Seabolt, had responsibility for reviewing all sales and purchase agreements. Given the fact that Seabolt reported directly to Jones, as well as Timbervest's small size at the time (no more than 15 people worked there) and Jones's role in approving sales agreements as a member of Timbervest's investment committee, we believe that he must have known that the agreements provided for the brokerage commissions to be paid to the shell entities, not Boden.

57 Jones conceded that the brokerage commissions created a "conflict of interest" and that he could "understand how it would be important to put something in writing" given the potential "expenditure of many millions of dollars by Timbervest" of BellSouth's money. Yet he testified that he never suggested that the purported oral agreement for the commissions be reduced to writing.

58 In the initial decision, the ALJ found that Zell and Jones "subjectively" believed that Shapiro's conversation with Schwartz in 2005 constituted sufficient disclosure about the brokerage commission payments and thus concluded that they lacked scienter in connection with those payments. As an initial matter, we note that it is not apparent to us from reading the Initial Decision that this finding was based on the ALJ's assessment of Zell's and Jones's demeanor rather than his evaluation of the evidence. In any event, our *de novo* review of the record leads us to conclude that the weight of the evidence demonstrates that Zell and Jones could not have subjectively believed Shapiro's disclosure was sufficient. As we discuss above, we find that at the time they approved the Tenneco Core and Kentucky property transactions as members of Timbervest's investment committee, Zell and Jones knew that they were going to receive an equal share of the brokerage commissions. In our view, this fatally undermines their contention that they believed Shapiro's 2005 disclosure to Schwartz had been sufficient because, at a minimum, they must have known that Shapiro had not disclosed the material fact that they (or Shapiro) would be receiving a share of the brokerage commissions. Further, Zell and Jones could not have subjectively believed the disclosure to Schwartz was sufficient because BellSouth, when it retained ORG, advised Zell in writing that any disclosures or reports to ORG were not to replace the disclosures to BellSouth. As Zell conceded during his testimony, "Timbervest was still to report to BellSouth as it always had[.]" Zell shared BellSouth's written directions with Jones, so Jones too could not have subjectively believed that any disclosure to Schwartz was sufficient.

D. Respondents' misconduct is covered by the Advisers Act.

Respondents argue that they cannot be held liable under the Advisers Act because their misconduct "involved real estate, not securities." The Advisers Act is not limited to misconduct that occurs in the course of securities transactions. Although the Act defines an "investment adviser" as someone who engages in the business of advising others about securities,[59] that advisory relationship gives rise to a broader fiduciary duty.[60] Where an investment adviser has an advisory relationship with a client, the Act provides (among other things) that "[i]t shall be unlawful for any investment adviser . . . to employ *any* device, scheme, or artifice to defraud *any* client."[61] This language is not limited to fraud in connection with a securities transaction. Had Congress intended such a limitation, it would have said so.[62] Thus, once an investment advisory relationship is formed, the Advisers Act does not permit an adviser to exploit that fiduciary relationship by defrauding his client in any investment transaction connected to the advisory relationship.[63] We believe that our long-standing interpretation of the scope of the Advisers' Act is appropriate because a contrary reading, which would allow investment advisers to exploit the advisory relationship by engaging in misconduct such as that at issue in this matter, would undermine the "climate of fair dealing which is so essential to maintain public confidence in the securities industry."[64]

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59 15 U.S.C. 80b-2(a)(11).

60 *Capital Gains*, 375 U.S. at 194; *Transamerica Mort. Advisors, Inc. v. Lewis*, 444 U.S. 11, 17 (1979).

61 15 U.S.C. § 80b-6(1) (emphasis added).

62 *Compare* Securities Act Section 17(a), 15 U.S.C. § 77q(a) (prohibiting fraud "in the offer or sale of any securities"); Exchange Act Section 10(b), 15 U.S.C. § 78j (prohibiting fraud "in connection with the purchase or sale of any security").

63 We have previously recognized the broad scope of Section 206 of the Advisers Act in a variety of contexts. *See, e.g.*, *Proxy Voting by Investment Advisers*, Investment Advisers Rel. No. 2106, 2003 WL 215467, at *2 (Jan. 31, 2003) ("Under the Advisers Act ... an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf. . . ."); *In the Matter of Bill C. (Billy) Crafton, Jr.*, Investment Advisers Rel. No. 3998 (Jan. 15, 2015) (investment adviser liable for collecting undisclosed fees regarding life insurance); *see also Applicability of the Investment Advisers Act*, Advisers Act Release No. 1092, 1987 WL 112702, at *9 (Oct. 8, 1987) (staff interpretive release stating that Sections 206(1) and 206(2) "do not refer to dealings in securities but are stated in terms of the effect or potential effect of prohibited conduct on the client"); *SEC v. Lauer*, 2008 WL 4372896, at *24 (S.D. Fla. Sept. 24, 2008); THOMAS P. LEMKE & GERALD T. LINS, REGULATION OF INVESTMENT ADVISERS (2013 ed.), at § 2:30 ("[T]he SEC has applied [206(1) and 206(2)] where fraud arose from an investment advisory relationship, even though the wrongdoing did not specifically involve securities.").

64 *Capital Gains*, 375 U.S. at 201.

Respondents do not dispute that Timbervest was a registered investment adviser. It is also apparent that Timbervest entered into an advisory relationship with the three BellSouth pension trusts that wholly owned New Forestry and with New Forestry, LLC, signing investment management agreements with each of these entities. These agreements empowered Timbervest to render advice regarding securities, such as investments in money market funds and equity investments in timber companies. And Timbervest did in fact provide advice about securities.[65] Timbervest's fraud in connection with the real estate transactions, and the individual Respondents' aiding, abetting, and causing of that fraud, are therefore prohibited by the Advisers Act.[66]

IV. Remedial Sanctions

As a preliminary matter, we note that Respondents argue that no sanctions should be imposed here due to 28 U.S.C. § 2462. That provision provides in pertinent part that:

> Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued . . . .

28 U.S.C. § 2462. It is undisputed that this proceeding was not brought within five years of the violations. Nonetheless, Section 2462 does not prevent us from imposing equitable remedial sanctions in this matter.[67]

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65 For example, Timbervest in April 2006 advised BellSouth to acquire a $50 million equity interest in the Timbervest Crossover Fund.

66 Timbervest did not dispute in its briefs on appeal that it was an investment adviser with respect to New Forestry and the BellSouth pension funds. Indeed, when the Division's response brief expressly argued that the Advisers Act applies here because Timbervest had these advisory relationships, Respondents did not dispute that Timbervest was an investment advisor with respect to these entities. Because this is not a question of subject-matter jurisdiction, *Arbaugh v. Y & H Corp.*, 546 U. S. 500, 514 (2006), we find that Respondents have waived any claim that they lacked an investment advisory relationship with New Forestry and the BellSouth entities.

67 That said, we have considered the passage of time since Respondents' misconduct in considering whether and how to fashion the relief at issue to ensure that the remedies are equitable. *See SEC v. Rind*, 991 F.2d 1486, 1492-93 (9th Cir. 1993); *SEC v. Continental Tobacco Co.*, 463 F.2d 137, 162 (5th Cir. 1972). In considering the passage of time, it is also pertinent that Respondents: (1) executed a complex fraud involving both misrepresentations and omissions; (2) employed secret agreements, middlemen, and shell companies to execute their fraud; and (3) offered testimony during the Commission's investigation that has turned out to lacked credibility.

The terms "civil fine, penalty, or forfeiture" in Section 2462 refer to relief "imposed in a punitive way,"[68] *i.e.*, relief that is "intended to punish" wrongdoers.[69] But the remedies at issue here—barring the Timbervest partners from associating with an investment adviser, and requiring Respondents to cease and desist their securities law violations and to disgorge their ill-gotten gains—are equitable, not punitive.[70] Barring the Timbervest partners from associating with an investment adviser is not "punishment" nor is it "punitive" because such bars protect investors in the future from unfit professionals.[71] Similarly, relief that requires Respondents to

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68 *Meeker v. Lehigh Valley R.R. Co.*, 236 U.S. 412, 423 (1915).

69 *Gabelli v. SEC*, 133 S.Ct. 1216, 1223 (2013).

70 *See also United States v. Banks*, 115 F.3d 916, 918-19 (11th Cir. 1997) (Section 2462 "does not apply to equitable remedies"); *United States v. Telluride Co.*, 146 F.3d 1241, 1245-46 (10th Cir. 1998) (same).

71 *Hudson v. United States*, 522 U.S. 93, 103-105 (1997) (holding that disbarment is not a penalty and affirming order of permanent debarment from the banking industry and a prohibition on banking activities), *aff'g*, 92 F.3d 1026 (10th Cir. 1996). *See also Coghlan v. NTSB*, 470 F.3d 1300, 1305-1306 (11th Cir. 2006) (holding that Section 2462 does not apply to the license revocation because it was remedial and designed to prevent future harm); *SEC v. Kelly*, 663 F. Supp. 2d 276, 286-87 (S.D.N.Y. 2009) (holding that Section 2462 does not apply to officer and director bars) (collecting cases); *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940) (expulsion from securities exchanges "is remedial, not penal"); *SEC v. Culpepper*, 270 F.2d 241, 248-50 (2d Cir. 1959) (revocation of broker-dealer registration is not "punishment"); *accord United States v. Naftalin*, 606 F.2d 809, 812 (8th Cir. 1979).

We take this opportunity to clarify two matters in connection with prior Commission opinions. *First*, in our prior decisions we have at times *not* expressed the view that Section 2462 is categorically inapplicable to bars. This is explained by the fact that our administrative orders may under Exchange Act Section 25(a)(1) always be appealed to the D.C. Circuit, in which *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996), states the controlling rule—*i.e.*, that a bar based "solely in view of ... past misconduct" could constitute a penalty for purposes of Section 2462. *Id.* at 490 n.20. But in district court actions, we have generally taken the position that Section 2462 does not apply to equitable remedies, *SEC. v. Quinlan*, 373 F. App'x 581 (6th Cir. 2010); *SEC v. Kelly*, 663 F. Supp. 2d 276 (S.D.N.Y. 2009), and outside of the D.C. Circuit, the Commission maintains that *Johnson* was incorrectly decided, *Koch v. SEC*, 177 F.3d 784 (9th Cir. 1999) (decided on other grounds). Therefore, to the extent that we have acknowledged the applicability of *Johnson* in certain, previous adjudicatory decisions, those decisions should not be understood as a change from our position expressed above that Section 2462 does not apply to bars. *See, e.g.*, *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1260 (D.C. Cir. 1996) (recognizing that "agencies have the power of nonacquiescence in decisions of a single circuit"); *Johnson v. Railroad Retirement Bd.*, 969 F.2d 1082, 1092 (D.C. Cir. 1992). *Second*, we recognize that there are statements in prior Commission adjudicatory decisions that referred to Section 2462 as prohibiting the Commission from considering conduct that occurred outside the five-year statute of limitations in deciding whether to impose a bar. *See, e.g.*, *Warwick Capital* cease their violations and comply with the law is not a "penalty" nor is it inequitable; its purpose is not to punish for past violations but to protect the public by preventing future violations.[72] And disgorgement, which simply "restores the *status quo ante*," is inherently equitable (not punitive) and thus is not within Section 2462's ambit.[73]

Furthermore, we do not justify the relief "solely in view of . . . past misconduct."[74] Rather, we focus on "the degree of risk [Respondents] pose[] to the public," including "findings demonstrating [Respondents'] unfitness to serve the investing public."[75]

A. Associational bars are warranted.

In assessing the Timbervest partners' current competence and degree of future risk, we are guided in part by our traditional sanctions framework, which looks to:

> the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will

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Management, Inc., 2008 WL 149127, at *10 ("Section 2462 precludes consideration of Respondents' conduct occurring before July 6, 2001, in determining whether to impose an investment advisory bar or civil penalties."). We do not believe that this is a correct understanding of Section 2462 even under the view that the D.C. Circuit has adopted in *Johnson*—because conduct taking place before the five-year limitations period may shed light on the respondent's current competence or future risk to the public, *cf.* 87 F.3d at 489. *See generally Birkelbach v. SEC*, 751 F.3d 472, 481-82 (7th Cir. 2014) (recognizing that the Commission may consider "conduct outside the five-year time frame" in crafting a sanction because it may be pertinent to, among other things, the "possibility of future violations").

72 *See Meadows v. SEC*, 119 F.3d 1219, 1228 & n.20 (5th Cir. 1997).

73 *Johnson*, 87 F.3d at 491 (holding that Section 2462 does not apply to "disgorgement of ill-gotten profits"). *Accord Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009); *SEC v. Calvo*, 378 F.3d 1211, 1218 (11th Cir. 2004). We note that Respondents do not argue that disgorgement is a punitive "forfeiture" under Section 2462 and, thus, we consider any such argument waived. And in any event, there would be no merit to such a contention. *See Riordan v. SEC*, 627 F.3d 1230, 1234 & n.1 (D.C. Cir. 2010) (concluding that disgorgement is not a forfeiture covered by Section 2462); *SEC v. Contorinis*, 743 F.3d 296, 306-07 (2d Cir. 2014) (highlighting the "substantive distinctions" between disgorgement and forfeiture).

74 *Johnson*, 87 F.3d at 490 n.20.

75 *Meadows*, 119 F.3d at 1228 n.20; *accord Johnson*, 87 F.3d at 489 (recommending that "the SEC [ ] focus[ ] on Johnson's current competence or the degree of risk she posed.").

present opportunities for future violations.[76]

Applying that framework, we believe that associational bars are warranted.[77]

The Timbervest partners' conduct was egregiously self-interested and undertaken with scienter.[78] As described above, they arranged together to cause Timbervest to commit the Section 206 violations. They used shell companies and cashier's checks to hide the commission payments. Through their role on the Timbervest investment committee, they falsely lowered Tenneco Core's valuation before the sale to Chen Timber and changed the property's name after the repurchase in an effort to cover up the fraudulent transaction. All of this allowed them to maximize their own gain by obtaining the Tenneco Core property for their new investment fund (TVP-1) at a discounted price. The individual Respondents' actions also allowed them to secretly and personally obtain nearly $1.15 million in brokerage commissions to which they were not entitled and which they obtained in flagrant disregard of their fiduciary obligations. Moreover, their violations were part of a pattern that involved several unlawful transactions and two similar attempted transactions (*i.e.*, the attempted sale-and-secret-repurchase of the Glawson tract[79] and the attempted sale of Rocky Forks on which Respondents intended to collect a commission[80]). Collectively, this misconduct demonstrates that the individual Respondents lack the consistent high degree of professional ethics that is required for them to operate as fiduciaries and that their ethical deficiencies could lead to further violations of their fiduciary

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76 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1993)); *see also Vladislav Zubkis*, 2005 WL 3299148, at *5 (Dec. 2, 2005).

77 The initial decision below reasoned that because the Commission's sanction framework was the basis of "the remedies analysis found wanting in *Johnson*," that framework did not properly consider risk and fitness. But this reflects an incorrect understanding of our sanctions framework and of *Johnson* itself. The Commission's sanctions framework focuses on a respondent's current competence and the degree of risk he poses to public investors and the securities markets. *See also Vladislav Zubkis*, 2005 WL 3299148, at *5.

78 As we assess the individual Respondents' competence and risk to the public, we believe that scienter is "highly relevant to a determination of whether the defendant has the propensity to commit future violations." *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 542 (2d Cir. 1973). As the Supreme Court explained in *Aaron v. SEC*, when "establish[ing] a sufficient evidentiary predicate to show that such future violation may occur," an "important factor in this regard is the degree of intentional wrongdoing evident in a defendant's past conduct." 446 U.S. 680, 701 (1980).

79 As discussed earlier, in late 2005, Respondents attempted to sell and repurchase another BellSouth property, the Glawson property. That attempt to sell-and-repurchase BellSouth property failed due to the threat of exposure from a third party.

80 *See supra* Part III(B)(2).

responsibilities if they are permitted to remain associated with an investment adviser.

Further demonstrating the individual Respondents unfitness and risk to the public is the fact that they have provided absolutely no assurances against future violations; indeed, far from providing such assurances, Respondents' continue to claim that Boden's undisclosed fee "was designed, and did, in fact, benefit New Forestry" and that the "Tenneco Core [sale] provided excellent value to" New Forestry.[81] Our concern about the risk that the individual Respondents pose is increased by the fact that they continue to interact with the investing public and directly control hundreds of millions of dollars of clients' money; all of this would leave them well-placed to repeat their misconduct in the future. Other considerations also lead us to conclude that they lack current competence and pose a risk to the investing public. Respondents have shown no recognition of the wrongful nature of their misconduct or the harm that they caused BellSouth.[82] Further, based on our *de novo* review of the record, we agree with the ALJ's findings that Respondents are "oblivious[] to their fiduciary obligations, which continues today."[83]

Moreover, within the five-year limitations period, the individual Respondents have continued to demonstrate that they the pose a substantial degree of risk to the investing public and that they are unfit to be associated with any investment adviser given the sensitive fiduciary role that advisers occupy. As recently as 2012, Respondents falsely described the underlying transactions to BellSouth's successor notwithstanding their fiduciary obligation to act with honesty and utmost good faith toward clients.[84] In addition, throughout 2009 and 2010, the

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81 Timbervest Opening Br. at 3, 6.

82 For example, throughout this proceeding Respondents have consistently and brazenly asserted in their briefs that the sale of Tenneco Core "was designed to benefit New Forestry" and that it provided "excellent value" to BellSouth. They have similarly maintained that the "fee arrangement was designed to, and did, in fact, benefit New Forestry."

83 As an example, when questioned about the failure to advise BellSouth regarding the use of shell companies, Jones testified in disregard of Respondents' fiduciary obligations that "what was important to Timbervest is what was owed to Mr. Boden, it was paid to Mr. Boden, and that was the end of the story."

84 Specifically, although Respondents in 2011 first advised BellSouth's successor in interest—AT&T—about the Commission's investigation, they continued to deny any wrongdoing for months. They also failed during this time to disclose either the brokerage commission payments or the Tenneco Core sale-and-secret-repurchase arrangement. For example, on June 8, 2012, Timbervest's in-house counsel sent AT&T a letter falsely claiming that the brokerage commissions were paid to Boden under a preexisting arrangement; the letter also omitted any mention of the fact that the commissions were paid to shell entities. Similarly, on August 3, 2012, Timbervest's in-house counsel sent another letter to AT&T, but this letter falsely described the Tenneco Core sale and repurchase as independent transactions that were entered into separately.

individual Respondents continued to ignore their fiduciary responsibilities to BellSouth by using the fund's valuable Glawson property without permission and free of charge for their own benefit.[85] These additional considerations further demonstrate that the individual Respondents are unfit to be associated with an investment advisor and pose a continuing substantial danger to the investing public.[86]

B. Cease-and-desist orders are warranted.

Respondents argue that the cease-and-desist orders are precluded by Section 2462 and, in any event, are unwarranted. We disagree.

As discussed above, it is well established that cease-and-desist orders are "'purely remedial and preventative' and not a 'penalty' or 'forfeiture'" subject to Section 2462.[87]

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[85] Specifically, we find that the weight of the evidence demonstrates that during this period Respondents did not disclose to BellSouth that they: (1) formed a hunting club ("Alcovy Hunt Club") comprised of Boden, Jones, and various Timbervest employees and their families; (2) caused Timbervest (through a vote of the investment committee) to cancel a revenue-generating hunting lease and awarded Alcovy Hunt Club a free one; (3) began holding dove hunts at Glawson, to which Respondents invited prominent members of the Atlanta business community (indeed, going so far as to refer to Glawson as "our farm" in the invitations that Boden sent); and (4) began using Glawson to promote the commingled funds that Timbervest was launching by hosting barbeques and conducting "timber tours." The various activities for which Respondents used the Glawson property benefitted them personally and represented undisclosed conflicts of interest.

[86] We appreciate that the underlying violations occurred almost nine years ago. But we are also mindful that, right up until the period when the Division began to investigate Respondents, they were disregarding their fiduciary responsibilities to BellSouth by using the Glawson property for their own personal benefit. And the fact that Respondents may have been on their good behavior thereafter during the pendency of the investigation and this proceeding does not assure us that they will adhere to their fiduciary obligations once the spotlight is again off of them. In any event, the lapse of time must be weighed against the considerations described above that strongly counsel for associational bars here. We also do not believe that, given the complexity of the fraud, the Division demonstrated unreasonable delay in bringing this action. *See SEC v. First Am. Bank and Trust Co.*, 481 F.2d 673, 682 (8th Cir. 1973) (explaining that injunctive relief under the securities laws is proper where "the very existence of improper conduct in the past raises an inference that such conduct will continue in the future even though the improper conduct has been discontinued"); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1101 (2d Cir. 1972) ("[C]essation of illegal activities in contemplation of an SEC suit does not preclude the issuance of an injunction enjoining violations."). Respondents' total lack of remorse and their continued pattern of advancing falsehoods in this case also support the issuance of the bars.

[87] *Riordan v. SEC*, 627 F.3d 1230, 1234 (D.C. Cir. 2010) (quotation omitted); *accord Harding Advisory LLC*, 2015 WL 137642, at *84 (Jan. 12, 2015).

Respondents argue that the imposition of a cease-and-desist order here would be punitive because such an order would have collateral consequences. The only concrete consequence that Respondents identify is their temporary ineligibility for a Rule 506 exemption.[88] But far from rendering a cease-and-desist order punitive, that ineligibility is itself prophylactic.[89]

For essentially the same reasons that we believe the individual Respondents should be barred from associating with any investment adviser, we believe that cease-and-desist orders are appropriate here. In this regard we note that, although the individual Respondents will no longer be permitted to associate with an investment adviser, they will not be barred from associating with other entities in the securities industry and thus they may have future opportunities to commit violations.[90] We believe that cease-and-desist orders could have a beneficial deterrent effect on Respondents to prevent them from committing future securities law violations. Accordingly, we believe that cease-and-desist orders are warranted here.

C. Disgorgement of the Tenneco Core disposition fee is warranted.

We now turn to the issue of the appropriate amount of disgorgement.[91] As BellSouth's investment advisory firm, Timbervest was contractually authorized to receive a onetime

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88 An issuer is disqualified from relying on the exemptions provided by Commission Rule 506(b) and 506(c) of Regulation D if certain covered persons associated with the offering are deemed a "bad actor" under Commission Rule 506(d). *See* 17 CFR 230.506(d). A covered person is deemed a bad actor if, *inter alia*, the person has become subject to a cease-and-desist order in the previous five years due to a violation of "scienter-based anti-fraud provision of the federal securities laws." *Id.* 230.506(d)(v)(A). Among the persons that can qualify as a covered person under Rule 506(d) is any investment manager of an issuer that is a pooled investment fund or a managing member of such investment manager. *Id.*

89 *See* Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, Securities Act Release No. 9414, 78 FR 44730-01, 44744 (July 24, 2013) (rule promotes investor protection). In any event, whether a sanction is a "penalty" is "not measured from the subjective perspective of the accused" because that standard "would render virtually every sanction a penalty." *Coghlan*, 470 F.3d at 1306. Instead, whether a sanction is a penalty depends on whether a sanction serves the punitive purpose of punishing the defendant for past misconduct as opposed to, as here, serving the remedial purpose of protecting the public interest.

90 *See generally SEC v. Shapiro*, 494 F.2d 1301, 1308 (2d Cir. 1974) ("One who has displayed such frailty in the past and faces so many temptations in the future may well need the admonition of an injunction to obey the law.").

91 The Division did not seek to disgorge the unauthorized brokerage commission payments that Respondents obtained on the sale of Tenneco Core and the Kentucky properties because, after the Commission's investigation began, Respondents reimbursed these amounts to BellSouth.

disposition fee of 3 percent of the gross sales price of any timberlands where the gross sales price was at least 90 percent of the fair market value of the property. Tr. 144. Timbervest received a disposition fee on both the Tenneco Core transaction ($403,500) and the Kentucky property sale ($822,583.50), which the Division now seeks to disgorge.

"Disgorgement is an equitable remedy" that deprives the wrongdoer of ill-gotten gains.[92] Moreover, the amount disgorged must "be a reasonable approximation of the profits causally connected to the violation."[93] And the passage of time does not obviate the public interest in preventing an unjust enrichment.[94]

Applying those principles, we believe that Respondents should disgorge the Tenneco Core disposition fee. Respondents insist there is no causal connection between their misconduct and the Tenneco Core fee because, in their view, Timbervest sold Tenneco Core pursuant to BellSouth's 2005 directive to reduce BellSouth's portfolio. But the weight of the evidence demonstrates that far from selling Tenneco Core for BellSouth's benefit, Respondents sold that property as part of a scheme to secretly acquire it for TVP-1.[95] Moreover, if Respondents had correctly valued Tenneco Core at its approximately $15.5 million fair market value—instead of assigning it an artificially low $12.04 million valuation—Respondents would not have earned a disposition fee on the sale because the $13.45 million sales price was more than 90 percent below Tenneco Core's approximate value. In our view, these considerations more than support the necessary causal nexus to warrant disgorgement of the Tenneco Core disposition fee. And because the individual Respondents collaborated and had a close working relationship in carrying out the misconduct, and they controlled Timbervest, Respondents' liability for the disgorgement and prejudgment interest shall be joint and several.[96]

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92 *Contorinis*, 743 F.3d at 301; *accord Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 399 (1940) (explaining that the purpose of disgorgement is "not to inflict punishment but to prevent an unjust enrichment").

93 *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 198); *accord SEC v. AbsoluteFuture.com*, 393 F.3d 94, 96 (2d Cir. 2004).

94 *See Zacharias v. SEC*, 569 F.3d 458, 471-72 (D.C. Cir. 2009) (holding that Section 2462 does not apply to disgorgement orders).

95 In this regard, we note that Tenneco Core was not included on an initial list of proposed 2006 sales that was provided to BellSouth and that Respondents falsely told BellSouth that the sale resulted from an unsolicited offer, when in fact the sale occurred after Boden solicited Wooddall.

96 *See, e.g.*, *SEC v. Calvo*, 378 F.3d 1211, 1215 (11th Cir. 2004) ("It is a well settled principle that joint and several liability is appropriate in securities laws cases where two or more individuals or entities have close relationships in engaging in illegal conduct.") (citing *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3rd Cir.1997).

By contrast, we believe that the record fails to demonstrate that the Kentucky sale was causally related to Respondents' wrongdoing. Unlike the Tenneco Core transaction, the Division did not present evidence that Respondents' illicit conduct motivated or otherwise caused the Kentucky sale, nor does the Division point to any such evidence now. There is no evidence, for example, that the sale of the Kentucky property was not at fair market value or that it was not undertaken by Timbervest pursuant to BellSouth's 2005 disposition mandate. Thus, we find that the Division has failed to demonstrate a sufficient causal nexus to support disgorgement of the Kentucky property disposition fee.

V. Claims of Prejudicial Error

Respondents additionally argue that a number of irregularities occurred in the proceedings and that these warrant a reversal. We disagree.

A. Rule 230(b)(2) was not violated.

Respondents assert that the Division violated Rule of Practice Rule 230(b)(2), which provides that the Division may not withhold material from its pre-OIP investigative file that is favorable to a respondent because it is either exculpatory or might be used to impeach witnesses. To establish a violation of Rule 230(b)(2), Respondents must demonstrate that the Division withheld evidence that is favorable to them and that the withheld evidence was material[97]—*i.e.*, that there is a reasonable probability that the evidence's disclosure would have resulted in a different outcome.[98]

Respondents start by alleging that the Division was required to produce notes from its June 2012 interview with ORG's Edward Schwartz. The Division inadvertently produced those notes, but Respondents were required to return them. In Timbervest's opening brief, it claims that the notes demonstrate that Schwartz initially told the Division that when he discussed Boden's fee arrangement with Shapiro in a 2005 phone call, "he was aware that the subject of the fee agreement was Mr. Boden" and that "he gave his approval." As noted above, those

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97 *See, e.g.*, *optionsXpress, Inc.*, 2013 WL 5635987, at *3 (Oct. 16, 2013); *see also John Thomas Capital*, 2013 WL 6384275, at *4-*6 & n.31 (Dec. 6, 2013).

98 *optionsXpress, Inc.*, 2013 WL 5635987, at *3. *Accord Kyles v. Whitley*, 514, U.S. 419, 434 (1995) ("A reasonable probability of a different result is accordingly shown when the government's evidentiary suppression undermines confidence in the outcome of the trial.") (quotation omitted). *See also Smith v. Cain*, 132 S. Ct. 627, 630 (2012) (materiality requires a showing that "the likelihood of a different result is great enough to undermine [the] confidence in the outcome of the trial") (quotation omitted); *United States v. Johnson*, 519 F.3d 478, 488 (D.C. Cir. 2008) (materiality requires "a reasonable probability that, had the evidence been disclosed . . . the result of the proceeding would have been different") (quotation omitted); *United States v. Gil*, 297 F.3d 93, 103 (2d Cir. 2002) ("Where the evidence against the defendant is ample or overwhelming, the withheld *Brady* material is less likely to be material than if the evidence of guilt is thin.").

statements differ from Schwartz's hearing testimony that the discussion was hypothetical.[99] Nevertheless, we conclude that the notes are not material because, in reaching our determination about liability here, we assumed *arguendo* that Shapiro's account of the conversation was accurate. Yet even giving Shapiro this benefit of the doubt, as discussed above, we found that he made material omissions and misstatements that did not adequately notify BellSouth about Respondents' commissions; for example, the weight of the evidence demonstrates that there was no five-year agreement between Boden and Timbervest, contrary to Shapiro's purported representations to Schwartz.

Respondents also challenge the Division's failure to produce its Wooddall interview notes. In Timbervest's opening brief, they contend that those notes show that "when the Division staff interviewed him in April 2012, Wooddall said that there was an understanding that Timbervest wanted to buy [Tenneco Core] back but that he could not recall any specific price or percentage return." Respondents further contend those statements are inconsistent with Wooddall's hearing testimony that there was an agreement as to price. Even accepting Respondents' characterization of the notes, however, Respondents fail to demonstrate a reasonable probability that the outcome would be different. At most, the notes might show that initially Wooddall did not remember or convey certain details. Even without the notes, Respondents established during Wooddall's testimony that his memory was less than perfect. Most importantly, even accepting Respondents' characterization of the notes, they would not cast any doubt on Wooddall's consistent testimony that Timbervest agreed to repurchase Tenneco Core in advance of the original sale to Chen Timber. And, the totality of the unusual facts and circumstances surrounding the sale and repurchase, in our view, overwhelmingly supports Wooddall's core testimony that Boden had arranged to repurchase Tenneco Core at the time of the original sale to Chen Timber.[100]

B. No notice violation occurred.

Respondents also argue that they were forced to litigate claims not listed in the OIP. Under our Rules of Practice, the OIP sets forth a "short and plain statement of the matters" to be determined and, in so doing, defines the "scope" of the administrative proceeding.[101] We have

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99 *See supra* at III(B)(2).

100 In any event, in conducting our *de novo* review of the record, we have separately reviewed the Division's Schwartz and Wooddall interview notes, some of which were filed under seal. Our independent review of those items has not undermined our confidence in the outcome of these proceedings. On that basis, we also deny Respondents' motion to compel production of those notes. We likewise deny Respondents' request to require the Division to produce all other interview summaries of witness who testified at the administrative hearing because Respondents have not even attempted to explain what, if any, material information that they believe those documents contain.

101 17 C.F.R. § 201.200(b)(3), (d)(2); *see also Gordon Brent Pierce*, Exchange Act Release No. 71664, 2014 WL 896757, at *12 n.49, *18 (Mar. 7, 2014), *aff'd in relevant part*, *Pierce v. SEC*, 786 F.3d 1027, 1036 (D.C. Cir. 2015).

consistently held that there is no "right to a disclosure of evidence in advance of the hearing."[102] In particular, although a respondent is entitled to be "sufficiently informed of the nature of the charges against him so that he may adequately prepare his defense,"[103] the OIP is not required to contain a "recital of the evidence which may be introduced at the hearing" to support those charges.[104] In short, the limited function of an OIP is to provide notice of *what* violations of the securities laws are alleged; it need not detail *how* the Division ultimately will try to prove them.

Applying that standard, Respondents' notice-related claims lack merit. The OIP here alleged, among other things, that: (1) "[a]t the time of the initial sale of Alabama property [*i.e.*, Tenneco Core], Boden told [Wooddall] that Timbervest would repurchase the . . . property"; (2) the sale and repurchase occurred through a middleman; (3) the transaction was not disclosed to BellSouth; and (4) the transaction violated the Advisers Act.[105]

Respondents contend that the undervaluation of Tenneco Core should not be considered because the OIP never specifically pleaded that fact. The underlying, "pertinent securities law violation" was and has remained the undisclosed sale-and-repurchase of Tenneco Core in violation of the Advisers Act—which is what the OIP alleged.[106] Although the undervaluation of Tenneco Core is an additional evidentiary data point from which Respondents' motive can be inferred, it is in no sense a new claim or charge. Likewise, to the extent that Respondents raise various arguments about the terminology that the OIP and the ALJ used to describe the Tenneco Core transaction, these arguments have no bearing on our basic conclusion that, regardless of terminology (and consistent with the OIP's underlying allegations), Respondents concealed the round-trip nature of the Tenneco Core transaction. We find that the OIP's allegations sufficiently informed Respondents of the underlying "charge[] in enough detail to allow [them] to prepare a defense," and so we reject the lack-of-notice claim.[107]

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102 *Adopting Release*, *Rules of Practice*, Exchange Act Release No. 9795, 1972 WL 125354, at *1 (Sept. 27, 1972) (collecting decisions).

103 *Morris J. Reiter*, Exchange Act Release No. 6108, 1959 WL 59479, at *2 (Nov. 2, 1959).

104 *Charles M. Weber*, Exchange Act Release No. 4830, 1953 WL 44090, at *2 (Apr. 16, 1953); *accord Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *14 (June 30, 2005); *Russell Maguire & Co.*, Exchange Act Release No. 3045, 1941 WL 37144, at *2 (Oct. 18, 1941) ("[D]isclosure of evidence is not the function of pleading.").

105 *Timbervest, LLC*, Advisers Act Release No. 3678, 2013 WL 5320976, at *2 (Sept. 24, 2013).

106 *See Clawson v. SEC*, No. 03-73199, 2005 WL 2174637, at *1 (9th Cir. Sept. 8, 2005) (finding notice sufficient where the facts ultimately found were "consistent with" and "subsumed in" the theory alleged in the OIP).

107 *Rita J. McConville*, 2005 WL 1560276, at *14.

We find Respondents' claim to be without merit for the additional reason that, in "administrative proceedings, the standard for determining whether notice is adequate is whether 'the respondent understood the issue and was afforded full opportunity to justify [his] conduct during the course of the litigation.'"[108] "Thus, the question on review is not the adequacy of the [OIP] but is the fairness of the whole procedure," and we may consider post-OIP filings in evaluating whether the respondent had fair opportunity to prepare his or her defense.[109] It was *Respondents' themselves* who opened the door on the undervaluation issue by asserting before the hearing that the sale was a good deal based on Timbervest's valuation methodology.[110] Likewise, there can be no doubt that Respondents had a full opportunity to argue that the Tenneco Core transaction was neither a parking arrangement nor a cross trade: The parties' post-hearing briefs contain extensive discussion of those points. Accordingly, we are satisfied that Respondents had ample notice of how their conduct might be found to have violated the securities laws.

Finally, Respondents contend that they were unaware that their 2005 attempt to sell the Glawson property and their subsequent personal use of that property during the 2009-2010 period would be at issue. It is true that the OIP does not discuss the Glawson property. Yet neither has there been any attempt to find that Respondents committed a securities-law violation in relation to that property. For this threshold reason alone, Respondents' lack-of-notice claim fails; the "scope" of the proceeding has not been expanded. We instead relied upon the Glawson property for two, narrow purposes. *First*, the fact that Timbervest previously tried to carry out a secret sale-and-repurchase of another property bolsters our conclusion that it orchestrated a secret sale-and-repurchase of the Tenneco Core tract (the actual basis for liability).[111] There is no requirement that the OIP preview what evidence the Division would rely upon at the hearing to prove the latter violation.[112] *Second*, Respondents' history with the Glawson property is

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108 *John P. Flannery*, Exchange Act Release No. 73840, 2014 WL 7145625, at *36 & n.170 (Dec. 15, 2014); *see also Clawson*, 2005 WL 2174637, at *1 (rejecting due-process claim asserting that the Commission found respondent "liable on a theory not alleged in the . . . OIP" where, *inter alia*, the "administrative hearing itself clarified" the matter)

109 *John P. Flannery*, 2014 WL 7145625, at *36 (quotation marks omitted) (citing "multiple letters [filed] with the law judge"). Put another way, although only the OIP—and not any "motion, brief, or other filing"—establishes the charges in the proceeding, *Pierce*, 786 F.3d at 1036, other filings may serve to clarify or elaborate upon, and thus provide additional notice of, the matters in dispute.

110 *See* Division Ex. 74, Timbervest's Wells Submission, at pp. 14, 16-17, 31-36.

111 *Cf.* Fed. R. Evid. 404 (b)(2) (providing that evidence of prior acts is generally admissible for purpose of proving, among other things, common motive, opportunity, intent, and plan).

112 *See, e.g.*, *Rita J. McConville*, 2005 WL 1560276, at *14; *Morris J. Reiter*, 1959 WL 59479, at *2; *Charles M. Weber*, 1953 WL 44090, at *2; *Russell Maguire & Co.*, 1941 WL 37144, at *2.

relevant to our public-interest assessment as to what sanctions are warranted. The OIP specifically placed at issue "[w]hat . . . remedial action is appropriate in the public interest"[113] and we long have held that we may consider circumstances not recited in the OIP in determining whether a sanction is necessary to protect the public.[114]

Respondents' lack-of-notice claim also fails as a factual matter. The record demonstrates that they had ample notice that the Glawson property would be at issue. Approximately a month before the hearing began, Respondents learned through the Division's first witness list that the Division could call Reid Hailey as a witness concerning "Respondent's [sic] intent/plan to arrange planned sales . . . and repurchases by entities controlled by Respondents." Boden solicited Hailey for the failed 2005 Glawson sale-and-repurchase transaction. Similarly, Respondents cannot object to consideration of their personal use of the Glawson property because they—not the Division—first elicited testimony concerning that use. Specifically, it was in response to a question from Respondents' counsel during the hearing about Timbervest's performance on behalf of BellSouth that an AT&T official testified "about ... [Respondents] using [Glawson] for their—you know, to advance their position in Atlanta society."[115] For all

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[113] *Timbervest, LLC*, 2013 WL 5320976, at *4.

[114] *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at *7 (June 29, 2012) (finding assurances of future compliance undermined by the record evidence of "additional disclosure failures" outside those charged in OIP); *Calais Resources Inc.*, Exchange Act Release No. 67312, 2012 WL 2499349, at *7 n.40 (June 29, 2012) (collecting cases in which the Commission "consider[ed] subsequent filing failures and other matters that fall outside the order instituting proceedings in assessing appropriate sanctions"); *Gateway Int'l Holdings, Inc.*, Exchange Act Release No. 53907, 2006 WL 1506286, at *5 n.30 (May 31, 2006) ("Although we are not finding violations based on those failures, we may consider them, and other matters that fall outside the OIP, in assessing appropriate sanctions."); *see also J. Stephen Stout*, Exchange Act Rel. No. 43410 (Oct. 4, 2000), 73 SEC Docket 1441, 1467 n.64, 2000 WL 1469576, at *16 n.64 (in a matter in which the respondent was found to have engaged in unsuitable and unauthorized trading, the Commission considered respondent's later misconduct, involving his creation of an arbitration scheme, to be relevant in determining that a bar was appropriate). We note that the Commission at one point did not consider matters outside of the OIP in assessing what sanctions are appropriate, *Int'l Shareholders Servs. Corp.*, [1975-1976 Transfer Binder] Fed.Sec.L.Rep (CCH), ¶ 80,493, Exchange Act Rel. No. 12389 (April 29, 1976), but we have long since rejected that restrictive approach.

[115] Not only did Respondents open the door to their misuse of the Glawson property at trial, as detailed in the Division's Opposition to Strike Uncharged Allegations, or, in the Alternative, to Introduce Additional Evidence, they followed up on the issue during cross-examination, had a sufficient opportunity to address it more fully if they desired in their case in chief, and never claimed to need additional time to do so. Thus, respondents' lack-of-notice claim fails for the additional and independent reason that they did not "suffer[] prejudice as a result of the supposed lack of notice." *John P. Flannery*, 2014 WL 7145625, at *36; *see also Clawson*, 2005 WL

the above reasons, we find no merit to their claims.[116]

C. Respondents have failed to demonstrate bias.

Respondents claim that the ALJ who presided over the administrative hearing and who issued the initial decision, Cameron Elliot, was biased, but they have failed to meet the standard required to demonstrate bias.

As an initial matter, we note that ALJs are presumed to be unbiased.[117] To overcome that presumption, Respondents must show "that the ALJ's behavior, in the context of the whole case, was 'so extreme as to display clear inability to render fair judgment.'"[118] There must be a "showing of conflict of interest or some other specific reason for disqualification."[119] "[J]udicial rulings alone," moreover, "almost never constitute a valid basis for a bias [claim]."[120]

As evidence of the ALJ's bias, Respondents cite a number of his decisions in this proceeding, including his findings that Timbervest undervalued Tenneco Core, that Reid Hailey

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2174637, at *1 (finding that the respondent suffered "no prejudice" when he "failed to identify any additional evidence or defenses he would have proffered had he been given specific notice").

116 For the reasons set forth in the Division's December 9, 2014 opposition papers, we also deny Respondents' Motion to Strike Uncharged Allegations, or, in the Alternative, to Introduce Additional Evidence. Further, with respect to Respondents' contentions about the Division's reliance on evidence of the misuse of the Glawson property during the 2009-2010 period, we note that Respondents' in their post-hearing briefs were plainly on notice that the Division was relying on this evidence to support its sanctions request. Yet Respondents never moved to submit additional evidence at that time and they have not offered us a reasonable explanation for this failure. *See In the Matter of the Application of Eric J. Weiss*, 2013 WL 1122496, at *9 (March 19, 2013) (party seeking to introduce additional evidence after the initial decision must "show with particularity.... that there were reasonable grounds for failing to adduce such evidence previously" (quoting Rule 452, 17 C.F.R . 201.452)). For this additional reason, we reject their belated request.

117 *Schweiker v. McClure*, 456 U.S. 188, 195 (1982); *Withrow v. Larkin*, 421 U.S. 35, 47 (1975).

118 *Rollins v. Massanari*, 261 F.3d 853, 858 (9th Cir. 2001) (quoting *Liteky v. United States*, 510 U.S. 540, 551 (1994)); *accord Keith v. Barnhart*, 473 F.3d 782, 788 (7th Cir. 2007).

119 *Schweiker*, 456 U.S. at 195-96.

120 *Liteky*, 510 U.S. at 555;*accord Marcus v. Director, Office of Workers' Compensation Programs*, 548 F.2d 1044, 1051 (D.C. Cir. 1976) ("The mere fact that a decision was reached contrary to a particular party's interest cannot justify a claim of bias, no matter how tenaciously the loser gropes for ways to reverse his misfortune.").

was a credible witness, and that Respondents' claims were unbelievable in certain respects. But those claims constitute a recitation of the rulings that Respondents disagree with, and disagreement is not evidence of bias. Moreover, based on our independent *de novo* review, we determined that each of those findings was comfortably supported by the weight of the evidence. And furthermore, Respondents ignore the various findings and conclusions that favored them, such as the ALJ's erroneous interpretation of 28 U.S.C. § 2462 and the findings (which we believe are contrary to the weight of the evidence) that Boden entered into an oral contract with Shapiro in 2002 and that that Jones and Zell were only negligent with respect to the brokerage commissions.

In support of their claim of bias, Respondents also rely on an article in *Wall Street Journal* that asserts that ALJ Elliot has a record of siding with the Division.[121] Even if we credit this assertion, this would not show—as required—that the ALJ displayed a clear inability to render fair judgment in this matter.[122] Though a history of a law judge ruling for an agency may be relevant in assessing bias, that history must be analyzed in the context of the record.[123] Based on the record in this case, again, Respondents have failed to identify any probative evidence of bias, particularly in light of the overwhelming evidence that they violated Section 206.

Finally, Respondents rely on another *Wall Street Journal* article in which a former ALJ of the Commission alleged that she experienced pressure from the Chief ALJ to rule in favor of the Division during her tenure at the Commission.[124] Respondents acknowledge that the former ALJ "departed the Commission years before the hearing in this matter," which was presided over by ALJ Elliot.[125] And far from presenting the requisite, "convincing evidence that 'a risk of actual bias or prejudgment'" is present, Respondents offer only unsupported "speculation or

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121 *See* Jean Eaglesham, *SEC Is Steering More Trials to Judges It Appoints*, THE WALL STREET JOURNAL (Oct. 20, 2014). *But see* David Zaring, *SEC's In-House Judges Not Too Tough, a Review Shows*, N.Y. TIMES (Aug. 31, 2015).

122 Nothing in our decision should be understood to suggest that we agree with the assertions or conclusions in the article.

123 *See, e.g.*, *In re IBM*, 618 F.2d 923, 930 (2d Cir. 1980) (explaining that "[i]t seems evident that statistics alone, no matter how computed, cannot establish extrajudicial bias"); *see also Southern Pacific Commc'n Co. v. AT&T*, 740 F.2d 980, 995 (D.C. Cir. 1984) (holding that statistical one-sidedness in rulings cannot, by itself, support an inference of judicial bias).

124 *See* Jean Eaglesham, *SEC Wins with In-House Judges*, THE WALL STREET JOURNAL (May 6, 2015).

125 The Chief ALJ decided several pre-hearing motions. However, ALJ Elliot revisited the Chief ALJ's denial of additional *Brady* disclosure, a ruling that we have reviewed *de novo*. *See supra* Part V(A). Likewise, the Chief ALJ's denial of Respondents' motion for summary disposition is of no consequence given the subsequent trial of the matter before ALJ Elliot. *E.g.*, *Pahuta v. Massey-Ferguson, Inc.*, 170 F.3d 125, 130 (2d Cir. 1999).

inference" in attempting to link the former ALJ's allegations to this proceeding.[126] That is not enough, in our view, to demonstrate bias, nor is it enough to warrant further factual development as to Respondents' claims.[127] Accordingly, although we accept the *Wall Street Journal* articles for inclusion in the record, we otherwise deny the discovery requests set forth in Respondents' Motion to Allow Submission of Additional Evidence and for Leave to Adduce Additional Evidence filed on May 20, 2015.[128]

V. Constitutional Challenges

Respondents make a series of constitutional challenges related to the administrative forum in which this action was brought.[129] They claim that their hearing before an

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126 *Navistar Int'l Transp. Corp. v. EPA*, 941 F.2d 1339, 1360 (6th Cir. 1991). A showing of actual bias is required to compel disqualification of an ALJ because the "appearance of impropriety standard is not applicable to administrative law judges." *Bunnell v. Barnhart*, 336 F.3d 1112, 1114 (9th Cir. 2003) (collecting cases).

127 *Cf. Attorney General's Manual on the Administrative Procedure Act*, § 6 at p. 73 (1947) ("Hearings are not required on every charge of bias or disqualification . . . ."). The Manual, as "a contemporaneous interpretation [of the APA]," *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 546 (1978), is "give[n] 'considerable weight,'" *Brock v. Cathedral Bluffs Shale Oil Co.*, 796 F.2d 533, 537 (D.C. Cir. 1986) (citation omitted).

128 In an abundance of caution, the Chair of the Commission requested that the Office of the Inspector General investigate the bias allegations made in the May 6th *Wall Street Journal* article. On August 7, 2015, the OIG released an Interim Report of Investigation that we have determined to adduce into the record. *See* Office of Inspector General, U.S. Securities and Exchange Commission, *Interim Report of Investigation*, Case #15-ALJ-0482-I (Aug. 7, 2015), *available at* http://www.sec.gov/oig/reportspubs/oig-sec-interim-report-investigation-admin-law-judges.pdf. Based on his interim review of emails and interviews with ALJ Elliot and Chief ALJ Murray, the "OIG has not developed any evidence to support the allegations of bias in ALJs' decisions in the Commission's administrative proceedings." *Id.* at 4. Specifically, ALJ "Elliot denied being influenced by anyone on 'how to decide [his] cases or suggest or make [him] biased in any fashion'" and Chief ALJ "Murray stated that there was no merit to the allegations of bias." *Id.* at 3-4. The Interim Report of Investigation is probative and Respondents have "not offered any convincing evidence that this report is untrustworthy." *See, e.g.*, *Perrin v. Anderson*, 784 F.2d 1040, 1047 (10th Cir. 1986) (affirming admissibility of report of internal investigation). It provides a further basis for our skepticism about the appropriateness and likely utility of additional, open-ended discovery.

129 The constitutional claims raised here implicate many "threshold questions" regarding the Commission's rules and practices. *Elgin v. Dep't of Treasury*, 132 S. Ct. 2126, 2140 (2012); *see also Thunder Basin Coal Co. v. Reich*, 510 U.S. 200, 214-15 (1994). In the course of considering the constitutional claims, we address those questions and legal principles. It is important that the Commission have an opportunity to address constitutional issues in the first instance as it has in the past. *See, e.g.*, *Gary M. Kornman*, Exchange Act Release No. 59403,

administrative law judge was unconstitutional because of the manner in which the ALJ was appointed and the manner in which he may be removed. Respondents further claim that their rights were violated by the "decision to file this case in [an] administrative forum as opposed to federal court."

Although such wholesale challenges to the Commission's use of administrative proceedings and ALJs are a recent phenomenon, we note that the Commission's use of its administrative forum is not. Administrative proceedings have long been a key feature of the scheme of securities regulation established by Congress. In 1934, for example, Congress authorized the Commission to institute administrative proceedings to expel any member or officer of a national securities exchange "whom the Commission finds has violated" the securities laws.[130] And in 1940, Congress authorized the Commission to bar individuals from acting as investment advisers "if the Commission finds" after an administrative hearing that doing so is "in the public interest."[131] Over subsequent years—and often in response to crises in the financial markets—Congress has expanded those authorities to enable the Commission to more effectively and efficiently protect investors.[132] Congress has also long authorized the use of ALJs throughout the federal government. Congress has empowered "[e]ach agency [to] appoint as many administrative law judges as are necessary," and it has established a comprehensive scheme to govern the details of ALJs' employment in the civil service.[133] The Commission has for many decades relied upon ALJs to prepare initial decisions in its administrative proceedings.[134]

With that background in mind, we turn to Respondents' specific challenges.

2009 WL 367635, at *12 (Feb. 13, 2009) (double jeopardy claim); *Vladen Vindman*, Securities Act Release No. 8670, 2006 WL 985308, at *11 & n.60 (Apr. 14, 2006) (Seventh Amendment claim).

130 Exchange Act Section 19(a)(3), 48 Stat. 881, 898 (1934).

131 Advisers Act Section 203(d), 54 Stat. 851.

132 *See, e.g.*, Securities Enforcement Remedies and Penny Stock Reform Act of 1990; Sarbanes-Oxley Act of 2002; Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

133 5 U.S.C. §§ 3105, 1101 *et seq.*; 1 U.S.C. § 556 (generally authorizing all agencies to rely on ALJs); *see also* 15 U.S.C. § 78d-1(a) (authorizing the Commission to delegate functions to "an administrative law judge"); Exchange Act Section 4(b), 48 Stat. 885 (original Exchange Act provision authorizing the Commission to appoint "examiners").

134 *Cf. Charles Hughes & Co. v. SEC*, 139 F.2d 434 (2d Cir. 1943) (reviewing Commission order revoking broker-dealer registration following proceedings before hearing examiner).

A. The Appointments Clause does not apply to Commission ALJs.

Respondents argue that ALJ Cameron Elliot—who presided over this matter and issued the Initial Decision—was not appointed in a manner consistent with the Appointments Clause of the Constitution. We find that the appointment of Commission ALJs is not subject to the requirements of the Appointments Clause.

Under the Appointments Clause, certain high-level government officials must be appointed in particular ways: "Principal officers" must be appointed by the President (and confirmed by the Senate), while "inferior officers" must be appointed either by the President, the heads of departments, or the courts of law.[135] The great majority of government personnel are neither principal nor inferior officers, but rather "mere employees" whose appointments are not restricted by the Appointments Clause.[136] It is undisputed that administrative law judge Elliot was not appointed by the President, the head of a department, or a court of law.[137] Respondents therefore contend that his appointment violates the Appointments Clause because, in their view, he should be deemed an inferior officer. The Division counters that he is an employee and thus there was no violation of the Appointments Clause.

As we recently explained,[138] the D.C. Circuit's decision in *Landry v. FDIC* generally controls our resolution of this question.[139] *Landry* held that, for purposes of the Appointments Clause, ALJs at the Federal Deposit Insurance Corporation ("FDIC"), who oversee administrative proceedings to remove bank executives, are employees rather than inferior officers. *Landry* explained that the touchstone for determining whether adjudicators are inferior officers is the extent to which they have the power to issue "final decisions."[140] Although ALJs at the FDIC take testimony, conduct trial-like hearings, rule on the admissibility of evidence, and

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135 The Clause provides that the President "by and with the advice and consent of the Senate, shall appoint . . . officers of the United States . . . but the Congress may by law vest the appointment of such inferior officers, as they think proper, in the President alone, in the courts of law, or in the heads of departments." U.S. Const. art. II, §2, cl. 2.

136 *Landry v. FDIC*, 204 F.3d 1125, 1134 (D.C. Cir. 2000) (quoting *Freytag v. Commissioner*, 501 U.S. 868, 882 (1991)); *Buckley v. Valeo*, 424 U.S. 1, 126 (1976).

137 The Commission constitutes the "head of a department" when its commissioners act collectively. *See Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 561 U.S. 477, 512-13 (2010).

138 *In the Matter of Raymond J. Lucia Companies*, Exchange Act Release No. 34-75837, 2015 WL 5172953, at *21-23 (Sept. 3, 2015).

139 204 F.3d 1125 (D.C. Cir. 2000).

140 *Landry*, 204 F.3d at 1133-34.

have the power to enforce compliance with discovery orders, they "can never render the decision of the FDIC."[141] Instead, they issue only "recommended decisions" which the FDIC Board of Directors reviews *de novo*, and "[f]inal decisions are issued only by the FDIC Board."[142] The FDIC ALJs thus function as aides who assist the Board in its duties, not officers who exercise significant authority independent of the Board's supervision. Because ALJs at the FDIC "have no such powers" of "final decision," the D.C. Circuit "conclude[d] that they are not inferior officers."[143]

The mix of duties and powers of the Commission's ALJs are very similar to those of the ALJs at the FDIC. Like the FDIC's ALJs, the Commission's ALJs conduct hearings, take testimony, rule on admissibility of evidence, and issue subpoenas. And like the FDIC's ALJs, the Commission's ALJs do not issue the final decisions that result from such proceedings. Just as the FDIC's ALJs issue only "recommended decisions" that are not final, the Commission's ALJs issue "initial decisions" that are likewise not final.[144] Respondents may petition the Commission for review of an ALJ's initial decision,[145] and it is our "longstanding practice [to] grant[] virtually all petitions for review."[146] Indeed, we are unaware of any case in which the Commission has not granted a petition for review. Absent a petition, we may also choose to review a decision on our own initiative.[147] In either case, our rules expressly provide that "the initial decision [of an ALJ] shall not become final."[148] Even where an aggrieved person fails to file a timely petition for review of an initial decision and we do not order review on our own

[141] *Id.* at 1133.

[142] *Id.*

[143] *Id.* at 1134.

[144] *See* 17 CFR 201.360(a)(1) & (d).

[145] 17 CFR 201.411(b).

[146] Exchange Act Release No. 35833, 1995 WL 368865, at *80-81 (June 9, 1995); *see also* Exchange Act Release No. 33163, 1993 WL 468594, at *55-59 (Nov. 5, 1993) (explaining that we are "unaware of any case in which the Commission has declined to grant a petition for review"). We reiterated this policy in the context of amendments to our Rules of Practice in 2004 that eliminated the filing of oppositions to petitions for review. We deemed such oppositions pointless, "given that the Commission has long had a policy of granting petitions for review, believing that there is a benefit to Commission review when a party takes exception to a decision." Exchange Act Release No. 48832, 2003 WL 22827684, at *13 (Nov. 23, 2003).

[147] 17 CFR 201.411(c); *see also* 15 U.S.C. 78d-1(b) (providing that "the Commission shall retain a discretionary right to review the action of any . . . administrative law judge . . . upon its own initiative or upon petition").

[148] 17 CFR 201.360(d)(1).

initiative, our rules provide that "*the Commission* will issue an order that the decision has become final," and it becomes final only "upon issuance of the order" by the Commission.[149] Moreover, as does the FDIC, the Commission reviews our ALJs' decisions *de novo*.[150] Upon review, we "may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part," any initial decision.[151] And "any procedural errors" made by an ALJ in conducting the hearing "are cured" by our "thorough, de novo review of the record."[152] We may expand the record by "hear[ing] additional evidence" ourselves or remanding for further proceedings before

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149 17 CFR 201.360(d)(2) (emphasis added). An initial decision does *not* become final simply "on the lapse of time" for seeking review. Exchange Act Release No. 49412, 2004 WL 503739, at *12 (Mar. 12, 2004).

150 We do not view the fact that we accord Commission ALJs deference in the context of demeanor-based credibility determinations to afford our ALJs with the type of authority that would qualify them as inferior officers. *First*, as we have repeatedly made clear, we do not accept such findings "blindly," and we will "disregard explicit determinations of credibility" when our *de novo* review of the record as a whole convinces us that a witness's testimony is credible (or not) or that the weight of the evidence warrants a different finding as to the ultimate facts at issue. *Id.* at *10; *accord Francis V. Lorenzo*, Exchange Act Release No. 74836, 2015 WL 1927763, at *10 n.32 (Apr. 29, 2015); *Irfan Mohammed Amanat*, Exchange Act Release No. 54708, 2006 WL 3199181, at *8 n.46 (Nov. 3, 2006); *see also Kay v. FCC*, 396 F.3d 1184, 1189 (D.C. Cir. 2005) ("The law is settled that an agency is not required to adopt the credibility determinations of an administrative law judge."). *Second*, our practice in this regard is no different from the FDIC's and so does not warrant a departure from *Landry*. *Compare [Redacted] Insured State Nonmember Bank*, FDIC-82-73a, 1984 WL 273918, at *5 (June 18, 1984) (stating, "as a general rule," that "the assessment of the credibility of witnesses" by the ALJ is given "deference" by the FDIC) *with Ramon M. Candelaria*, FDIC-95-62e, 1997 WL 211341, at *3-4 (Mar. 11, 1997) (noting that the FDIC ALJ found respondent to be "entirely credible" but rejecting respondent's testimony "in light of the entire record").

151 17 CFR 201.411(a); *see also* 5 U.S.C. 557(b) ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision . . . ."). In performing its *de novo* review, the Commission relies on staff attorneys that are responsible for advising and assisting the Commission in adjudication matters that are pending before it. These staff members review the administrative record, analyze the factual, legal, and procedural issues raised by the case, and prepare a preliminary draft of the decision for Commission consideration (and otherwise assist the Commission in issuing the decision). The Commission may review, and direct questions to the staff regarding, the underlying record. We understand that this process is comparable to that at many other government agencies where the department head is responsible for adjudicating administrative appeals.

152 *Heath v. SEC*, 586 F.3d 122, 142 (2d Cir. 2009); *see also, e.g., Anthony Fields*, Exchange Act Release No. 74344, 2015 WL 728005, at *20 (Feb. 20, 2015) ("[O]ur de novo review cures any evidentiary error that the law judge may have made.").

the ALJ, and may "make any findings or conclusions that in [our] judgment are proper and on the basis of the record."[153]

Respondents attempt to distinguish *Landry* by arguing that the authority of our ALJs is "significantly different" from the authority of the FDIC's ALJs.[154] But the differences Respondents identify are superficial distinctions without substantive difference. They point out that FDIC ALJs issue "recommended decisions," while our ALJs issue "initial decisions"; and litigants can file "exceptions" with the FDIC Board, while here they file "petitions." But these are merely differences in terminology, not substance. The only substantive difference Respondents purport to identify is the fact that the Commission is "not obligated to review all" initial decisions; our power of review is technically discretionary under our rules. The same is true, however, of the FDIC Board, which has discretion to "limit the issues to be reviewed to those findings and conclusions to which opposing arguments or exceptions have been filed by the parties."[155] And in any event, as explained above, we have a longstanding practice of hearing all petitions for review of initial decisions. Thus, whatever power to decline review we may have on paper is not a power we exercise in fact, and such paper authority does not significantly distinguish our ALJs from their counterparts at the FDIC.

Respondents also argue that our ALJs "control the record for review" and "decide[] what is in the record." But that is incorrect, as we have ultimate control over the record. As we have explained before, we have "plenary authority over the course of [our] administrative proceedings and the rulings of [our] law judges—both before and after the issuance of the initial decision and irrespective of whether any party has sought relief."[156] This includes authority over all evidentiary and discovery-related rulings. We are not limited by the record that comes to us. As explained above, we may expand the record. The fact that our ALJs may rule on evidentiary matters and discovery issues (subject to our *de novo* review) does not distinguish them from the FDIC's ALJs in *Landry* who have the same authority.

The Supreme Court's decision in *Freytag v. Commissioner*[157] is not inconsistent with *Landry*. In *Freytag*, the Supreme Court deemed a "special trial judge" of the Tax Court to be an inferior officer. But as *Landry* recognized, ALJs are different from those special trial judges.[158]

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153 17 CFR 201.411(a); 17 CFR 201.452.

154 During the oral argument before the Commission, Respondents were expressly asked whether "is it your position actually that *Landry* was wrongly decided or is distinguishable from this situation," and their counsel responded only that "*Landry* is distinguishable."

155 12 CFR 308.40(c)(1).

156 *Michael Lee Mendenhall*, Release No. 4051 (March 19, 2015), 2015 WL 1247374, at *1.

157 501 U.S. 868 (1991).

158 *Landry*, 204 F.3d at 1133 (explaining that the special trial judges at issue in *Freytag* exercised "authority . . . not matched by the ALJs").

The greater role and powers of the special trial judges relative to Commission ALJs, in our view, makes *Freytag* inapposite here. *First*, unlike the ALJs whose decisions are reviewed *de novo*, the special trial judges made factual findings to which the Tax Court was required to defer, unless clearly erroneous.[159] *Second*, the special trial judges were authorized by statute to "render the [final] decisions of the Tax Court" in significant, fully-litigated proceedings involving declaratory judgments and amounts in controversy below $10,000.[160] As discussed above, our ALJs issue initial decisions that are not final unless the Commission takes some further action. *Third*, the Tax Court (and by extension the court's special tax judges) exercised "a portion of the judicial power of the United States," including the "authority to punish contempts by fine or imprisonment."[161] Commission ALJs, by contrast, do not possess such authority.[162] And while Commission ALJs may issue subpoenas to compel noncompliance, they are powerless to enforce their subpoenas; the Commission itself would need to seek an order from a federal district court to compel compliance.[163] In this respect, too, our ALJs are akin to the FDIC's ALJs that *Landry* found to be "mere employees."[164]

Based on the foregoing, we conclude that the mix of duties and powers of our ALJs is similar in all material respects to the duties and role of the FDIC's ALJs in *Landry*.[165]

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159 *See id.*

160 *Freytag*, 501 U.S. at 882.

161 *Id.* at 891.

162 *See* 17 CFR 201.180. The Commission's rules provide ALJs with authority to punish contemptuous conduct only in the following ways. If a person engages in contemptuous conduct before the ALJ during any proceeding, the ALJ may "exclude that person from such hearing or conference, or any portion thereof," or "summarily suspend that person from representing others in the proceeding in which such conduct occurred for the duration, or any portion, of the proceeding." *Id.* 201.180(a). If there are deficiencies in a filing, a Commission ALJ "may reject, in whole or in part," the filing, such filing "shall not be part of the record," and the ALJ "may direct a party to cure any deficiencies." *Id.* 201.180(b). Finally, if a party fails to make a required filing or to cure a deficiency with a filing, then a Commission ALJ may enter a default, dismiss the case, decide the particular matter at issue against the person, or prohibit the introduction of evidence or exclude testimony concerning that matter." *Id.* 201.180(c). Any such ruling would, of course, be subject to *de novo* Commission review.

163 *See* 15 U.S.C. § 78u(c).

164 *See* 12 CFR 308.25(h), 308.26(c), 308.34(c) (providing that an aggrieved party must apply to a federal district court for enforcement of a subpoena issued by a FDIC ALJ).

165 We do not find any relevance in the fact that the federal securities laws and our regulations at times refer to ALJs as "officers" or "hearing officers." There is no indication that Congress intended "officers" or "hearing officers" to be synonymous with "Officers of the

Accordingly, we follow *Landry*, and we conclude that our ALJs are not "inferior officers" under the Appointments Clause.[166]

B. The dual for-cause removal restrictions on Commission ALJs are constitutional.

Respondents next argue that the manner of removing ALJs is unconstitutional in light of the Supreme Court's decision in *Free Enterprise Fund v. Public Company Accounting Oversight Board*.[167] In that case, the Court held that the structure of the Public Company Accounting Oversight Board (PCAOB) was unconstitutional because it "commit[ed] substantial executive authority to officers protected by two layers of for-cause removal."[168] The PCAOB consisted of inferior officers who exercised executive power, but who could only be removed for cause by principal officers—SEC Commissioners—who themselves could only be removed for cause by the President.[169] The Court found this "novel structure" contrary to "Article II's vesting of the executive power in the President," including the President's obligation to "ensure that the laws are faithfully executed," because it deprived the President of sufficient control over members of the PCAOB.[170]

Based on *Free Enterprise*, Respondents argue that the Commission's ALJs are unconstitutional because they are likewise protected by two layers of for-cause removal:

United States," U.S. Const. art. II, § 2, cl. 2, and the word "officer" in our regulations has no such meaning. We also note in this regard that the Administrative Procedure Act "consistently uses the term 'officer' or the term 'officer, employee, or agent'" to "refer to [agency] staff members." Kenneth Culp Davis, *Separation of Functions in Administrative Agencies,* 61 HARV. L. REV. 612, 615 & n.11 (1948). *Cf.* 5 U.S.C. §§ 556, 557 (referring to official who presides over evidentiary hearing as the "presiding employee").

166 Beyond *Landry*, we believe that our ALJs are properly deemed employees (rather than inferior officers) because this is how Congress has chosen to classify them, and that decision is entitled to considerable deference. *See Burnap v. United States*, 252 U.S. 512, 516 (1920). For example, as we discussed above, Congress created and placed ALJ positions within the competitive service system, just like most other federal employees. Like such other employees, an ALJ who believes that his employing agency has engaged in a prohibited personnel practice can seek redress either through the Office of Special Counsel or the Merit Systems Protection Board. *See* 5 U.S.C. §§ 1204, 1212, 1214, 1215, 1221. And ALJs—like other employees—are subject to reductions-in-force. *See id.* § 7521(b).

167 561 U.S. 477 (2010).

168 561 U.S. at 505.

169 *Id.* at 486-87.

170 *Id.* at 505, 496.

Commission ALJs can be removed only for cause by the Merit Systems Protection Board, and members of that board can only be removed for cause by the President.[171] But *Free Enterprise* did not establish a categorical rule prohibiting two layers of for-cause removal wherever it may be found in the Executive Branch. Indeed, the Supreme Court emphasized that the "size and variety of the Federal Government . . . discourage general pronouncements" about what removal structures may, or may not, be constitutional in different situations.[172] Thus, contrary to Respondents' view, *Free Enterprise* did not turn on the technicalities of removal; it turned instead on the core constitutional question of whether "Article II's vesting of the executive power in the President," including his authority to ensure that the laws are faithfully executed, was frustrated by the distinctive structure and features of the PCAOB.[173]

When *Free Enterprise* is so understood, it becomes apparent that "the real question is whether the removal restrictions [at issue] are of such a nature that they impede the President's ability to perform *his* constitutional duty, and the functions of the officials in question must be analyzed in that light."[174] For the reasons explained below, we conclude that ALJs differ from the PCAOB members in a number of significant ways, and those differences obviate any constitutional concerns from the dual for-cause removal restrictions in the context of ALJs.[175]

First, the Court in *Free Enterprise* made clear that its "holding . . . does not address that subset of independent agency employees who serve as administrative law judges," and the Court indicated that there would be no separation-of-powers problem if ALJs are deemed to be employees rather than inferior officers.[176] *Free Enterprise* left little doubt that civil servants who are not "executive officers" may enjoy multiple layers of protection from presidential removal without violating the separation of powers. Our conclusion that the Commission's ALJs are employees therefore disposes of Respondents' *Free Enterprise* objection.

Second, even if the Commission's ALJs are considered officers, the nature of their duties differs so dramatically from those of the PCAOB as to obviate any potential concerns about the removal limitations. The PCAOB was "charged with enforcing the Sarbanes-Oxley Act, the

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171 *See* 5 U.S.C. §§ 7521, 1202(d).

172 561 U.S. at 506.

173 *Id.* at 496.

174 *Morrison v. Olson*, 487 U.S. 654, 691 (1988) (emphasis added).

175 Courts that have addressed the question have agreed that the limitations on removal of Commission ALJs are not unconstitutional. *See Duka v. SEC*, 2015 WL 1943245, at *8-10 (S.D.N.Y. Apr. 15, 2015) (finding no likelihood of success on removal issue); *Hill v. SEC*, 2015 WL 4307088, at *19 n.12 (N.D. Ga. June 8, 2015) (expressing "serious doubts" that the removal restrictions are unconstitutional).

176 *Free Enterprise*, 561 U.S. at 507 n.10.

securities laws, the Commission's rules, its own rules, and professional accounting standards," among other duties.[177] It was "empowered to take significant enforcement actions" and engage in the "daily exercise of prosecutorial discretion"—all core "executive activities typically carried out by officials within the Executive Branch."[178] In contrast, as the Court in *Free Enterprise* recognized, ALJs are "unlike members of the Board" insofar as they "perform adjudicative rather than enforcement or policymaking functions"[179]—and limited adjudicative power at that. And the exercise of such "adjudicative" functions beyond presidential control has long been deemed constitutionally permissible.[180]

Third, even if the Commission's ALJs were empowered to exercise the kind of power that the Constitution requires the President to control, removal would be only one of many means of control. *Free Enterprise* acknowledged that one level of for-cause removal was permissible.[181] But two levels of for-cause removal were problematic *in that case* because "[n]either the President, nor anyone directly responsible to him, nor even an officer whose conduct he may review only for good cause, has full control over the Board."[182] As *Free Enterprise* observed, the PCAOB had "significant independence in determining its priorities and intervening in the affairs of regulated firms (and the lives of their associated persons) without Commission preapproval or direction."[183] Our ALJs are very different, as they merely take the cases that come to them after we initiate an administrative proceeding, and every one of their decisions can be revisited in the course of our *de novo* review. Nor are we even required to delegate functions to ALJs in the first place.[184]

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177 *Id.* at 485.

178 *Id.* at 504; *see also id.* at 485 (explaining that the Board has "expansive powers to govern an entire industry").

179 *Id.* at 507 n.10.

180 *See Humphrey's Executor v. United States*, 295 U.S. 602, 627-8 (1935) (explaining that a "judicial aid" who acts in an adjudicative capacity "cannot in any proper sense be characterized as an arm or an eye of the executive"); *Weiner v. United States*, 357 U.S. 349 (1958) (upholding war claims commission over which the President had no power of removal). *Morrison* is not to the contrary. The Court there did "not mean to suggest that an analysis of the functions served by the officials at issue is irrelevant"—only that the functions "must be analyzed in th[e] light" of "whether the removal restrictions are of such a nature that they impede the President's ability to perform his constitutional duty." 487 U.S. at 691.

181 561 U.S. at 501; *see also Humphrey's Executor*, 295 U.S. at 602.

182 *Free Enterprise*, 561 U.S. at 496.

183 *Id.* at 504-05.

184 *See* 15 U.S.C. § 78d-1(a).

Fourth, unlike the structure of the PCAOB, the ALJ system is not novel and has been in place for over 70 years. The Court emphasized in *Free Enterprise* that "[p]erhaps the most telling indication of the severe constitutional problem with the [PCAOB] is the lack of historical precedent for this entity."[185] But the ALJ system and the tenure protections ALJs enjoy have been in place since the Administrative Procedure Act was enacted in 1946. This system is not an unusual innovation, but rather a system that has been working effectively for almost 70 years. Unlike in *Free Enterprise*, the challengers here are the ones advocating for radical change. When persons within an independent agency perform adjudicative functions, they are "to be nonpartisan; and [they] must, from the very nature of [their] duties, act with entire impartiality."[186] A system in which adjudicators are brought more directly within the President's control could undermine that impartiality. We do not believe such a result is compelled by *Free Enterprise*, nor do we believe that it would be wise.[187]

Accordingly, we reject Respondents' challenge to the dual for-cause removal limitations on Commission ALJs.

C. Respondents did not experience an equal protection violation.

Respondents claim that the Commission's "decision to file this case in its administrative forum as opposed to federal court" violated their constitutional rights to equal protection of the laws.[188] In asserting this claim, Respondents do not allege that they have been singled out because of their membership in any particular class or group. Nor do they dispute that the Commission has statutory authority to institute administrative proceedings against them under the Advisers Act and the Investment Company Act of 1940. Instead, Respondents contend that the Commission's discretionary choice of an administrative forum disadvantages them relative to similarly situated individuals whose cases are brought and adjudicated in federal court. We reject this claim for three reasons.

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185 561 U.S. at 505 (quoting Judge Kavanaugh).

186 *Humphrey's Executor*, 295 U.S. at 624; *see also Wiener*, 357 U.S. at 354 ("one who holds his office only during the pleasure of another, cannot be depended upon to maintain an attitude of independence against the latter's will") (quoting *Humphrey's Executor*, 295 U.S. at 629).

187 We also note that the standard for removing Commission law judges differs from the "unusually high standard" that was applicable to the PCAOB in *Free Enterprise*. *Id.* at 503. The Board members could only be removed for "willful violations of the Act, Board rules, or the securities laws; willful abuse of authority; or unreasonable failure to enforce compliance." *Id.* This is different from an "ordinary dual for-cause standard," *id.* at 502, like the one that governs ALJs, *see* 5 U.S.C. § 7521(a).

188 *See generally Washington v. Davis*, 426 U.S. 229, 239 (1976) (explaining that "the Due Process Clause of the Fifth Amendment contains an equal protection component prohibiting the United States from invidiously discriminating between individuals or groups") (citing *Bolling v. Sharpe*, 347 U.S. 497 (1954)).

First, Respondents' claim is not legally cognizable. Respondents rely on *Village of Willowbrook v. Olech*, which held that someone who does not allege membership in a particular class may assert a "class-of-one" equal protection claim by establishing that "she has been intentionally treated differently from others similarly situated and that there is no rational basis for the difference in treatment."[189] But the Supreme Court has subsequently made clear that *Olech*, which involved a landowner's challenge to a zoning decision, does not apply to every kind of government action. In *Engquist v. Oregon Department of Agriculture*, the Court explained that there "are some forms of state action . . . which by their nature involve discretionary decisionmaking based on a vast array of subjective, individualized assessments."[190] In such cases, "treating like individuals differently is an accepted consequence of the discretion granted," and "allowing a challenge based on the arbitrary singling out of a particular person would undermine the very discretion that such state officials are entrusted to exercise."[191]

The Commission's choice of forum is such a discretionary decision. Congress gave the Commission authority to initiate administrative proceedings, as well as to bring civil actions in federal court.[192] The Commission's choice to use either or both of those means to enforce the securities laws is a matter of broad agency discretion.[193] Such a decision depends on a highly individualized assessment of the facts and circumstances of a given case. Moreover, Respondents cite no decision from any court finding that a class-of-one claim can be used to challenge the government's choice of forum. And in an analogous case, at least one federal court of appeals has held that "the discretion conferred on prosecutors choosing whom and how to prosecute" precludes a class-of-one claim.[194] The defendant in that case objected to the fact that he was prosecuted in federal court, while allegedly similarly situated defendants were prosecuted in state court. But the appeals court rejected his class-of-one claim because the "logic [of *Engquist*] is equally applicable to the exercise of prosecutory discretion," where "there is no readily apparent standard" against which to measure a prosecutor's charging decision and the decision "is solely for the executive branch to make without fear of second-guessing by the

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189 528 U.S. 562, 564 (2000).

190 553 U.S. 591, 594 (2008) (holding that "a 'class-of-one' theory of equal protection has no place in the public employment context").

191 *Id.*

192 *See* 15 U.S.C. §§ 80b-3, 80b-9.

193 *See* 17 CFR 201.5(b) ("After investigation or otherwise the Commission may in its discretion take one or more of the following actions: Institution of administrative proceedings . . . , initiation of injunctive proceedings in the courts, ...").

194 *United States v. Moore*, 543 F. 3d 891, 901 (7th Cir. 2008).

judiciary."[195] The same is true with respect to the Commission's choice of forum in pursuing a civil enforcement action for a violation of the securities laws.

Second, even if Respondents' class-of-one claim were cognizable, they fail to make the threshold showing that they have been "treated differently from others similarly situated."[196] Persons asserting a class-of-one claim "must show an extremely high degree of similarity between themselves and the persons to whom they compare themselves."[197] But Respondents allege only vaguely that the Commission "has brought cases, including cases against investment advisers in federal court," citing just one example of a case that "concerned violations of Advisers Act Sections 206(1&2)." The mere fact that another case involves the same provisions of the Advisers Act does not demonstrate that Respondents are being treated differently from others similarly situated for purposes of equal protection.[198]

Third, Respondents have failed to establish that "there is no rational basis for the difference in treatment."[199] Respondents speculate that the Commission's "motive is to disadvantage Respondents in their defense of this matter and to compel settlements," but there is no basis for this allegation. Nor do Respondents even attempt to substantiate their claim "by 'negativing every conceivable basis which might support' the government action."[200] And they could hardly do so, as a choice of venue made even "solely for reasons of administrative convenience" is within the bounds of prosecutorial discretion.[201] Here, for example, it was particularly rational to pursue this enforcement matter in the administrative forum because the proceedings involved a request for an associational bar; had the Commission pursued this action in district court in the first instance, a follow-on administrative proceeding would have been

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195 *Id.* at 900-01; *see also United States v. Green*, 654 F.3d 637, 650 (6th Cir. 2011) (rejecting a class-of-one claim premised on "government's decision to prosecute [the defendant] under MEJA in the civilian justice system while prosecuting his coconspirators under UCMJ in the military justice system").

196 *Olech*, 528 U.S. at 564.

197 *Clubside, Inc. v. Valentin*, 468 F.3d 144, 159 (2d Cir. 2006).

198 *See Chau v. SEC*, 72 F. Supp. 3d 417, 435 n.148 (S.D.N.Y. Dec. 11, 2014) ("This Court ... has serious doubts about whether plaintiffs' 'superficial comparisons' are sufficient to allege plausibly a 'class of one' claim, particularly as to the SEC's discretionary choice of the forum in which to bring charges.").

199 *Olech*, 528 U.S. at 564.

200 *Campbell v. Rainbow City*, 434 F.3d 1306, 1314 n.6 (11th Cir. 2006) (quoting *Warren v. City of Athens*, 411 F.3d 697, 711 (6th Cir. 2005)).

201 *Moore*, 543 F. 3d at 899.

necessary to consider the associational bar. By bringing this proceeding in the administrative forum in the first instance, an additional step in the final resolution of the claims was eliminated.

For the foregoing reasons, we reject Respondents' equal protection claim.

VI. Conclusion

For the reasons explained above, we find that Timbervest violated Sections 206(1) and 206(2) of the Advisers Act, and that the individual Respondents, acting with scienter, aided, abetted, and caused those violations.

An appropriate order will issue.[202]

By the Commission (Chair WHITE and Commissioners GALLAGHER, STEIN, and PIWOWAR); Commissioner AGUILAR not participating.

Brent J. Fields
Secretary

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

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[202] 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. Finally, any pending motions not expressly addressed in this opinion are denied as moot.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4197 / September 17, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31830 / September 17, 2015

Admin. Proc. File No. 3-15519

In the Matter of

TIMBERVEST, LLC,
JOEL BARTH SHAPIRO,
WALTER WILLIAM ANTHONY BODEN, III,
DONALD DAVID ZELL, JR., and
GORDON JONES II

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Joel Barth Shapiro, Walter William Anthony Boden, Donald David Zell, Jr., and Gordon Jones II be barred from association with any investment adviser; and it is further

ORDERED that Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Boden, Donald David Zell, Jr., and Gordon Jones II cease and desist from committing or causing any violations or future violations of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940; and it is further

ORDERED that Timbervest, LLC, Joel Barth Shapiro, Walter William Anthony Boden, Donald David Zell, Jr., and Gordon Jones II disgorge, jointly and severally, $403,500, plus prejudgment interest of $181,814.05, such prejudgment interest calculated beginning from November 1, 2006, with such interest continuing to accrue on all funds owed until they are paid, in accordance with Commission Rule of Practice 600.[1]

Payment of the amounts to be disgorged (and the prejudgment interest thereon) shall be (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to the Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South

[1] 17 C.F.R. 201.600.

MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding. A copy of the cover letter and instrument of payment shall be sent to the Commission's Division of Enforcement, directed to the attention of the counsel of record.

By the Commission (Chair WHITE and Commissioners GALLAGHER, STEIN, and PIWOWAR); Commissioner AGUILAR not participating.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **September 2015**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(147 DOCUMENTS)

2 of 2

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4198 / September 17, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31831 / September 17, 2015

Admin. Proc. File No. 3-15519

In the Matter of

TIMBERVEST, LLC,
JOEL BARTH SHAPIRO,
WALTER WILLIAM ANTHONY BODEN, III,
DONALD DAVID ZELL, JR., and
GORDON JONES II

ORDER STAYING REMEDIAL SANCTIONS

In light of the representations that Commission counsel made to the federal district court during the hearing for a motion for a preliminary injunction in connection with this administrative proceeding,[1] we have determined *sua sponte* that a stay of the sanctions imposed in this matter would be appropriate. The Commission has discretion to grant a stay of its final orders pending judicial review if it finds that "justice so requires."[2] We find that standard satisfied here.[3] Accordingly, it is

ORDERED that the sanctions imposed by the Commission in the Order Imposing Remedial Sanctions shall be stayed until the latter of (i) the expiration of the period for the Respondents to file a petition for review of the final order,[4] or (ii) if Respondents file a timely petition for review, then until the court of appeals issues its mandate.[5]

1 *See Timbervest, LLC v. SEC* (N.D. Ga. 1:15-cv-2106), Dkt. 25, at 29, n.11 (Aug. 4, 2015).

2 Section 705 of the Administrative Procedure Act provides that an agency may stay its own action pending judicial review when it finds that "justice so requires." 5 U.S.C. § 705.

3 We reach this finding without considering either Respondents' likelihood of litigation success or their potential harm in the absence of a stay.

4 *See* Advisers Act Section 213, 15 U.S.C. 80b-13.

Respondents to file a petition for review of the final order,[4] or (ii) if Respondents file a timely petition for review, then until the court of appeals issues its mandate.[5]

By the Commission (Chair WHITE and Commissioners GALLAGHER, STEIN, and PIWOWAR); Commissioner AGUILAR not participating.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

4 *See* Advisers Act Section 213, 15 U.S.C. 80b-13.

5 *See* FED. R. APP. P. 41. The "[i]ssuance of the mandate formally marks the end" of the court of appeals' jurisdiction over the matter. *N. California Power Agency v. Nuclear Regulatory Comm'n*, 393 F.3d 223, 224 (D.C. Cir. 2004) (quoting *Johnson v. Bechtel Assocs. Prof'l Corp.*, 801 F.2d 412, 415 (D.C. Cir. 1986) (per curiam)).

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9914 / September 17, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75941 / September 17, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31829 / September 17, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3697 / September 17, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16819

In the Matter of PHILIP A. PENDERGRAFT, KEVIN W. MCALEER, CPA, THOMAS R. JOHNSON, and CHARLES W. YANCEY, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C, 15(b), AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, 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 Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), against Philip A. Pendergraft, Exchange Act Sections 4C and 21C, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice against Kevin W. McAleer, CPA, Exchange Act Section 21C against Thomas R. Johnson, and Exchange Act Section 15(b) against Charles W. Yancey.

II.

In anticipation of the institution of these proceedings, 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, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C, 15(b), and 21C of the Securities Exchange Act of 1934, 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[1] that

A. Summary

1. These proceedings relate to approximately $100 million in failed margin loans made by now-defunct Penson Financial Services, Inc. ("PFSI")—which was once the second largest clearing broker-dealer in the U.S.—to certain of its customers. PFSI made the bulk of these margin loans between 1999 and 2008 to Christopher J. Hall and his affiliates, including a company named Call Now, Inc. ("Call Now"), who invested in risky, unrated municipal bonds. Hall was the Chairman of Call Now's board of directors, and in 2006 Call Now became a large shareholder of PFSI's publicly traded parent company, Penson Worldwide, Inc. ("PWI").

2. In the wake of the financial crisis of 2008, PFSI incurred significant losses on these margin loans to Hall and Call Now because their margin collateral had plummeted in value. A substantial portion of Hall and Call Now's margin collateral consisted of distressed municipal bonds related to a financially struggling horse racetrack in Texas operated by Call Now. Hall and Call Now failed to satisfy margin calls issued by PFSI because they did not have sufficient assets. Hall and Call Now's primary hope of satisfying PFSI's margin calls rested on speculation that a future change in Texas gambling laws would allow slot machines at Texas horse racetracks. Nevertheless, PFSI failed to liquidate these customers' collateral to satisfy their margin calls because doing so

[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.

would lock in large losses for PFSI and PWI (collectively "Penson"). Instead, in 2009 and 2010 Penson extended additional loans to these customers, hoping that they would survive financially and their collateral value would improve in the future so that Penson could reverse the losses on the margin loans. But these additional loans improperly increased Hall and Call Now's indebtedness to PFSI in violation of federal margin regulations, which are designed to prevent the excessive use of credit by broker-dealers.

3. Under the accounting standards governing public companies and broker-dealers, Penson should have recognized losses on the loans as early as 2009, but did not do so until nearly two years later. As a result, Penson failed to present its financial statements in SEC filings in conformity with accounting principles generally accepted in the U.S. ("GAAP"), for the annual periods ended December 31, 2009 and December 31, 2010, and with respect to PWI, the quarterly periods ended March 31, 2010 through June 30, 2011. In addition, Penson failed to adequately disclose the nature of the loans in SEC filings for the 2009 and 2010 annual periods in violation of applicable disclosure requirements.

4. PWI ultimately recorded more than $60 million in losses for these loans in 2011 and 2012. These losses and other disclosures about the loans beginning in 2011 contributed to a series of events resulting in PWI and PFSI's bankruptcies in 2013.

5. Respondent Philip A. Pendergraft, Penson's co-founder, Director and CEO of PWI, and an Executive Vice President ("EVP") of PFSI, managed Penson's loans to Hall, Call Now, and their related entities and exercised substantial control over certain key operations of PFSI. Pendergraft, along with Respondent Kevin W. McAleer (PWI's CFO), was responsible for the improper accounting treatment and disclosure of these loans in PWI and PFSI's filings with the Commission. Respondent Thomas R. Johnson, who was a Director of PWI, and a Director and the President/CEO of Call Now, was a cause of PWI's improper disclosures as he knew or should have known that these disclosures were materially misleading when he signed PWI's filings with the Commission. Finally, Respondent Charles W. Yancey, PFSI's President/CEO, failed reasonably to supervise Pendergraft, an EVP and associated person of PFSI, who managed PFSI's margin loans to Hall, Call Now, and their related entities, and directed PFSI's recordkeeping and financial reporting with respect to those loans for the relevant periods.

B. Respondents

6. **Philip A. Pendergraft**, age 56, is a resident of Arlington, Texas. Pendergraft was a co-founder, a Director, and the Chief Executive Officer of PWI, and an Executive Vice President and associated person of PFSI from May 1995 to July 2012. He held Series 3, 4, 7, 15, 24, 27, 53, and 63 licenses.

7. **Kevin W. McAleer, CPA**, age 64, is a resident of Frisco, Texas. McAleer was PWI's Chief Financial Officer from February 2006 to March 2012. McAleer has been a CPA since 1976 and currently is licensed as a CPA by the Texas Board of Accountancy.

8. **Thomas R. Johnson**, age 48, is a resident of Orleans, Massachusetts. Johnson was a Director of PWI from August 2003 to May 2011. Johnson also was a Director and the President/CEO of Call Now, Inc. from November 2001 to approximately November 2011. He held Series 7, 24, 52, and 63 licenses.

9. **Charles W. Yancey**, age 59, is a resident of Colleyville, Texas. He was PFSI's President and CEO from August 2005 to February 2012. Yancey currently is associated with a registered broker-dealer and holds Series 7, 24, 55, and 63 licenses.

C. <u>Other Relevant Entities</u>

10. **Penson Worldwide, Inc.** was a Delaware corporation with its principal place of business in Dallas, Texas, that provided clearing, execution, and other services to the securities brokerage industry through its subsidiaries. In October 2012, PWI filed Forms 25 and 15 voluntarily withdrawing its common stock from listing on the Nasdaq Global Market and terminating its registration under Exchange Act Sections 12(b) and 12(g). On January 11, 2013, PWI and its subsidiaries filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the District of Delaware.

11. **Penson Financial Services, Inc.** was a North Carolina corporation with its principal place of business in Dallas, Texas. PFSI was a wholly owned subsidiary of SAI Holdings, Inc. ("SAI"), which was a wholly owned subsidiary of PWI. From 2009 to 2011, PFSI was the second largest clearing broker-dealer in the U.S. based on the number of correspondents. PFSI was registered as a broker-dealer with the Commission from February 1990 to October 2012, when its filed Form BDW became effective. On January 11, 2013, PFSI filed for bankruptcy along with PWI.

12. **Christopher J. Hall**, age 56, was the Chairman and controlling shareholder of Call Now, Inc. for all relevant periods. Hall was a former CFO and financial operations principal of Howe, Solomon & Hall, Inc., which was registered as a broker-dealer with the Commission from June 1983 to February 2000.

13. **Call Now, Inc.** was a Nevada corporation with its principal place of business in the City of Selma, Texas. Call Now's primary business was the operation and management of the Retama Park horse racetrack owned by the Retama Development Corporation, a municipal corporation of Selma. Call Now's common stock was registered under Exchange Act Section 12(g) until August 1, 2014, when its registration was revoked by the Commission for failure to file periodic reports since the period ended June 30, 2011.

D. **Facts**

Background

14. PFSI was PWI's U.S.-based and largest clearing broker-dealer subsidiary. PFSI generated substantial interest income from its margin lending business—extending credit to correspondent broker-dealers and customers to purchase securities on margin collateralized by existing cash or securities in their margin accounts. PFSI's margin lending business was subject to, among other things, the margin regulations of the Board of Governors of the Federal Reserve System ("Federal Reserve Board") and the Financial Industry Regulatory Authority ("FINRA").[2] These margin regulations generally require a margin account to maintain minimum equity (maintenance margin) of at least 25% of the current market value of the marginable securities in the account. PFSI's internal margin policies also required a margin account to maintain a 25% minimum maintenance margin rate.

15. When the margin equity of a PFSI customer's margin account fell below the 25% minimum maintenance margin rate, PFSI's systems generated a maintenance margin call. PFSI's policies required its operations personnel to demand the customer to deposit the required cash or marginable securities into the account within three days to cure the margin deficiency. PFSI's customer margin account agreement required the customer promptly to pay, upon demand, any margin indebtedness or deficiency. If the customer failed to do so, PFSI typically liquidated securities or other assets from the customer's account to redress the margin deficiency. In some instances PFSI also obtained guarantees or other pledges of collateral from margin customers to address margin deficiencies. PFSI generally established an allowance for doubtful accounts and recognized a bad debt expense when the collateral, guarantees, or other rights were insufficient to cover potential losses on margin loans.

Penson's Relationship With Christopher J. Hall and Call Now, Inc.

16. From 1999 to 2008, PFSI extended substantial margin loans to Christopher J. Hall and his affiliates, who primarily invested in risky, unrated municipal bonds. By 2008, these margin loans were maintained in four accounts—Hall's personal account, The Hemisphere Trust ("Hemisphere," a Belize-based trust controlled by Hall), The Global Trust ("Global," another Belize-based trust purportedly cross-guaranteed by Hemisphere), and Call Now's account (controlled by Johnson) (collectively "Hall/Call Now" or the "Hall/Call Now accounts"). During this period, Pendergraft was PFSI's primary relationship manager for Hall/Call Now based on his prior business relationship with Hall.

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2 Exchange Act Section 7(c); Regulation T, 12 C.F.R. §§ 220.1 – 220.12; NASD Conduct Rule 2520 ("NASD Rule 2520"). NASD Rule 2520 was amended and superseded by FINRA Rule 4210 effective December 2, 2010.

17. One of the key investments in the Hall/Call Now accounts was in unrated municipal bonds issued by the Retama Development Corporation ("RDC"), which owned the Retama Park horse racetrack. The RDC had issued $93.9 million in two series of bonds since 1993 to build and fund Retama Park—$7 million of Series A bonds, secured by Retama Park's facilities, and $86.9 million in Series B revenue bonds ("Retama B Bonds") that paid interest only if Retama Park generated sufficient revenue. But Retama Park had struggled financially since it opened in 1995 and the RDC never paid interest on the Retama B Bonds. Retama Park's primary hope of making a profit was legislation in Texas that would allow expanded gambling, including slot machines, at Texas horse racetracks. Since Retama Park opened, however, every bill proposing such legislation had failed in the Texas Legislature.

18. Hall and his affiliates, including Call Now, owned the vast majority of the Retama B Bonds, held in their PFSI accounts, and other Retama Park related assets. Hall and Call Now's goal with these investments was to operate Retama Park and lobby the Texas Legislature to pass enhanced gambling legislation, which purportedly would cause the value of their Retama Park related assets to appreciate and be sold at a premium to a casino or other gaming company. To finance portions of this plan, Hall and Call Now withdrew cash from their PFSI margin accounts to make loans to the RDC, which repeatedly needed money to avoid defaulting on its debts and to pay its and Retama Park's operating expenses. Hall and Call Now also obtained substantial additional margin loans from PFSI for purchasing or carrying hundreds of unrated municipal bonds and other securities, and Call Now also withdrew cash from its margin account partially to fund its own operating expenses.

19. Also, at Penson's request in 2003, Hall and Johnson (on behalf of Call Now) agreed to have Call Now purchase $6.6 million of PWI's convertible notes by borrowing from Call Now's PFSI margin account to fund the purchase. At the time, PWI needed capital to grow its business, and Penson determined that a quick way to raise that capital was to have Call Now buy PWI's notes with a margin loan from PFSI. In exchange, PWI agreed to use its best efforts to appoint a nominee of Call Now to its Board of Directors, and Johnson thereafter was elected to PWI's Board in August 2003. In May 2006, PWI completed an initial public offering of its common stock, and Call Now converted its PWI notes to common stock to become PWI's fifth largest common stockholder. Call Now also became a related party of PWI due to Johnson's dual role as a PWI director and a Call Now director and officer.

20. The Hall/Call Now accounts were unusual at PFSI for at least the following reasons. First, they were direct customer accounts not associated with a correspondent broker, which was not common at PFSI. Second, the accounts obtained substantial margin loans to purchase or carry unrated municipal bonds, whereas PFSI generally made margin loans to customers to purchase equity securities. Finally, Pendergraft was the primary relationship manager for the Hall/Call Now accounts instead of PFSI's operations department, which was otherwise responsible for monitoring margin lending risk and enforcing margin requirements.

PFSI's Margin Loans to Hall/Call Now Were Troubled by 2009

21. By early 2008, the margin equity for Hall and Hemisphere's accounts had fallen below FINRA's and PFSI's 25% minimum maintenance margin rate for all customer margin accounts. Instead of issuing margin calls to Hall and Hemisphere per PFSI's policies, however, PFSI lowered the minimum maintenance margin rate for the unrated municipal bonds in Hall and Hemisphere's accounts from 25% to 7% (which corresponds to FINRA's minimum maintenance margin rate for municipal bonds) so that, in effect, no margin call would be issued to the customers.[3]

22. But during 2008, Hall and Hemisphere's unrated municipal bonds had further declined in value, causing their margin equity to fall below the 7% minimum maintenance margin rate. Pendergraft, throughout 2008, had demanded that Hall deposit additional collateral into Hall and Hemisphere's accounts, but Hall failed to deposit sufficient collateral to satisfy the accounts' margin deficiency. Although FINRA's margin rules and PFSI's policies required PFSI to obtain the required margin from Hall and Hemisphere within fifteen business days of the date the margin deficiency occurred, PFSI could not do so because Hall did not have sufficient assets.[4] PFSI also did not request FINRA to grant it additional time to obtain the required margin. PFSI decided not to liquidate the mostly unrated municipal bonds in Hall and Hemisphere's accounts because they could not be sold without locking in substantial losses for PFSI. Because the accounts' margin equity was below the minimum maintenance margin rate, PFSI was required to deduct Hall and Hemisphere's margin deficiency from its net capital in accordance with the Commission's net capital rule.[5] By December 31, 2008, PFSI had deducted $14.2 million, as "other deductions and/or charges" from its net capital for Hall and Hemisphere's margin deficiency.

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[3] NASD Rule 2520(e)(2)(B) required a minimum maintenance margin rate of 7% of the current market value of any positions in exempted securities, including municipal bonds. NASD Rule 2520(f)(1) also required that "[s]ubstantial additional margin must be required in all cases where the securities carried in 'long' or 'short' positions are subject to unusually rapid or violent changes in value, or do not have an active market on a national securities exchange, or where the amount carried is such that the position(s) cannot be liquidated promptly." PFSI's own policies required a minimum maintenance margin rate of the greater of 15% of the current market value, or 7% of face value, for investment grade municipal bonds.

[4] NASD Rule 2520(f)(6) required that "[t]he amount of margin or 'mark to market' required by any provision of this Rule shall be obtained as promptly as possible and in any event within fifteen days from the date such deficiency occurred, unless [the NASD or FINRA] has specifically granted the member additional time." PFSI's policies also stated that if a margin account's equity fell below the 25% maintenance rate, PFSI would "liquidate enough securities to bring the account back to a 25% maintenance rate."

[5] *See* Exchange Act Rule 15c3-1(c)(2).

23. By early 2009, PFSI's senior executives, including Yancey, became aware of irregularities with PFSI's margin loans to the Hall/Call Now accounts. Hall and Hemisphere's accounts repeatedly appeared on PFSI's exception and risk management reports that tracked large margin debts, outstanding margin calls, or negative equity (unsecured loan balances). Many PFSI senior executives were aware that the Hall/Call Now accounts held mostly unrated municipal bonds, which were distressed or in default, and PFSI generally did not extend margin loans on such collateral. The executives also knew that PFSI had taken net capital charges for Hall and Hemisphere's margin deficiency. But all of PFSI's executives, including Yancey, deferred to Pendergraft on the issues raised by these accounts. Pendergraft instructed PFSI executives, including Yancey, not to get involved with the Hall/Call Now accounts because he was managing them personally in consultation with certain members of PWI's Board. Pendergraft, as PFSI's co-founder and EVP, exercised substantial control over certain key PFSI operations, including computations of PFSI's net capital and management of the Hall/Call Now accounts. PFSI's senior executives generally did not challenge Pendergraft's authority or actions over those matters.

24. Of all the PFSI executives, only Yancey attempted to address the risks posed by PFSI's margin loans to Hall and Hemisphere. Other PFSI executives looked to Yancey to address those risks. Although Yancey reported to Pendergraft in Pendergraft's capacity as CEO of PWI, Yancey supervised Pendergraft in Pendergraft's capacity as an EVP and associated person of PFSI. By early 2009, Yancey became more aware of the Hall/Call Now accounts as Hall and Hemisphere's accounts became more distressed. Yancey was aware that the Hall/Call Now loan balances continued to increase, Hall and Hemisphere's accounts continued to appear on PFSI's negative equity reports, and PFSI deducted from its net capital increasing amounts of those accounts' margin deficiencies. Yancey told Pendergraft that PFSI should stop extending loans to the Hall/Call Now accounts and should liquidate their collateral. Yancey also denied requests for additional loans to those accounts. But Pendergraft rebuffed Yancey's efforts. Yancey routinely sought assurances from Pendergraft that the accounts were being properly managed. Pendergraft assured Yancey on numerous occasions that the accounts' collateral had substantial value and would recover in the future, and that Yancey should not worry about the accounts and instead focus on growing PFSI's business. Though Yancey repeatedly voiced his concerns about the loans to Pendergraft thereafter, Yancey did not take additional measures that reasonably would be expected to address Pendergraft's management of the Hall/Call Now accounts.

25. By early 2009, PFSI's operations personnel effectively ceased monitoring the Hall/Call Now accounts because of Pendergraft's control over them. Pendergraft also instructed PFSI's margins department to "abate" or close without any action any margin calls generated by PFSI's systems for the Hall/Call Now accounts as he would handle margin issues personally with Hall and Call Now.

<u>Penson Makes Another Loan to Hall in 2009 to Support His Account</u>

26. By March 2009, Hall's personal account had a negative equity balance of $9 million. Hall also had unmet margin calls in the amount of $15.8 million. At Pendergraft's demand, Hall agreed to pledge to Penson his controlling interest of 1.5 million restricted shares of

Call Now as additional collateral, but told Pendergraft that he needed to borrow $3.7 million to pay off purportedly existing liens on the shares. Pendergraft agreed to have Penson lend Hall the money to do so.

27. In exchange for Hall's pledge of 1.5 million Call Now shares to Penson, Pendergraft, after discussions with certain PWI directors and officers, arranged for a loan to Hall from SAI (PWI's subsidiary that owned PFSI) via promissory notes and stock pledge agreements effective June 2009 ("SAI loan"). The SAI loan to Hall was payable on demand, like a margin loan, and charged an interest rate of 7.45%, which PFSI had charged on margin loans. Pendergraft directed PFSI to wire the loan proceeds from PFSI's bank accounts to a trust account of Hall's lawyer in Florida, per Hall's wiring instructions. After the PFSI wires were received by the trust account, Hall delivered the Call Now stock certificates to PFSI. PFSI then deposited the shares into Hall's margin account, thereby reversing the account's negative balance of $9 million to a positive balance by July 2009.

28. This SAI loan to Hall was made in contravention of Regulation T, which prohibits the withdrawal of cash from any margin account that creates or increases a margin deficiency, and PFSI's own policies, which prohibited the withdrawal of any cash from a margin account that was subject to a maintenance margin call.[6] The SAI loan was effectively a margin loan as it was a demand loan that charged PFSI's margin loan interest rate, funded by PFSI, and collateralized by Hall's Call Now shares. Although the value of Hall's Call Now shares deposited into his PFSI margin account supposedly restored the account to a positive balance, the shares were non-marginable, and had no effect on his account's existing margin deficiency. Because the SAI loan was effectively a margin loan, however, the loan actually had the effect of increasing Hall's account's margin deficiency by $3.7 million. Most PFSI executives, including Yancey, were not aware of the SAI loan when it was made.

29. By June 2009, Penson's loans to Hall/Call Now reached $89 million as unpaid loan interest continued to accrue and Call Now withdrew cash from its margin account to fund Retama Park and its own operating expenses, including portions of Hall and Johnson's Call Now salaries. Hall and Hemisphere's margin accounts continued to be subject to daily margin calls that Hall had failed to meet since 2008. Though Penson and Hall had hoped that the 2009 session of the Texas Legislature (which meets every odd-numbered year) would result in enhanced gambling legislation, bills proposing such legislation failed to reach a floor vote before the session adjourned in June 2009.

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[6] Regulation T, 12 C.F.R. § 220.4(e)(1)(ii), permits the withdrawal of cash or securities from an account except if "[t]he withdrawal, together with other transactions, deposits, and withdrawals on the same day, would create or increase a margin deficiency."

FINRA Instructs PFSI to Take a 100% Haircut to Net Capital for the Retama B Bonds

30. During the summer of 2009, FINRA's exam staff conducted a cycle examination of PFSI, and found that PFSI failed to comply with FINRA's margin rules because the Retama B Bonds owned by Hall/Call Now were not marginable securities. The FINRA exam staff reached this conclusion because the Retama B Bonds were unrated, did not have an active market, and had deferred on interest payments. After discussions with PFSI's executives and outside counsel, the FINRA exam staff instructed PFSI to apply a 100% margin maintenance rate or "haircut" to its net capital for the value of the bonds, issue margin calls to the account holders, and submit a plan of liquidation of the collateral. The FINRA exam staff reviewed these conclusions in an exit meeting with all senior PFSI executives in October 2009.

31. PFSI eventually agreed to treat the bonds as non-marginable, and applied a 100% haircut for their value, resulting in an additional $20 million deduction to PFSI's net capital. This was on top of the nearly $20 million in net capital charges PFSI was already taking for Hall and Hemisphere's margin deficiency. By September 30, 2009, PFSI had deducted approximately $40 million from its net capital for the Hall/Call Now accounts' margin deficiency, and reported net capital of $92 million. Though PFSI did not violate minimum net capital requirements, its margin loans to the Hall/Call Now accounts had substantially reduced its net capital.

32. On September 24, 2009, pursuant to FINRA's instructions, PFSI also sent maintenance margin call letters to Hemisphere, Global, and Call Now. The letters stated that, based on FINRA's determination that the Retama B Bonds in their accounts were not marginable, Hemisphere, Global, and Call Now needed to deposit in their accounts additional margin in the amounts of $8.25 million, $2.7 million, and $5.3 million, respectively, by September 30, 2009. Hemisphere, Global, and Call Now failed to deposit any margin in response to these margin calls.

Penson "Restructures" Hall and Call Now's Debts to Support Their Accounts

33. By yearend 2009, Penson's loans to the Hall/Call Now accounts totaled $91 million and became severely distressed due to further declines in collateral value and unpaid interest. Hall and Hemisphere's accounts had become unsecured by more than $26 million. Margin calls on all four of the Hall/Call Now accounts remained unpaid for months as the customers lacked "the wherewithal" to pay. PFSI's net capital charges for those unpaid margin calls had soared to $56 million, compared with PFSI's reported net capital of $95 million at yearend 2009. Penson did not liquidate or foreclose on the accounts' illiquid collateral because liquidation would result in significant losses to Penson, and foreclosure would result in the impractical outcome of Penson controlling Call Now and Retama Park's operations. Penson concluded that the only viable option was to restructure Hall/Call Now's debts to obtain as much collateral as possible.

34. In February 2010, Pendergraft, after months of negotiations with Hall and Johnson (on behalf of Call Now), devised a complex transaction ("restructuring transaction") involving Penson, Hall, and Call Now. The purpose of the transaction was to obtain as much collateral as possible to reduce the unsecured portion of Hall's margin loan, which was $15.7 million at yearend

2009. Because Call Now's collateral (which included PWI stock) was relatively more liquid than Hall's, Penson demanded that Call Now transfer approximately $10 million in additional equity in cash and other assets to Hall by buying Hall's illiquid collateral, including certain unrated municipal bonds and an additional 721,463 Call Now shares.

35. Because Call Now did not have enough cash or liquid assets to finance this transaction, Penson again authorized the use of PFSI's capital, like the SAI loan, to make an improper loan to Call Now. PWI "converted" Call Now's $13.9 million outstanding margin loan at PFSI into a two-year promissory note in favor of PWI, effectively transferring the debt from Call Now's margin account and PFSI's books to PWI. This promissory note, which was collateralized in part by all of the securities in Call Now's margin account, ostensibly reset Call Now's margin debt to zero and allowed it to borrow on margin again from its PFSI margin account. Then, against part of the same collateral securing Call Now's promissory note, Pendergraft directed PFSI to extend another $5.5 million in margin loans to Call Now so that it could use those proceeds to buy Hall's illiquid collateral. While this transaction increased the equity in Hall's account by approximately $10 million, Call Now's overall indebtedness to Penson also increased from $13.9 million to $19.4 million as a result of this transaction.

36. Indirectly related to this transaction, Pendergraft directed PFSI to extend another $500,000 margin loan to Call Now and another $1 million margin loan to Hall in February and April 2010, respectively, when Call Now and Hall's accounts were subject to unmet margin calls. Call Now used the $500,000 to fund its investment and operating expenses for 2010, including portions of Hall's and Johnson's $200,000 annual Call Now salaries. Hall loaned the $1 million to the RDC for its and Retama Park's operating expenses.

37. These extensions of credit, like the SAI loan, were in contravention of Regulation T and PFSI's policies.

FINRA Finds That PFSI Lacked Sufficient Internal Controls on the Hall/Call Now Loans

38. In the summer of 2010, the FINRA exam staff conducted a cycle examination of PFSI. The FINRA exam staff concluded that PFSI did not have sufficient controls over its extension of credit to the Hall/Call Now accounts because the loans continued to be collateralized by unrated municipal bonds lacking an active market. The FINRA exam staff instructed PFSI to take a further $15.4 million deduction to its net capital for additional concentrated positions of unrated municipal bonds collateralizing the loans. The FINRA exam staff also concluded that Pendergraft's control over the Hall/Call Now accounts resulted in PFSI's failure to consider or identify risk factors such as the marketability and concentration of the collateral, liquidity risk, and the customers' creditworthiness. By not adequately considering these risk factors, the FINRA exam staff concluded, PFSI failed to supervise these credit extensions and materially impaired its net capital. The FINRA exam staff reviewed these conclusions at an exit meeting with all senior PFSI executives in October 2010.

39. By yearend 2010, Yancey knew or had reason to know that Pendergraft approved loans to Hall/Call Now in 2009 and 2010 that contravened Regulation T and PFSI's own policies and internal controls. Yancey knew that Pendergraft directed PFSI's associated persons not to record losses on the Hall/Call Now loans in PFSI's books and records and financial statements because Pendergraft had assured Yancey that he and other PWI executives had determined that the loans were collectable, following discussions with PWI's Board and auditor. But Yancey told Pendergraft that he doubted whether the Hall/Call Now loans were fully collectable because the loan balances continued to grow from 2009 to 2010, and because PFSI continued to take large deductions to its net capital for the Hall/Call Now loans since September 2009. Although Yancey continued to voice concerns to Pendergraft about extending additional credit to Hall/Call Now and advocated to liquidate their collateral to minimize losses for PFSI, Yancey failed to take additional measures that reasonably would be expected to prevent and detect Pendergraft's actions resulting in PFSI extending credit in contravention of Regulation T, and resulting in PFSI's failure to accurately record losses in its ledgers and to file its financial statements in conformity with GAAP.

Penson's Improper Accounting of the Hall/Call Now Loans in its 2009 Yearend Filings

40. PWI and PFSI were required under GAAP to evaluate whether the Hall/Call Now loans were impaired. Impairment is required to be recognized when information available before the financial statements are issued indicate that it is "probable" that the creditor will be unable to collect all amounts due, including principal and interest, in accordance with the loan's contractual terms.[7] PWI and PFSI were also required, under GAAP, to measure and recognize in their financial statements the amount of impairment losses associated with such loans, and to disclose the amount of the impaired loans and loans that were more than ninety days past due and still accruing.[8] These financial statements were included in PWI's Forms 10-K and 10-Q, and PFSI's annual audited reports filed with the Commission.

41. PWI and PFSI's accounting policies claimed that they "did not lend money to customers or correspondents except on a fully collateralized basis." Those policies also required PWI and PFSI to record a bad debt expense and an allowance for doubtful accounts if a margin customer's collateral value, guarantees, or other rights granted were insufficient to cover any potential losses.

42. At yearend 2009, Hall/Call Now collectively owed Penson $91 million, and were subject to margin calls for $56 million. Hall, Hemisphere, Global, and Call Now were required under their PFSI customer margin account agreements promptly to pay any indebtedness or deficiency upon demand from PFSI. Each of these four customers failed to meet PFSI's demands for payment by September 30, 2009.

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7 Financial Accounting Standards Board Accounting Standards Codification ("ASC") Topic 310-10-35-16.

8 ASC 310-10-35-22 & 310-10-50-7.

43. Nonetheless, PWI and PFSI, at Pendergraft and McAleer's direction, concluded that the Hall/Call Now loans were fully collectable and not impaired because they expected, without adequate basis, that (a) the real estate market would recover in 2010, or (b) the Texas Legislature likely would pass enhanced gambling legislation in 2011, either of which would cause the Hall/Call Now accounts' collateral value to improve and, at some point in the future, allow the customers to pay back their loans. For the same reasons, PWI and PFSI concluded that loss recognition and the establishment of an allowance for doubtful accounts for the Hall/Call Now loans was not necessary. PWI's Audit Committee and auditor concurred with these conclusions.

44. But these conclusions did not comply with GAAP. Because the Hall/Call Now accounts failed to meet their outstanding margin calls upon demand, it was at least probable at yearend 2009 that PWI and PFSI would be unable to collect all amounts due in accordance with the contractual terms of the margin loans. Neither the possible recovery of the real estate market, the possible enactment of gambling legislation, nor the additional collateral pledged in the restructuring transaction affected PWI and PFSI's inability to collect all amounts when due from the customers at yearend 2009. Further, PWI and PFSI failed to record a bad debt expense for the Hall/Call Now loans, or even to disclose that the loans were past due for more than ninety days and still accruing.

45. As a result, PWI and PFSI failed to properly identify the loans to Hall/Call Now as impaired, and to measure and recognize the amount of impairment in conformity with GAAP. Had PWI and PFSI properly identified the loans as impaired and measured the amount of impairment according to their own internal policies, they would have recorded a loss in the amount of approximately $19 million for the period ended December 31, 2009. Such a loss would have been material to PWI and PFSI's net income of $16 million and $35.3 million, respectively, for the same period. By failing to recognize this impairment charge, PWI and PFSI's financial statements, included in PWI's 2009 Form 10-K and PFSI's 2009 annual audited report, were not presented in conformity with GAAP, and were materially misstated and inaccurate for the period ended December 31, 2009. Because PWI's 2009 Form 10-K was incorporated by reference in the offering memorandum for PWI's April 2010 unregistered offering of $200 million in Senior Second Lien Secured Notes Due 2017 ("2010 Offering Memorandum"), PWI's 2010 Offering Memorandum also was materially misstated.

<u>Penson's Misleading Related Party Disclosures in Yearend 2009 Filings</u>

46. Under Item 404(a) of Regulation S-K, PWI was required to disclose any transaction in which PWI was a participant and the amount involved exceeded $120,000, and in which any related person of PWI had a direct or indirect material interest. Item 404(a) also required PWI to disclose any other information regarding the transaction or the related person in the context of the transaction that is material to investors in light of the circumstances of the particular transaction. Similarly, GAAP required PWI and PFSI to disclose material related party transactions, including the nature of the relationship involved, a description of the transactions, and such other information

deemed necessary to an understanding of the effects of the transactions on their financial statements.[9]

47. PWI's 2009 Form 10-K included the following disclosure in a note to the financial statements about the February 2010 Hall/Call Now restructuring transaction:

> Over the past several years, the Company has, through PFSI, its U.S. securities clearing broker-dealer subsidiary, extended margin credit to Call Now, among other of the Company's related parties. Such credit has been extended in the ordinary course of business, on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unaffiliated third parties and had not involved more than normal risk of collectability or presented other unfavorable features.
>
> The Company's management recently determined that certain municipal bonds underlying Call Now's margin position had suffered reduced liquidity, and began working with Call Now to restructure the margin loan. As part of the restructuring, on February 25, 2010, Call Now converted $[13,922,000] of its outstanding margin loan into a Promissory Note in favor of the Company accumulating interest at a rate of 10% per year. The Company's management currently believes that all amounts due under the Promissory Note will be collected pursuant to the terms of the Promissory Note. . . . Mr. Thomas Johnson has no interest in the Call Now margin account or the Promissory Note, except to the extent of his approximately 3.2% ownership interest in Call Now. Mr. Johnson abstained from voting on all matters on behalf of the Company.

48. This disclosure did not comply with GAAP and was materially misleading in numerous ways. First, it failed to disclose that the true purpose of the transaction was to obtain as much collateral as possible for Hall's unsecured debt. Second, it failed to disclose that Call Now had failed to pay margin calls issued by PFSI because it determined, at FINRA's instruction, that the Retama B Bonds held by Call Now were not marginable collateral. Third, the loans to Call Now were not made in the ordinary course—Call Now received favorable treatment from Penson because it was a related party. Fourth, it omitted the fact that Penson premised collectability of the loan on speculation as to the recovery of the real estate market and gambling legislation. Finally, it omitted the fact that Johnson, on behalf of Call Now, had obtained loans from PFSI to Call Now to fund its operating expenses, including portions of his and Hall's annual $200,000 salaries.

49. These materially misleading disclosures were also substantially included in PFSI's 2009 annual audited report, and PWI's 2010 definitive Proxy Statement on Schedule 14A, which was used to solicit votes to reelect Pendergraft and Johnson as PWI Directors through 2013. The disclosures also were incorporated by reference in PWI's April 2010 Offering Memorandum. As a result, PFSI's 2009 annual audited report, and PWI's 2010 Schedule 14A and April 2010 Offering Memorandum also contained materially misleading disclosures and were inaccurate.

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[9] ASC 850-10-50.

Penson's Accounting and Disclosure Errors in 2010

50. In PWI's quarterly reports on Forms 10-Q for the periods ended from March 31, 2010 to September 30, 2010, PWI continued to fail to identify the Hall/Call Now loans as impaired and to measure and recognize impairment losses on those loans. PWI also continued to fail to disclose the amount of loans over ninety days past due and still accruing. As a result, PWI's quarterly financial statements for these periods were not presented in conformity with GAAP and were materially misstated.

51. By yearend 2010, Penson's loans to Hall/Call Now had reached $95 million, and the customers continued to fail to meet outstanding margin calls. The real estate market did not recover in 2010 to improve the collateral value underlying the loans. The possibility of gambling legislation in 2011 was Penson's main hope for collecting on the loans.

52. Penson placed Hall and Hemisphere's loans on nonaccrual status and ceased to accrue interest on them beginning in March 2010. Effective January 1, 2011, Penson placed all of the Hall/Call Now loans on nonaccrual status and ceased to accrue interest on them, indicating that Penson no longer believed that it would collect all amounts due under the terms of the loan agreements with these customers.

53. In its 2010 Form 10-K, PWI disclosed that it had $97.4 million in loans or receivables "primarily from customers and correspondents" for which interest income was recorded when received. PWI did not disclose that the vast majority of these receivables were the $95 million in loans to Hall/Call Now, who were direct customers of PFSI not introduced through a correspondent broker-dealer. Even though Penson ceased to accrue interest on the Hall/Call Now loans, Penson continued to treat the loans as fully collectable. PFSI's 2010 annual audited report did not make any disclosures about these loans being placed on nonaccrual status.

54. As a result, PWI and PFSI failed to properly identify the loans to Hall/Call Now as impaired, and to measure and recognize the amount of impairment of the loans as required by GAAP. Had PWI and PFSI properly identified the loans as being impaired and measured the amount of impairment according to their own internal policies, they would have recorded cumulative losses of at least $18 million for the period ended December 31, 2010. This amount would have been material to both PWI's reported net loss of $19.8 million and PFSI's reported net income of $23.6 million for the same period. By failing properly to account for and adequately to disclose the nature of the Hall/Call Now loans, PWI and PFSI's financial statements, included in PWI's 2010 Form 10-K and PFSI's 2010 annual audited report, were not presented in conformity with GAAP and were materially misstated and inaccurate for the period ended December 31, 2010.

55. PWI's 2010 Form 10-K, PWI's 2011 definitive Proxy Statement on Schedule 14A, and PFSI's 2010 annual audited report contained essentially the same related party disclosure about the Call Now loan as in their respective 2009 Form 10-K, 2010 Schedule 14A, and 2009 annual audited report. For the reasons described above in connection with the disclosures in PWI's

2009 Form 10-K, PWI's 2010 Form 10-K and Schedule 14A, and PFSI's 2010 annual audited report were materially misleading and inaccurate.

PWI's Accounting Errors in its 2011 Quarterly Reports

56. In its Form 10-Q for the period ended March 31, 2011, PWI again failed to identify and measure any impairment on the loans to Hall/Call Now as required by GAAP. Had PWI done so, it would have recorded cumulative losses totaling at least $20 million for the period.

57. But PWI did, in its Form 10-Q, disclose that it had approximately $97 million in "Nonaccrual Receivables" —almost entirely the Hall/Call Now loans—of which approximately $43 million were collateralized by RDC bonds and related assets. The Form 10-Q further disclosed that, should expanded gambling legislation not be enacted in 2011, it is possible that the collateral underlying the receivables might be impaired, resulting in a write down of a portion of the receivables that could be material in amount. The Form 10-Q, however, failed to disclose the nature of the remaining $54 million in Nonaccrual Receivables and whether they were adequately collateralized. Nevertheless, three days after this Form 10-Q was filed, PWI's stock price had dropped by approximately 40%, and Johnson resigned as a Director of PWI.

58. Three months later, in its Form 10-Q for the period ended June 30, 2011, PWI finally disclosed that the carrying value of the Nonaccrual Receivables collateralized by the RDC bonds and related assets were not fully collectable and recorded an impairment charge of $43 million—PWI's biggest losses ever. However, PWI should have recognized in prior periods at least $20 million of impairment losses on the Hall/Call Now loans. PWI disclosed that one factor underlying the decision to record an impairment charge was the Texas Legislature's adjournment in June 2011 without passing enhanced gambling legislation. PWI also began to foreclose on certain collateral underlying the Hall/Call Now accounts. PWI ultimately recorded approximately $60 million in losses on these loans by the first quarter of 2012.

59. Pendergraft, McAleer, and Johnson each signed PWI's annual reports on Forms 10-K for the periods ended December 31, 2009, and December 31, 2010. Pendergraft and McAleer also signed PWI's quarterly reports on Forms 10-Q for the periods ended from March 31, 2010 to June 30, 2011, and certified each periodic report identified above.

Penson's Demise

60. In PWI's August 5, 2011 earnings conference call, Pendergraft admitted that the company had made mistakes in extending credit to Hall/Call Now: "Our mistake—really a couple of mistakes here—one was not bringing these accounts into line with our new policies and procedures [on credit extension]. And second—was not just going out and liquidating the accounts when we [began] to see illiquidity in the underlying assets."

61. PWI's disclosures and impairment of the loans to Hall/Call Now in 2011 contributed to a series of events that ultimately led to Penson's demise in 2013. In 2011, PWI's

clearing businesses were already experiencing lower trading commissions and interest revenues due to the weak global economy and market volatility. The losses on the loans to Hall/Call Now in 2011 seriously undermined confidence in PWI's ability to operate as a going concern. PWI's creditors restricted credit lines that were vital to its operations, correspondents and customers ceased doing business with PFSI, and investors sold millions of PWI shares at depressed prices. These events caused a liquidity crisis that prohibited PWI from servicing or restructuring more than $260 million in outstanding debts. As a result, PWI was forced to sell its clearing broker-dealer subsidiaries, including PFSI's clearing business, and file for bankruptcy protection in 2013.

E. Violations

62. Securities Act Section 17(a)(2) prohibits any person from obtaining money or property in the offer or sale of securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Securities Act Section 17(a)(3) prohibits any person from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities.

63. Exchange Act Section 7(c) prohibits a broker or dealer, directly or indirectly, from extending or maintaining credit or arranging for the extension or maintenance of credit to or for any customer in violation of rules and regulations prescribed by the Federal Reserve Board. Regulation T, prescribed under Section 7(c), prohibits, among other things, the withdrawal of cash or securities from a margin account that creates or increases a margin deficiency. 12 C.F.R. § 220.4(e)(1)(ii).

64. Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 require every issuer of a security registered pursuant to Exchange Act Section 12 to file with the Commission annual and quarterly reports as the Commission may require. Rule 13a-14 mandates, among other things, that an issuer's principal executive and financial officers certify each periodic report. Rule 12b-20 requires that the issuer's filings contain such further material information as may be necessary to make the required statements, in the light of the circumstances under which they were made, not misleading.

65. Exchange Act Section 13(b)(2)(A) requires issuers to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets. Section 13(b)(2)(B) requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded to permit the preparation of financial statements in conformity with GAAP. Section 13(b)(5) prohibits any person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, and from knowingly falsifying any book, record, or account under Section 13(b)(2). Rule 13b2-1 prohibits any person from directly or indirectly falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A).

66. Exchange Act Section 14(a) requires issuers that solicit any proxy or consent or authorization in connection with any security registered pursuant to Section 12 of the Exchange Act (other than an exempted security) to comply with such rules as the Commission may promulgate. Rule 14a-9 prohibits the use of proxy statements containing materially false or misleading statements or materially misleading omissions.

67. Exchange Act Section 15(b)(4)(E) requires a broker or dealer reasonably to supervise, with a view to preventing violations of the federal securities laws, another person who commits such violation, if such other person is subject to its supervision. Exchange Act 15(b)(6) incorporates by reference Section 15(b)(4)(E) and allows for the imposition of sanctions against persons associated with a broker or dealer for failing reasonably to supervise.

68. Exchange Act Section 17(a) requires each broker-dealer to make and keep records and make and disseminate such reports as the Commission may prescribe. Rule 17a-3(a)(2) requires broker-dealers to maintain ledgers reflecting assets and liabilities, income and expense and capital accounts. Exchange Act Section 17(e) and Rule 17a-5 require broker-dealers to file with the Commission annual audited reports containing, among other things, financial statements prepared in conformity with GAAP. The records and reports required by these rules must be accurate.

69. Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) of the Commission's Rules of Practice provide, in pertinent part, that "[t]he Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . [t]o have willfully violated . . . any provision of the Federal securities laws or the rules and regulations thereunder." 17 C.F.R. § 201.102(e)(1)(iii).

70. As a result of the conduct described above, Pendergraft willfully[10] violated Securities Act Sections 17(a)(2) and 17(a)(3), Exchange Act Section 13(b)(5), and Exchange Act Rules 13a-14 and 13b2-1. Pendergraft also willfully aided and abetted and caused PWI's violations of Exchange Act Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a), and Rules 12b-20, 13a-1,13a-13, and 14a-9. Pendergraft also willfully aided and abetted and caused PFSI's violations of Exchange Act Sections 7(c), 17(a), and 17(e), Exchange Act Rules 17a-3(a)(2) and 17a-5, and Regulation T.

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[10] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. S.E.C.*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. S.E.C.*, 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. S.E.C.*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

71. As a result of the conduct described above, McAleer willfully[11] violated Exchange Act Section 13(b)(5), and Rules 13a-14 and 13b2-1 within the meaning of Section 4C(a)(3) and Rule 102(e)(1)(iii). McAleer also caused PWI's violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B), and Rules 12b-20, 13a-1, and 13a-13.

72. As a result of the conduct described above, Johnson caused PWI's violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 14(a), and Rules 12b-20, 13a-1, and 14a-9.

73. As a result of the conduct described above, Yancey failed reasonably to supervise Pendergraft, an associated person of PFSI, within the meaning of Exchange Act Section 15(b)(6), incorporating by reference Section 15(b)(4)(E), with a view to preventing and detecting Pendergraft's aiding and abetting and causing PFSI's violations of Exchange Act Sections 7(c), 17(a), and 17(e), Exchange Act Rules 17a-3(a)(2) and 17a-5, and Regulation T.

F. <u>Undertakings</u>

74. Respondents Pendergraft, McAleer, Johnson, and Yancey have undertaken to cooperate fully with the Commission in any and all investigations, litigation, administrative or other proceedings commenced by the Commission or to which the Commission is a party relating to or arising from the matters described in the Order. In connection with such investigations, litigation, administrative or other proceedings, Respondents agree to the following: (i) to produce, without service of a notice or subpoena, any and all documents and other materials and information as reasonably requested by the Commission; (ii) to appear and testify without service of a notice or subpoena in such investigations, interviews, depositions, hearings and trials, at such times and places as reasonably requested by the Commission; and (iii) to respond promptly to all inquiries from the Commission. Respondent Yancey also has undertaken to provide to the Commission, within fifteen (15) days after the end of the six-month suspension period described below, an affidavit that he has complied fully with the sanctions applicable to him described in Section IV below.

IV.

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

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

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[11] *See id.*

A. Philip A. Pendergraft

1. Respondent Pendergraft shall cease and desist from committing or causing any violations and any future violations of Securities Act Sections 17(a)(2) and 17(a)(3), and Exchange Act Sections 7(c), 13(a), 13(b)(2)(A), 13(b)(2)(B), 13(b)(5), 14(a), 17(a), and 17(e), Exchange Act Rules 12b-20, 13a-1, 13a-13, 13a-14, 13b2-1, 14a-9, 17a-3(a)(2), and 17a-5, and Regulation T.

2. Pendergraft 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. 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

c. 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.

3. Any reapplication for association by Pendergraft 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 Pendergraft, 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.

4. Pendergraft shall pay a civil money penalty in the amount of $100,000 to the Commission. Payment shall be made in $20,000 installments within 15, 90, 180, 270, and 360 days of the date of entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments must be made as set forth in paragraph E below.

5. Pendergraft shall comply with the undertaking in Section III, paragraph 74, above.

B. Kevin W. McAleer

1. Respondent McAleer shall cease and desist from committing or causing any violations and any future violations of Exchange Act Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5), and Exchange Act Rules 12b-20, 13a-1, 13a-13, 13a-14, and 13b2-1.

2. McAleer is denied the privilege of appearing or practicing before the Commission as an accountant.

3. After one year from the date of this Order, McAleer 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:

a. 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 McAleer'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

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

1) McAleer, 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;

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

3) McAleer 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

4) McAleer 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.

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

5. McAleer shall pay a civil money penalty in the amount of $25,000 to the Commission. Payments shall be made in $5,000 installments within 15, 90, 180, 270, and 360 days of the date of entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments must be made as set forth in paragraph E below.

6. McAleer shall comply with the undertaking in Section III, paragraph 74, above.

C. Thomas R. Johnson

1. Respondent Johnson shall cease and desist from committing or causing any violations and any future violations of Exchange Act Section 13(a), 13(b)(2)(A), 14(a), and Exchange Act Rules 12b-20, 13a-1, and 14a-9.

2. Johnson shall pay a civil money penalty in the amount of $25,000 to the Commission. Payment shall be made in $5,000 installments within 15, 90, 180, 270, and 360 days of the date of entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments must be made as set forth in paragraph E below.

3. Johnson shall comply with the undertaking in Section III, paragraph 74, above.

D. Charles W. Yancey

1. Respondent Yancey be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of six (6) months, effective on the date of entry of this Order.

2. Yancey, shall, within fifteen (15) days of the entry of this Order, pay a civil money penalty in the amount of $25,000 to the Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made as set forth in paragraph E below.

3. Yancey shall comply with the undertakings in Section III, paragraph 74, above.

E. Respondents may make payments in the following ways:

1. By transmitting payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

2. By making direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

3. 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

4. Payments by check or money order must be accompanied by a cover letter identifying each payor by name as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

F. The Commission will hold funds paid pursuant to this Section in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to 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 pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, 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, 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 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

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. 9916 / September 18, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75946 / September 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16339

In the Matter of **JOHN BRINER, ESQ.,** **DIANE DALMY, ESQ.,** **DE JOYA GRIFFITH, LLC,** **ARTHUR DE JOYA, CPA,** **JASON GRIFFITH, CPA,** **CHRIS WHETMAN, CPA,** **PHILIP ZHANG, CPA,** **M&K CPAS, PLLC,** **MATT MANIS, CPA,** **JON RIDENOUR, CPA, and** **BEN ORTEGO, 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 SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934 AND INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS, AND IMPOSING SANCTIONS, PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, AS TO JOHN BRINER, ESQ.**

I.

On January 15, 2015, the Securities and Exchange Commission ("Commission") deeming it appropriate and in the public interest, instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against John Briner, Esq. ("Briner" or "Respondent"). On May 20, 2015, the administrative law judge presiding over this proceeding determined that Briner is in default for failing to defend the proceeding. Further, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Briner pursuant to Rule 102(e)(3)(i)(B) of the Commission's

Rules of Practice.[1]

II.

Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b)(6) of the Securities Exchange Act of 1934 and Instituting Public Administrative Proceedings, and Imposing Sanctions, Pursuant to Rule 102(e) of the Commission's Rules of Practice, as to John Briner, Esq. (the "Order"), as set forth below.

III.

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

A. **RESPONDENT**

1. **Briner**, 38, is an attorney and a Canadian citizen who resides in Vancouver, British Columbia. Briner's law firm was MetroWest Law Corporation ("MetroWest"). Briner created twenty issuers (identified below) and caused each of them to file Form S-1 registration statements for the sale of stock to the public. Briner also controlled Jervis Explorations Inc. ("Jervis"), a British Columbia corporation. In 2010, to resolve a prior unrelated Commission action against him alleging a pump-and-dump and market manipulation scheme, Briner consented to the entry of a federal court judgment that enjoined him from violating the antifraud and securities registration provisions of the federal securities laws; barred him for five years from participating in penny stock offerings; and ordered him to disgorge ill-gotten gains of $52,488.32 plus prejudgment interest and pay a civil penalty of $25,000. SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB). The Commission subsequently suspended Briner from appearing or practicing before it as an attorney, with a right to apply for reinstatement after five years. John Briner, Exchange Act Release No. 63371, 2010 WL 4783445 (Nov. 24, 2010).

B. **OTHER RELEVANT ENTITIES**

2. **Jervis** is a British Columbia corporation whose sole director is Briner. Jervis purportedly sold certain British Columbia mineral claims to each of the issuers.

3. **De Joya Griffith, LLC** ("De Joya") is a registered public accounting firm based in Henderson, Nevada. De Joya issued audit reports for nine of the twenty issuers.

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

> The Commission ... may . . . temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: . . . found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

4. **M&K CPAS, PLLC** ("M&K") is a registered public accounting firm based in Houston, Texas. M&K issued audit reports for eleven of the twenty issuers.

5. **La Paz Mining Corp.** ("La Paz") is a Nevada corporation organized in November 2011. Its Form S-1 states that it has its principal offices in Peoria, Arizona.

6. **Tuba City Gold Corp.** ("Tuba City") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Dundas, Ontario, Canada.

7. **Braxton Resources Inc.** ("Braxton") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Peoria, Arizona.

8. **Clearpoint Resources Inc.** ("Clearpoint") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Peoria, Arizona.

9. **Gold Camp Explorations Inc.** ("Goldcamp") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in St. Alberta, Alberta, Canada.

10. **Gaspard Mining Inc.** ("Gaspard") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Ocala, Florida.

11. **Coronation Mining Corp.** ("Coronation") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Ocala, Florida.

12. **Jewel Explorations Inc.** ("Jewel") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Winnipeg, Manitoba, Canada.

13. **Canyon Minerals Inc.** ("Canyon") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Salt Lake City, Utah.

14. **Stone Boat Mining Corp.** ("Stone Boat") is a Nevada corporation organized in September 2011. Its Form S-1 states that it has its principal offices in Chihuahua, Mexico.

15. **Goldstream Mining Inc.** ("Goldstream") is a Nevada corporation organized in November 2011. Its Form S-1 states that it has its principal offices in Ocala, Florida.

16. **Chum Mining Group Inc.** ("Chum") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Edmonton, Alberta, Canada.

17. **Eclipse Resources Inc.** ("Eclipse") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Winnipeg, Manitoba, Canada.

18. **PRWC Energy Inc.** ("PRWC") is a Nevada corporation organized in May 2012. Its Form S-1 states that it has its principal offices in Salt Lake City, Utah.

19. **Kingman River Resources** ("Kingman") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Dundas, Ontario, Canada.

20. **Bonanza Resources Corp.** ("Bonanza") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Edmonton, Alberta, Canada.

21. **CBL Resources Inc.** ("CBL") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Panama City, Panama.

22. **Lost Hills Mining Inc.** ("Lost Hills") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Panama City, Panama.

23. **Yuma Resources Inc.** ("Yuma") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in St. Albert, Alberta, Canada.

24. **Seaview Resources Inc.** ("Seaview") is a Nevada corporation organized in June 2012. Its Form S-1 states that it has its principal offices in Sterrett, Alabama.

25. The issuers identified in paragraphs 5 through 24 (collectively, the "Issuers") filed Form S-1 registration statements, and in some instances amendments to those registration statements, for intended public offerings of securities qualifying as penny stock, on the dates, and in the amounts, listed in the chart under Appendix A (the "Forms S-1"). In June and July 2013, after receiving investigative subpoenas, eighteen of the Issuers sought to withdraw their Forms S-1 on the grounds that the Issuer had "determined not to pursue" the proposed initial public offering. The withdrawals were not granted, although the registration statements never became effective. On March 20, 2014, an Administrative Law Judge issued stop orders suspending the effectiveness of these registration statements. La Paz Mining Inc., et al., Init. Dec. Rel. No. 580, 2014 WL 1116694 (Mar. 20, 2014). The stop orders became final on May 2, 2014. La Paz Mining Inc., et al., Sec. Act Rel. 9582, 2014 WL 1802275 (May 2, 2014).

C. BRINER' CONDUCT

Briner Acquired Mineral Claims Through Jervis

26. In 2011, Briner became the sole director of a British Columbia shelf company and changed its name from 0827796 BC Ltd. to Jervis. Between September 2011 and May 2013, Jervis acquired 68 mineral claims (which are rights to extract resources from identified land tracts) located in British Columbia. These mineral claims, as with all British Columbia mineral claim transactions, were acquired online through the British Columbia Ministry of Energy and Mines (the "Ministry").

Briner Recruited Clients and Acquaintances to Serve as Officers

27. Around the time Briner caused Jervis to acquire the mineral claims, he recruited current and former law clients and acquaintances to serve as officers for the Issuers. The individuals recruited had little to no actual mining experience. Briner explained to his recruits that he needed people to serve as officers and directors for companies that he planned to take public. Briner presented an agreement stating, among other things, that the "term of [the] engagement shall be until the Company receives a trading symbol from FINRA for quotation on the [over the

counter bulletin board ("OTCBB")], at which time the [officer] and the Company shall be free to re-negotiate the terms of the engagement." Briner explained that when the companies obtained ticker symbols, he planned to bring in additional management, and the officer would have the option of staying on as a director.

28. Briner offered to pay the officers an initial "consulting" fee between $2,000 and $3,000 for each Issuer with the promise of another $7,000 to $8,000 per company when the Issuer obtained an OTCBB ticker symbol. Briner then sought the officers' signatures on the documents necessary to create the Issuers. These documents included, among other things, forms for incorporating the Issuers, articles of incorporation, bylaws, the officers' engagement agreements, and board minutes.

29. Briner recruited ten individuals to serve as officers. For each Issuer, Briner presented the relevant individual with decisions he had already made on behalf of the Issuer and a pre-packaged set of documents. Briner had already determined, among other things, the mineral claims the Issuer would purchase, the stock that would be purchased, and the accounting and legal professionals the Issuers would hire. The officers simply signed the documents Briner provided and sent them back to Briner. Briner (through a check drawn on a MetroWest bank account or a wire) then paid the officers the promised initial consulting fee.

Briner Caused Each Issuer to Engage in Two Material Transactions

30. Briner caused each Issuer to engage in two material transactions—the officer's purchase of Issuer stock and the Issuer's purchase of mineral claims from Jervis.

31. The Stock Purchase Transactions: The terms of the stock purchase transactions described in the Forms S-1 were the same for each Issuer. Each officer allegedly paid $30,000 in cash for Issuer stock. Briner supplied and the officers executed a stock purchase agreement and a "Treasury and Reservation Order" reflecting the issuance and purchase of the stock.

32. The stock purchase agreements, which are nearly identical for each Issuer, state, among other things, that the officer (identified by name) "is purchasing the Shares as principal for investment purposes only" and that "$30,000 [is] due and payable upon signing of this subscription . . . and shares shall be issued on a pro rata basis as payment is received."

33. In fact, none of the officers purchased any Issuer stock. None of the officers paid $30,000—or any funds—to the Issuers for any reason. The officers also did not borrow funds to pay for the stock.

34. The Mineral Claim Purchases: Briner used the Issuers' purported mineral claim purchases to justify the Issuers' business purpose to avoid them being deemed "blank check" companies and, therefore, subject to the requirements of Rule 419 of the Securities Act, 17 C.F.R. § 230.419.

35. Briner caused Jervis and each of the Issuers to enter into an asset purchase agreement. The asset purchase agreements appear to reflect the Issuers' purchases of British Columbia mineral claims for between $7,500 and $8,500 from Jervis, and state that Jervis "delivers to the Purchaser, on execution hereof, all of the Claims unconditionally and free and clear of all

liens, charges, or encumbrances."

36. None of the Issuers ever acquired any mineral claims from Jervis or any other entity or individual. According to the Ministry, each of the mineral claims purportedly purchased continued to remain in Jervis's name.

Briner Caused the Issuers to Engage Professionals to Support the Filing of the Issuers' Form S-1 Registration Statements

37. Briner caused the Issuers to engage M&K and De Joya to audit the financial statements used in the Issuers' Forms S-1. De Joya provided reports for nine of the Issuers (identified in ¶¶ 5-13, above) and M&K provided audit reports for the other eleven (identified in ¶¶ 14-24, above).

38. Briner told De Joya and M&K that the Issuers intended to file Form S-1 registration statements and that the accounting for each of the Issuers had been outsourced to him. Briner also informed De Joya and M&K that he maintained all of the Issuers' purported funds "in trust" in an account he controlled (the "Master Trust Account"). Briner and his assistant were the exclusive contacts between De Joya and M&K and the Issuers. They created the Issuers' financial statements, provided De Joya and M&K with all of the supporting evidence for the audits, and responded to nearly all of De Joya's and M&K's questions about the Issuers.

39. Additionally, Briner caused the Issuers to hire Diane Dalmy ("Dalmy"), an attorney, to provide opinion letters in support of eighteen of the Issuers' registration statements. Dalmy provided opinion letters for these eighteen Issuers (all except La Paz and Goldstream).

The Issuers Filed Form S-1 Registration Statements Containing Material Misrepresentations and Omissions

40. Between July 19, 2012 and January 31, 2013, Briner caused the Issuers to file with the Commission nearly identical Form S-1 registration statements for their officers' public sale of stock that contained material misstatements and omissions. Briner caused these misstatements and omissions, described below, to be included in the Issuers' registration statements and knew, or recklessly disregarded, at the time the Issuers' registration statements were filed that these statements were false or misleading. Briner received $20,000 for his efforts on behalf of the Issuers, including efforts relating to the filing of the Forms S-1.

41. The registration statements were publicly available and each indicated that the Issuers were engaged in the exploration for gold and other minerals, but were currently in an exploration stage, were without known reserves, and had not yet begun actual mining. They each stated that the Issuers' mineral claims and business plans were obtained from Jervis. None of the registration statements disclosed any related party transactions or Briner's control over the Issuers.

42. First, the registration statements state that management for each Issuer consists of a single officer who "control[s]" and "solely govern[s]" the Issuer. All of the registration statements also state that other than management agreements between the Issuers and their officers, "there are no, and have not been since inception, any other material agreements or proposed transactions, whether direct or indirect, with . . . any promoters." None of the officers controlled the Issuers—

Briner did. Nor do any of the registration statements disclose in any way, directly or indirectly, Briner's role as a promoter and de facto control person of the Issuers.

43. Second, the registration statements state that the Issuers purchased their mineral claims from Jervis and that the Issuers "own[] 100% of the rights to the property." In fact, the mineral claims at issue were never transferred from Jervis to any of the Issuers.

44. Third, the registration statements each state that the Issuer's sole officer capitalized the Issuer via a purchase of Issuer stock for $30,000 in cash. None of the officers, however, paid the Issuers for stock.

45. Finally, each of the Issuers state that, as defined in the securities laws, it "[is] not a 'blank check company,' as [it] do[es] not intend to participate in a reverse acquisition or merger transaction." The Issuers were "blank check" companies as they each intended to engage in a business combination, such as a reverse merger.

D. BRINER VIOLATED SECTION 17(a) OF THE SECURITIES ACT

46. Based on the foregoing, the Commission finds that Respondent willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b)(6) of the Exchange Act, and Rule 102(e)(3)(i)(B) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Respondent Briner cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act;

B. Respondent Briner be, and hereby is:

(1) 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 15(d) of that Act; and

(2) 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 Briner is suspended from appearing and practicing before the Commission as an attorney.

D. Respondent Briner shall pay disgorgement of $20,000.00 and prejudgment interest of $1,820.94, and a civil penalty of $50,000.00, for a total of $71,820.94, 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). Payment shall be made in the following installments: (1) $17,955.23, within 90 days of the entry of the Order, (2) $17,955.23, within 180 days of the entry of the Order, (3) $17,955.23, within 270 days of the entry of the Order, and (4) $17,955.25, within 360 days of the entry of the Order. If any payment is not made by the date the payment is required by the Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately at the discretion of the staff of the Commission, without further application.

E. Payment of disgorgement and civil penalties as described in Section IV.D. herein 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 the Respondent by name 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 Lara Shalov Mehraban, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, NY 10281.

F. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of 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.

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

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, 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

Appendix A

Issuer	Form S-1 Filing Date	Form S-1 Amendment Date	Amount of Intended Public Offering
La Paz	7/19/2012	9/25/2012	$20,000
Tuba City	1/2/2013	-	$12,000
Braxton	1/2/2013	-	$24,000
Clearpoint	1/2/2013	-	$16,000
Goldcamp	1/2/2013	-	$10,000
Gaspard	1/25/2013	-	$20,000
Coronation	1/25/2013	-	$30,000
Jewel	1/25/2013	-	$20,000
Canyon	1/25/2013	-	$24,000
Stone Boat	1/27/2012	9/24/2012 and 10/17/2012	$20,000
Goldstream	8/6/2012	9/24/2012 and 10/17/2012	$15,000
Chum	11/30/2012	-	$20,000
Eclipse	12/3/2012	-	$18,000
PRWC	12/6/2012	-	$20,000
Kingman	1/31/2013	-	$14,000
Bonanza	1/31/2013	-	$18,000
CBL	1/31/2013	-	$10,000
Lost Hills	1/31/2013	-	$20,000
Yuma	1/31/2013	-	$16,000
Seaview	1/31/2013	-	$10,000

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9917 / September 18, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75947 / September 18, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3699 / September 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16339

In the Matter of

JOHN BRINER, ESQ.,
DIANE DALMY, ESQ.,
DE JOYA GRIFFITH, LLC,
ARTHUR DE JOYA, CPA,
JASON GRIFFITH, CPA,
CHRIS WHETMAN, CPA,
PHILIP ZHANG, CPA,
M&K CPAS, PLLC,
MATT MANIS, CPA,
JON RIDENOUR, CPA, and
BEN ORTEGO, 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 DE JOYA GRIFFITH, LLC, ARTHUR DE JOYA, CPA, JASON GRIFFITH, CPA, AND PHILIP ZHANG, CPA

I.

On January 15, 2015, the Securities and Exchange Commission ("Commission") deeming it appropriate, instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e) of the Commission's Rules of Practice against De Joya Griffith, LLC ("De Joya"), Arthur De Joya, CPA, Jason Griffith, CPA ("Griffith"), and Philip Zhang, CPA ("Zhang") (together, "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, Respondents consent to the entry of this Order, as set forth below.

III.

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

RESPONDENTS

1. **De Joya** is a registered public accounting firm based in Henderson, Nevada. De Joya issued audit reports for nine issuers, as further described below. For all relevant times, Arthur De Joya, Griffith, and Zhang were partners of De Joya.

2. **Arthur De Joya**, 48, of Las Vegas, Nevada, is a CPA licensed in the state of Nevada, a partner of De Joya, and has served as a managing partner of De Joya.

3. **Griffith**, 37, of Las Vegas, Nevada, is a CPA licensed in the state of Nevada, a partner of De Joya, and was a managing partner of De Joya.

4. **Zhang**, 40, of Las Vegas, Nevada, is a CPA licensed in the state of Nevada and was a partner of De Joya.

RELEVANT ENTITIES AND INDIVIDUALS

5. **John Briner** ("Briner"), 35, is an attorney and a Canadian citizen who resides in Vancouver, British Columbia. Briner's law firm was MetroWest Law Corporation ("MetroWest"). Briner also controlled Jervis Explorations Inc. ("Jervis"), a British Columbia corporation. In 2010, to resolve a Commission action against him alleging a pump-and-dump and market manipulation scheme, Briner consented to the entry of a federal court judgment that enjoined him from violating the antifraud and securities registration provisions of the federal securities laws; barred him for five years from participating in penny stock offerings; and ordered him to disgorge ill-gotten gains of $52,488.32 plus prejudgment interest and pay a civil penalty of $25,000. SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB). The Commission subsequently suspended Briner from appearing or practicing before it as an attorney, with a right to apply for reinstatement after five years. John Briner, Exchange Act Release No. 63371, 2010 WL 4783445 (Nov. 24, 2010).

6. **Diane Dalmy** ("Dalmy"), 58, is an attorney who resides in Denver, Colorado and is

[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.

admitted to practice law in Colorado. Dalmy issued opinion letters for the issuers identified below.

7. **<u>Jervis</u>** is a British Columbia corporation whose sole director is John Briner. Jervis purportedly sold certain British Columbia mineral claims to each of the issuers, further described below.

8. **<u>La Paz Mining Corp.</u>** ("La Paz") is a Nevada corporation organized in November 2011. On July 19, 2012, La Paz filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. On September 25, 2012, La Paz filed an amendment to its Form S-1 registration statement. La Paz's registration statement states that it has its principal offices in Peoria, Arizona.

9. **<u>Tuba City Gold Corp.</u>** ("Tuba City") is a Nevada corporation organized in June 2012. On January 2, 2013, Tuba City filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $12,000 public offering. Its Form S-1 states that it has its principal offices in Dundas, Ontario, Canada.

10. **<u>Braxton Resources Inc.</u>** ("Braxton") is a Nevada corporation organized in May 2012. On January 2, 2013, Braxton filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $24,000 public offering. Its Form S-1 states that it has its principal offices in Peoria, Arizona.

11. **<u>Clearpoint Resources Inc.</u>** ("Clearpoint") is a Nevada corporation organized in May 2012. On January 2, 2013, Clearpoint filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $16,000 public offering. Its Form S-1 states that it has its principal offices in Peoria, Arizona.

12. **<u>Gold Camp Explorations Inc.</u>** ("Goldcamp") is a Nevada corporation organized in June 2012. On January 2, 2013, Goldcamp filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $10,000 public offering. Its Form S-1 states that it has its principal offices in St. Alberta, Alberta, Canada.

13. **<u>Gaspard Mining Inc.</u>** ("Gaspard") is a Nevada corporation organized in May 2012. On January 25, 2013, Gaspard filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. Its Form S-1 states that it has its principal offices in Ocala, Florida.

14. **<u>Coronation Mining Corp.</u>** ("Coronation") is a Nevada corporation organized in May 2012. On January 25, 2013, Coronation filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $30,000 public offering. Its Form S-1 states that it has its principal offices in Ocala, Florida.

15. **<u>Jewel Explorations Inc.</u>** ("Jewel") is a Nevada corporation organized in May 2012. On January 25, 2013, Jewel filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. Its Form S-1 states that it has its principal offices in Winnipeg, Manitoba, Canada.

16. **Canyon Minerals Inc.** ("Canyon") is a Nevada corporation organized in May 2012. On January 25, 2013, Canyon filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $24,000 public offering. Its Form S-1 states that it has its principal offices in Salt Lake City, Utah.

RESPONDENTS CONDUCTED MATERIALLY DEFICIENT AUDITS

Background

17. Beginning in or about November 2011, Briner contacted De Joya to conduct audits of nine issuers' financial statements that were to be included in Form S-1 registration statements. Zhang was the engagement partner for audits of Tuba City, Braxton, Clearpoint, Goldcamp, Gaspard, Coronation, Jewel, and Canyon (collectively, the "Issuers"). Arthur De Joya was the engagement quality review partner for audits of Clearpoint and Gaspard. Griffith (together with Zhang and Arthur De Joya, the "De Joya Partners") was the engagement quality review partner for audits of La Paz, Tuba City, Braxton, Goldcamp, Coronation, Jewel, and Canyon.

18. The De Joya Partners knew that Briner did the accounting and created the financial statements to be used in the Form S-1 registration statements for each of the Issuers. The De Joya Partners also knew that Briner maintained all of the Issuers' purported funds "in trust" in an account Briner controlled (the "Master Trust Account").

19. Briner and his assistant were the exclusive contacts between De Joya and each Issuer's officer. The De Joya Partners did not directly communicate with any of the Issuers' sole officers. The De Joya Partners knew that Briner provided all of the information concerning the Issuers and all of the supporting evidence for their audits.

20. The Issuers two largest transactions consisted of the officer's purchase of Issuer stock for $30,000 and the Issuer's purchase of British Columbia mineral claims for between $7,500 and $8,500 from Jervis.

21. Zhang conducted the Issuers' audits, including auditing the above transactions, and consented to the inclusion of De Joya's audit report in each of the Issuers' Form S-1 registration statements filed with the Commission. De Joya was paid a total of $37,500 in fees for the audits, including the fee for auditing of La Paz. Each audit report stated that "[w]e conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present the Issuers' financial position "in conformity with U.S. generally accepted accounting principles." As described below, the audit was so deficient that it amounted to no audit at all, and the De Joya Partners ignored red flags.

Respondents Failed to Detect Red Flags in Accepting and Continuing with the Issuers as Clients

22. Under PCAOB standard QC Section 20 (System of Quality Control for a CPA Firm's Accounting and Auditing Practice) ("QC 20"), "[p]olicies and procedures should be established for deciding whether to accept or continue a client relationship" and "[s]uch policies and procedures should provide the firm with reasonable assurance that the likelihood of association

with a client whose management lacks integrity is minimized" (at .14). [2]

23. Under PCAOB Auditing Standard No. 12 (Identifying and Assessing Risks of Material Misstatement) ("AS 12"), auditors should "evaluate whether information obtained from the client acceptance and retention evaluation process or audit planning activities is relevant to identifying risks of material misstatement" (¶ 41).

24. Additionally, under PCAOB Auditing Standard No. 7 (Engagement Quality Review) ("AS 7"), among other things, engagement quality review partners, should "evaluate the significant judgments made by the engagement team," (¶ 9) including "consideration of the firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process" (¶ 10 a.).

25. Finally, auditors must meet PCAOB standard AU Section 230 (Due Professional Care in the Performance of Work) ("AU 230"), which requires that auditors "exercise professional skepticism" (at .07), "consider the competency and sufficiency of the evidence" (at .08), and "neither assume[] that management is dishonest nor assume[] unquestioned honesty" (at .09).

26. De Joya's client acceptance policies and procedures in effect at the time it accepted the Issuers as clients required very little. De Joya's policy instructed its staff to "confirm individuals" and, if there was something to report, to "summarize findings, site [sic] sources, and email Partner." In practice, such check consisted of a simple Internet search.

27. Zhang failed to sufficiently question or otherwise investigate the Issuers' management, which would have revealed Briner's undisclosed role as a control person. Nor did he conduct a background check of Briner or Dalmy, which at minimum would have turned up, among other things, the Commission's complaint alleging fraud and suspension order against Briner, and that Briner had been on the OTC Market's Prohibited Attorney List since March 15, 2006, and that Dalmy had also been on the list since September 25, 2009.

28. Additionally, De Joya's client acceptance policies and procedures failed to detect clues that should have raised concerns. Upon referring the Issuers, Briner's assistant provided De Joya with the names of the officers, the inception dates, and the year-end dates for each of the Issuers. From this, De Joya was on notice that two of the officers controlled four Issuers. De Joya was also on notice that seven of the nine Issuers were incorporated on the same day or within one day of each other (May 31, 2012 or June 1, 2012).

29. This information should have at least caused De Joya and Zhang to question why the Issuers' dates of incorporation appeared to be coordinated. Zhang failed to ask any questions with respect to this information.

30. For the above reasons, De Joya's client acceptance policies and procedures failed to meet QC 20 and, in the course of utilizing these procedures during the engagements at issue, Zhang failed to meet AS 12 and AU 230, and Griffith and Arthur De Joya failed to meet AS 7.

[2] The PCAOB standards referenced herein are the standards that were in effect during the time of relevant conduct.

<u>Zhang Failed to Obtain an Understanding of the Issuers</u>

31. Under AS 12, auditors should "obtain an understanding of the company and its environment . . . to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement," including "[t]he nature of the company" (¶ 7.b.) and "[t]he company's objectives and strategies and those related business risks that might reasonably be expected to result in risks of material misstatement" (¶ 7.d.). Further, obtaining an understanding of the nature of the company includes understanding "[t]he company's organizational structure and management personnel; [t]he sources of funding of the company's operations and investment activities, including the company's capital structure[, t]he company's operating characteristics, including its size and complexity" (¶ 10), and "an understanding of internal control includes evaluating the design of controls that are relevant to the audit and determining whether the controls have been implemented" (¶ 20).

32. Additionally, auditors must meet AU 230, which requires that auditors "exercise professional skepticism" (at .07) and "should be knowledgeable about the client" and are responsible for the "supervision of[] members of the engagement team" (.06).

33. Zhang failed to obtain a sufficient understanding of the Issuers. What little understanding of the Issuers he obtained came almost entirely from draft Form S-1 registration statements and responses to certain questionnaires from the Issuers, both provided by Briner. Zhang did not obtain an understanding of the Issuers through direct communication with the Issuers' officers.

34. In obtaining an understanding of the Issuers, Zhang did not question the substantial similarities among the Issuers. The Issuers filed eight nearly identical Form S-1 registration statements. Using almost exactly the same language, each stated the following: (1) the Issuers are not blank check companies; (2) the Issuers' officers purchased Issuer stock for $30,000; (2) the Issuers purchased British Columbia mineral claims from Jervis; (3) Jervis supplied nearly all the Issuers' with their business plans; (4) the officers "solely" control the company; (5) the officers planned to devote only 4 to 5 hours each week to the business; and (6) the officers have not inspected the land comprising the mineral claims.

35. Within about a four-week period, Zhang read eight of these registration statements. Despite this, Zhang did not raise any concern about the similarities among the registration statements, or perform any enhanced procedures to respond to the level of risk presented.

36. For the above reasons, Zhang failed to meet AS 12 and AU 230.

The De Joya Partners Failed to Adequately Respond to Concerns <u>that Briner and Dalmy May Have Been Engaging in Fraud</u>

37. In early November 2012, while Zhang was conducting the initial audit for the Issuers, a De Joya staff member raised concerns to the De Joya Partners, including Griffith and Arthur De Joya, that Briner and Dalmy may be engaging in fraud with respect to the Issuers.

38. Under QC 20, "policies and procedures should provide the firm with reasonable assurance that the likelihood of association with a client whose management lacks integrity is

minimized" (at .14) and that the firm "[a]ppropriately considers the risks associated with providing professional services in the particular circumstances" (at .15 b.).

39. Under AS 12, "[t]he auditor's assessment of the risks of material misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments" (¶ 74).

40. Further, under PCAOB Auditing Standard No. 13 (The Auditor's Responses to the Risks of Material Misstatement) ("AS 13"), "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence [including] . . . modifying the planned audit procedures to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management's explanations or representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor, or examination of documentation from independent sources" (¶ 7).

41. Finally, under AS 7, the engagement quality review partner should "evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement," (¶ 9) including "significant risks identified by the engagement team, including fraud risks" (¶ 10.b.).

42. De Joya and Zhang failed to (a) properly consider the risks associated with the Issuers' audits, (b) apply professional skepticism in evaluating audit evidence indicating Briner and Dalmy may be engaging in fraud, (c) re-evaluate their risk assessments for the Issuers' audits in light of such evidence, and (d) regarding Arthur De Joya's and Griffith's roles as engagement quality review partners, appropriately evaluate the engagement teams' judgments to continue with the audits without appropriately re-assessing and responding to the risk of fraud in violation of QC 20, AS 12, AS 13, and AS 7.

43. On or about November 5, 2012, a De Joya staff member became concerned that Briner might be engaging in fraud in connection with the De Joya Issuers. Her concern stemmed from conversations she had with certain Issuers' officers in which nearly all her questions about the Issuers were deferred to Briner. These conversations caused her to conduct an internet search on Briner. She found, among other things, the Commission's complaint against him. Additional searches yielded news articles describing Briner and Dalmy as repeat securities fraud offenders.

44. As a result, the De Joya staff member sent four emails over three days sharing the negative information she found concerning Briner and Dalmy. First, on November 5, 2012, she sent Zhang and another De Joya partner, who was reviewing an interim financial statement for La Paz, an email containing links to the Commission's complaint against Briner (SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB)) and a Canadian news article stating, among other things, that the British Columbia Securities Commission issued an order (reciprocal to the Commission's order suspending Briner) banning Briner from trading shares in British

Columbia or "acting in a management or consultative capacity in any securities related matter."[3] In the email, she asked Zhang and the other De Joya partner to "review the links" and stated that she "will call [Zhang] tonight."

45. Second, that same day, the De Joya staff member sent another email to Zhang and the other De Joya partner with a link to an article posted on Pumpsanddumps.com stating that Briner and Dalmy "together and apart, the pair has been involved in dozens of schemes on the Vancouver market as well as the Pink sheets and OTC Bulletin Board, writing many a dubious legal opinion resulting in millions of dollars lost by thousands of investors."[4]

46. Third, on November 7, 2012, the De Joya staff member sent yet another email to Zhang and the other De Joya partner attaching an article about a De Joya client, MoneyMinding International Corp., and its counsel, Dalmy, who was described as having "a reputation for helping scoundrel promoters take dubious companies public on the U.S. over-the-counter markets." The article also specifically mentions De Joya as having "similarly helped many dubious companies go public on the bulletin board."[5]

47. Finally, the same day, the De Joya staff member forwarded the email and article to Griffith stating, "I thought I should forward this to you as well. I was doing research on Diane Dalmy and John Briner as we are working on some of their jobs and that's how I can [sic] across this article." Griffith then forwarded her email with the attached article to Arthur De Joya without comment.

48. In light of the negative background the De Joya staff member found and the officers' apparent inability to answer questions about the issuers, the staff member found it suspicious that Briner and Dalmy were working together on eight of the nine issuers that De Joya was auditing. The staff member discussed her concerns with Zhang. Zhang then discussed the staff member's concerns with the other De Joya partner and resolved that Zhang would raise them with Griffith and Arthur De Joya, which Zhang did.

49. Zhang opened the links in the emails the De Joya staff member sent, printed the documents, highlighted relevant portions, and brought them to separate face-to-face meetings with Arthur De Joya and Griffith. At these meetings it was collectively decided that De Joya could continue with the engagements because Briner was not appearing before the Commission in violation of his suspension.

50. Zhang and Arthur De Joya each informed the De Joya staff member of this decision and then continued with the audits without adjusting any audit procedures or taking any additional precautions in light of the facts they learned about Briner and Dalmy. Zhang ultimately signed

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[3] http://www.canadianjusticereviewboard.ca/article-securities%20lawyer.htm

[4] http://www.pumpsanddumps.com/2011/06/all-that-glitters-is-not-greenwood-gold.html

[5] http://blogs.vancouversun.com/2011/03/17/david-baines-two-victoria-startups-wade-into-bulletin-board-swamp/

audit reports containing unqualified opinions for the Issuers and Arthur De Joya and Griffith signed off on the Issuers' audits as Engagement Quality Review partners without taking any further action.

51. None of the above purported discussions were documented in any workpaper, or otherwise, in violation of PCAOB Auditing Standard No. 3 (Audit Documentation) ("AS 3"), which provides that auditors "must document significant findings or issues, actions taken to address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement" (¶ 12).

Zhang Failed to Properly Audit the Issuers' Cash

52. Under PCAOB standard AU Section 330 (The Confirmation Process) ("AU 330"), when "information about the respondent's [i.e., the person or entity from which a confirmation is requested] competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity comes to the auditor's attention, the auditor should consider the effects of such information on designing the confirmation request and evaluating the results" and, in circumstances where "the respondent is the custodian of a material amount of the audited entity's assets," the auditor should exercise "a heightened degree of professional skepticism" and "should consider whether there is sufficient basis for concluding that the confirmation request is being sent to a respondent from whom the auditor can expect the response will provide meaningful and appropriate audit evidence" (at .27).

53. Additionally, under PCAOB Auditing Standard No. 15 (Audit Evidence) ("AS 15"), "[t]he auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion" (¶ 4). To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based. "The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained" (¶ 8). Under AS 13, "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence" (¶ 7).

54. Zhang exhibited no concern about Briner's handling of the Issuers' alleged cash. Zhang knew that Briner held all of the Issuers' purported funds in the Master Trust Account and that none of the Issuers had their own bank account. Zhang also knew that Briner was a "consultant" to the Issuers and that MetroWest was a law firm. Zhang did not seek any appropriate audit evidence about what, if any, limitations governed Briner's use of the cash in his Master Trust Account. Nor did he ask for a reconciliation between Briner's Master Trust Account and the schedules Briner provided purportedly showing how much cash in his account was attributable to each Issuer.

55. In addition, Zhang violated the above standards by failing to apply professional skepticism in gathering and evaluating the evidence obtained, such as Briner's confirmation of Issuer cash, and consider Briner's "objectivity and freedom from bias with respect to the audited entity" in relation to the Issuers' cash confirmation Briner provided.

Zhang Disregarded Red Flags that Briner's Services to
<u>the Issuers Were Not Given Accounting Recognition</u>

56. Under PCAOB standard AU Section 334 (Related Parties) ("AU 334"), transactions that are indicative of the existence of related parties include, among other things, "transactions [that] are occurring, but are not being given accounting recognition, such as receiving or providing accounting, management or other services at no charge" (at .08(f)). Further, under AS 15, "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Finally, auditors must exercise professional skepticism throughout the course of the engagement consistent with standard AU 230.

57. Zhang failed to question Briner's fee arrangement with the Issuers. Instead, he relied on legal confirmation letters from Briner that conflicted on their face with what he knew to be true about the services Briner provided.

58. These letters each stated that "[a]s of the date of inception and up to the present date, the [Issuers were] not indebted to us for services and expenses (billed or unbilled) of which we are aware." Zhang knew that Briner provided substantial services to the Issuers, such as, among other things, performing accounting functions (paying expenses and recording transactions), drafting the Issuers' registration statements, and preparing the Issuers' financial statements for their registration statements. Zhang also knew that the Issuers' financial statements and general ledgers did not reflect payment for Briner's services. Despite this, Zhang did not ask Briner for any invoices, agreements, engagement letters, or any details about his fee arrangements with the Issuers. Nor did he conduct any related party analysis.

59. For the above reasons, Zhang failed to meet AU 334, AS 15, and AU 230.

Zhang Disregarded Red Flags that the Issuers'
<u>Stock Sales to Their Officers Were Shams</u>

60. Under AS 15, "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Under AS 12, the auditor should obtain "an understanding of the nature of the company include[ing]...the sources of funding of the company's operations" (¶ 10) and "[w]hen the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments" (¶ 74). Further, under AS 14, auditors should consider "[t]he sufficiency and appropriateness of the audit evidence obtained" (¶ 4.f.). In meeting these standards, auditors must apply professional skepticism and due care consistent with AU 230.

61. Briner provided De Joya with schedules for each of the Issuers that purportedly listed all of the Issuer's transactions (prepared by Briner allegedly reflecting cash attributable to

each Issuer from his Master Trust Account). Each appeared to indicate that individuals or entities named "Hyperion" management, "Luke Pretty," or "Dhaliwal" supplied the funds to pay for the officers' stock purchases. As such, these schedules contradicted the Stock Purchase Agreements, which all indicated that the officer purchased the Issuer's stock.

62. For some Issuers, the date listed for the stock purchase was prior to the Issuers' incorporation.

63. For others, the date listed for the stock purchase was after the Issuers purchased their mineral claims, which, if true, raises questions as to how the Issuers were able to finance a mineral claim purchase before having received the funds necessary to make the mineral claim purchase.

64. Despite the contradicting evidence regarding who paid for (and owned) the Issuers' stock, and when the transactions took place, Zhang took no further action with respect to these alleged stock purchases.

65. Although Zhang and De Joya staff questioned Briner about who paid for the stock purchase, they failed to obtain adequate supporting evidence that resolved this issue. In or about October 2012, De Joya staff requested supporting documentation and a breakdown by Issuer identifying who paid for the stock. Briner replied that the officers borrowed the funds, not only for the stock purchase, but also for the Issuers' mineral claim purchase from Jervis as well. As support, Briner sent copies of three checks: (1) $300,000 from Jagjit Dhaliwal to MetroWest, (2) $42,500 from MetroWest to Jervis, and (3) $41,543.75 from an unidentified individual or entity to Jervis. Briner also stated that the $300,000 was really from an entity called Global Investments (not Dhaliwal), which purportedly loaned the funds to the officers to incorporate and pay for company stock.

66. As Briner's response did not make clear who paid for the stock, the De Joya staff continued to request a breakdown by Issuer of who paid for the stock purchases (and also for the mineral claims). The breakdown Briner provided stated that an individual referred to as Luke Pretty paid $15,000 for the mineral claims allegedly purchased by Goldcamp and Tuba City. And that Luke Pretty paid $60,000 for Goldcamp's and Tuba City's officers' purchase of company stock. Global Investments paid the remaining funds to the Issuers.

67. Not satisfied with Briner's response, on November 27, 2012, Zhang emailed Briner asking who paid Jervis for the mineral claims stating "we have received contradicting information for this" and that if it was Global Investments "why [is it] not shown in [the] books." He also asked about Luke Pretty. But Briner did not provide any additional supporting documentation. Nor did Zhang seek clarification from the Issuers' officers.

68. As a result, Zhang failed to resolve these conflicts or obtain sufficient appropriate audit evidence to support De Joya's opinions and therefore violated PCAOB standards AS 15, AS 12, and AU 230.

Zhang Disregarded Red Flags that the Issuers'
<u>Mineral Claim Purchases Were Shams</u>

69. Zhang failed to investigate evidence from Briner that should have caused him to question the Issuers' alleged mineral claim purchases from Jervis.

70. During the audits, Zhang sought information about Briner's relationship with Jervis, in part because all of the Issuers purchased their mineral claims from Jervis. On or about October 25, 2012, Zhang participated in a conference call with Briner to discuss the issue. Following the call, Briner provided a letter dated October 26, 2012 stating that he "is only a director of Jervis Explorations Inc. [and a]s such he neither holds any ownership interests in that company nor is he involved in any decision making process of Jervis Explorations Inc." Learning that Briner was a director of Jervis and knowing that Briner played a substantial role in the Issuers' affairs should have caused Zhang to obtain evidence to corroborate Briner's assertions regarding the Issuers' mineral claim purchases from Jervis.

71. Zhang, therefore, violated AU 334 (because Briner appeared to control Jervis and Zhang failed to, among other things, "review the extent and nature of business transacted with [Jervis] for indications of previously undisclosed relationships" (.08(e))) and AS 13, which states that "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence." (¶ 7) Zhang also violated AS 15, AS 12, and AU 230 for failing to resolve the conflict between Briner's role as a director of Jervis and his statement that he is not involved in Jervis's decision making.

Zhang Failed to Resolve Discrepancies in the Audit
<u>Evidence Supporting the Officers' Fees</u>

72. Zhang accepted evidence that purported to support the officers' fees that did not in fact provide support. In some instances the evidence also was inconsistent with the schedules for the Issuers prepared by Briner purportedly reflecting cash attributable to the Issuers in the Master Trust Account.

73. On or about October 28, 2012, a De Joya staff accountant asked for documents reflecting the payment of fees to the officers (in the same communication discussed in ¶ 137, above). The next day, Briner's assistant sent documents reflecting wire transfers from MetroWest to, among others, Crown Capital Partners for $6,000 and Strategic Air Consultants for $4,000. Although Briner's assistant indicated that the wire to Crown Capital Partners was for La Paz's officer (for services to three companies), no other documents made this connection and La Paz's officer was not asked whether he was paid his fee. Briner's assistant did not state which officer was associated with Strategic Air Consultants, and Zhang did not try to find out. Nonetheless, Zhang accepted these documents as support for the officers' fees.

74. Further, the documents reflecting wire transfers from MetroWest to the officers for Canyon and Clearpoint were not consistent with these Issuers' schedules. The wire transfers were as follows: USD $4,000 to Canyon's officer and C $4,000 to Jewel's officer. But the schedule Briner provided for Canyon indicates that its officer was paid USD $3,000, and the schedule for

Jewel indicates that its officer was paid USD $3,000 in U.S. currency. Moreover, the wire transfer documents Briner provided do not indicate when the wire transfers purportedly occurred. The dates of the transactions listed in the schedules, therefore, cannot be compared with the wire transfer documents provided.

75. Zhang failed to resolve these conflicts or obtain sufficient appropriate audit evidence to support De Joya's opinions and therefore violated AS 15, AS 12, and AU 230.

Zhang and Griffith Failed to Detect Basic Accounting Errors and Inconsistencies Between the Financial Statements and the Registration Statements

76. Under AU 230, "[a]n auditor should possess 'the degree of skill commonly possessed' by other auditors and should exercise it with 'reasonable care and diligence' (that is, with due professional care)" (at .05). Further, under AS 7, an engagement quality review partner should "review the financial statements" and "read other information in documents containing the financial statements to be filed with the Securities and Exchange Commission . . . and evaluate whether the engagement team has taken appropriate action with respect to any material inconsistencies with the financial statements or material misstatements of fact of which the engagement quality reviewer is aware" (¶ 10 f. and g.).

77. During the audits and engagement quality reviews, Zhang and Griffith failed to detect basic mistakes in the Issuers' financial statements and inconsistencies between the financial statements and information contained in other parts of the registration statements as reflected in the chart under Appendix A.

78. Mistakes in the financial statements include, among other things, balance sheets that do not foot and conflicts between balance sheets and the notes to the financial statements. Inconsistences between the financial statements and other information in the registration statements include, among other things, the disclosure of a net loss in the registration statement that conflicts with what should be the same disclosure in the Statement of Operations in the financial statements. These errors may constitute material misstatements and reflect Zhang and Griffith's apparent lack of due care in conducting their audits and engagement quality reviews, respectively.

79. For the reasons contained in the chart under Appendix A, Zhang failed to meet AU 230 and Griffith failed to meet AU 230 and AS 7.

RESPONDENTS VIOLATED SECTION 17(a) OF THE SECURITES ACT, RULE 2-02 OF REGULATION S-X, AND ENGAGED IN IMPROPER PROFESSIONAL CONDUCT

80. De Joya falsely stated in its audit reports filed with each of the nine issuers' registration statements that they "conducted [their] audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present the Issuers' financial positions "in conformity with U.S. generally accepted accounting principles." Zhang signed or consented to the filings of these audit reports and Authur De Joya and Griffith provided concurring approval of issuance.

81. Additionally, De Joya and the De Joya Partners failed to meet the PCAOB standards discussed herein.

82. For these false reports, De Joya and the De Joya Partners collected a total of $37,500 in fees.

83. De Joya and the De Joya Partners knew, or were reckless in not knowing, that each of the Issuers for which they provided audit reports was a device, scheme, or artifice to defraud in violation of Section 17(a)(1) of the Securities Act. Further, by providing such reports, De Joya and the De Joya Partners acted unreasonably and caused the Issuers' violations of Sections 17(a)(1), (2), and (3) of the Securities Act. De Joya and the De Joya Partners also violated Sections 17(a)(2) and (3) of the Securities Act by falsely claiming that their audits complied with PCAOB standards.

84. Additionally, for failing to meet the PCAOB audit standards identified above in auditing the Issuers, De Joya and the De Joya Partners engaged in improper professional conduct pursuant to the Commission's Rules of Practice Rule 102(e)(1)(ii) by each engaging in at least one instance of highly unreasonable conduct or at least two instances of unreasonable conduct under Rule 102(e)(1)(iv). Further, De Joya violated Rule 2-02(b)(1) of Regulation S-X by providing audit reports included in the Issuers' Form S-1 Registration statements that falsely state that the Issuers' audits were made in accordance with PCAOB standards. The De Joya Partners caused De Joya's violations of Rule 2-02(b)(1) of Regulation S-X by consenting to the filing of these audit reports.

85. Further, as described above, De Joya and the De Joya Partners willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act thereby engaging in conduct subject to the Commission's Rules of Practice Rule 102(e)(1)(iii).

COMMISSION FINDINGS

Based on the foregoing, the Commission finds that:

A. Respondents willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act;

B. Respondents engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice;

C. De Joya violated Rule 2-02(b)(1) of Regulation S-X;

D. the De Joya Partners caused violations of Rule 2-02(b)(1) of Regulation S-X; and

E. Respondents willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act thereby engaging in conduct subject to Section 4C(a)(3) of the Exchange Act and Practice Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 4C and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondents shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(1), (2), and (3) of the Securities Act and Rule 2-02(b)(1) of Regulation S-X.

B. Respondent De Joya is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After five years from the date of this Order, De Joya may request that the Commission consider its reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as an independent accountant. Such an application must satisfy the Commission that:

a) De Joya 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. However, if registration with the Board is dependent upon reinstatement by the Commission, the Commission will consider the application on its other merits;

b) De Joya has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

c) De Joya 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) De Joya acknowledges its responsibility, as long as it 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.

D. The Commission will consider an application by De Joya to resume appearing or practicing before the Commission provided that its state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent De Joya shall pay disgorgement of $37,500.00 and prejudgment interest of $2,903.79, and a civil penalty of $18,750.00, for a total of $59,153.79, 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), which shall be paid in the following installments: (1) $14,788.44 within 10 days of the entry of this Order; (2) $14,788.44 within 120 days of the entry of this Order; (3) $14,788.44 within 210 days of the entry of this Order; and (4) $14,788.47 within 300 days of entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or 31 U.S.C. § 3717.

F. Respondent Zhang is denied the privilege of appearing or practicing before the Commission as an accountant.

G. After five years from the date of this Order, Zhang 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:

a) 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 Zhang'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

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

i. Zhang, 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;

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

iii. Zhang 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

iv. Zhang acknowledges his responsibility, as long as Zhang 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.

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

I. Respondent Zhang shall pay a civil penalty of $25,000.00, 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), which shall be paid in the following installments: $5,000.00 within 10 days of the entry of this Order, and $20,000.00 in four installments of $5,000.00 due on October 1, 2015, January 1, 2016, April 1, 2016, and one year from entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

J. Respondent Griffith is denied the privilege of appearing or practicing before the Commission as an accountant.

K. After three years from the date of this Order, Griffith 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:

a) 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 Griffith'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

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

i. Griffith, 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;

ii. Griffith, 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 Griffith's or the firm's quality control system that would indicate that Griffith will not receive appropriate supervision;

iii. Griffith 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

iv. Griffith 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.

L. The Commission will consider an application by Griffith 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 his application on other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Griffith's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

M. Respondent Arthur De Joya is denied the privilege of appearing or practicing before the Commission as an accountant.

N. After three years from the date of this Order, Arthur De Joya 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:

a) 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 Arthur De Joya'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

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

i. Arthur De Joya, 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;

ii. Arthur De Joya, 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 Arthur De Joya's or the firm's quality control system that would indicate that Arthur De Joya will not receive appropriate supervision;

iii. Arthur De Joya 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

iv. Arthur De Joya 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.

O. The Commission will consider an application by Arthur De Joya 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 his application on other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Arthur De Joya's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

P. Respondent Griffith shall pay a civil penalty of $15,000.00, 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), which shall be paid in the following installments: $3,000.00 within 10 days of the entry of this Order, and $12,000.00 in four installments of $3,000.00 due on October 1, 2015, January 1, 2016, April 1, 2016, and one year from entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Q. Respondent Arthur De Joya shall pay a civil penalty of $15,000.00, 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), which shall be paid in the following installments: $3,000.00 within 10 days of the entry of this Order, and $12,000.00 in four installments of $3,000.00 due on October 1, 2015, January 1, 2016, April 1, 2016, and one year from entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

R. Payment of disgorgement and civil penalties as described herein 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 the Respondent by name 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 Lara Shalov Mehraban, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, NY 10281.

S. 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.

T. 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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 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

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

Appendix A

Issuer	Engagement Partner	EQR Partner	Audited Financial Statement Errors/ Conflict Between Audited Financial Statements and Other Registration Statement Information
Tuba City	Zhang	Griffith	Audited Financial Statement Errors • The Total Liabilities and Stockholders' Equity amount on the Balance Sheet on Page F-3 does not foot. It is reported as $27,325, but the accurately footed amount is $19,825. • The amounts for Net Cash Used in Operating Activities of $(10,175), Net Cash Used in Investing Activities of $(7,500) and Net Cash Provided by Financing Activities of $30,000 do not foot to the amount presented as Increase in Cash on the Statement of Cash Flows on Page F-6. The amount presented is $19,825, but the amount accurately footed is $12,325. • Note 3, Acquisition of a Mineral Claim, on Page F-11 discloses that "the acquisitions costs have been impaired and expensed during 2012." The line Mineral property for $7,500 on the Balance Sheet on Page F-3 and the Statement of Operations on page F-4 reflect an unimpaired amount. • Note 6, Going Concern on page F-11, discloses that the company "has incurred a loss of $4,008." This amount does not match the Net loss of $10,175 presented on the Statement of Operations on Page F-4. • Note 7, Income Tax on Page F-11, discloses that the company "has $4,008 of net operating losses carried forward." This amount does not match the Net loss of $10,175 presented on the Statement of Operations on Page F-4. The SEC staff has not found any audit workpapers related to income taxes. Conflicts Between Audited Financial Statements and Other Registration Statement Information • The Net loss from operations of $4,008 in the Consolidated Statements of Income under Summary Financial Information on Page 5 does not match the same line item on the Statement of Operations on Page F-4 of $(10,175). The period for the $4,008 amount, however, was not specified. • The accounts payable amount of $1,333 in the Balance Sheet Data under Summary Financial Information on Page 5 does not match the same line item on the Balance Sheet on Page F-3, which is $0. • The deficit accumulated during exploration period amount of $(4,008) in the Balance Sheet Data under Summary Financial Information on Page 5 does not match the same line item on the Balance Sheet on Page F-3, which is $(10,175).
Canyon	Zhang	Griffith	Audited Financial Statement Error • The Stockholder's Equity section of the Balance Sheet does not foot. The amount reported is $25,325, but the accurate footing is $24,325.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9918 / September 18, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75948 / September 18, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3700 / September 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16339

In the Matter of

JOHN BRINER, ESQ.,
DIANE DALMY, ESQ.,
DE JOYA GRIFFITH, LLC,
ARTHUR DE JOYA, CPA,
JASON GRIFFITH, CPA,
CHRIS WHETMAN, CPA,
PHILIP ZHANG, CPA,
M&K CPAS, PLLC,
MATT MANIS, CPA,
JON RIDENOUR, CPA, and
BEN ORTEGO, 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 M&K CPAS, PLLC, MATT MANIS, CPA, AND JON RIDENOUR, CPA

I.

On January 15, 2015, the Securities and Exchange Commission ("Commission") deeming it appropriate, instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e) of the Commission's Rules of Practice against M&K CPAS, PLLC ("M&K"), Matt Manis, CPA ("Manis"), and Jon Ridenour ("Ridenour") (together, "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, Respondents consent to the entry of this Order, as set forth below.

III.

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

RESPONDENTS

1. **M&K** is a registered public accounting firm based in Houston, Texas. M&K issued audit reports for eleven issuers described further below.

2. **Manis**, 53, of Houston, Texas, is a CPA licensed in the state of Texas and a partner of M&K.

3. **Ridenour**, 37, of Houston, Texas, is a CPA licensed in the state of Texas and a partner of M&K.

RELEVANT ENTITIES AND INDIVIDUALS

4. **John Briner** ("Briner"), 35, is an attorney and a Canadian citizen who resides in Vancouver, British Columbia. Briner's law firm was MetroWest Law Corporation ("MetroWest"). Briner also controlled Jervis Explorations Inc. ("Jervis"), a British Columbia corporation. In 2010, to resolve a Commission action against him alleging a pump-and-dump and market manipulation scheme, Briner consented to the entry of a federal court judgment that enjoined him from violating the antifraud and securities registration provisions of the federal securities laws; barred him for five years from participating in penny stock offerings; and ordered him to disgorge ill-gotten gains of $52,488.32 plus prejudgment interest and pay a civil penalty of $25,000. SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB). The Commission subsequently suspended Briner from appearing or practicing before it as an attorney, with a right to apply for reinstatement after five years. John Briner, Exchange Act Release No. 63371, 2010 WL 4783445 (Nov. 24, 2010).

5. **Diane Dalmy** ("Dalmy"), 58, is an attorney who resides in Denver, Colorado and is admitted to practice law in Colorado. Dalmy issued opinion letters for the issuers identified below.

6. **Jervis** is a British Columbia corporation whose sole director is John Briner. Jervis purportedly sold certain British Columbia mineral claims to each issuer described below.

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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. **Stone Boat Mining Corp.** ("Stone Boat") is a Nevada corporation organized in September 2011. On January 27, 2012, Stone Boat filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. On September 24, 2012 and on October 17, 2012, Stone Boat filed amendments to its Form S1 registration statement. Stone Boat's registration statement states that it has its principal offices in Chihuahua, Mexico.

8. **Goldstream Mining Inc.** ("Goldstream") is a Nevada corporation organized in November 2011. On August 6, 2012, Goldstream filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $15,000 public offering. On September 24, 2012 and on October 17, 2012, Goldstream filed amendments to its Form S1 registration statement. Its registration statement states that it has its principal offices in Ocala, Florida.

9. **Kingman River Resources.** ("Kingman") is a Nevada corporation organized in June 2012. On January 31, 2013, Kingman filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $14,000 public offering. Its registration statement states that it has its principal offices in Dundas, Ontario, Canada.

10. **Bonanza Resources Corp.** ("Bonanza") is a Nevada corporation organized in June 2012. On January 31, 2013, Bonanza filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $18,000 public offering. Its registration statement states that it has its principal offices in Edmonton, Alberta, Canada.

11. **CBL Resources Inc.** ("CBL") is a Nevada corporation organized in June 2012. On January 31, 2013, CBL filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $10,000 public offering. Its registration statement states that it has its principal offices in Panama City, Panama.

12. **Lost Hills Mining Inc.** ("Lost Hills") is a Nevada corporation organized in June 2012. On January 31, 2013, Lost Hills filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. Its registration statement states that it has its principal offices in Panama City, Panama.

13. **Yuma Resources Inc.** ("Yuma") is a Nevada corporation organized in June 2012. On January 31, 2013, Yuma filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $16,000 public offering. Its registration statement states that it has its principal offices in St. Albert, Alberta, Canada.

14. **Seaview Resources Inc.** ("Seaview") is a Nevada corporation organized in June 2012. On January 31, 2013, Seaview filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $10,000 public offering. Its registration statement states that it has its principal offices in Sterrett, Alabama.

15. **Chum Mining Group Inc.** ("Chum") is a Nevada corporation organized in June

2012. On November 30, 2012, Chum filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. Its registration statement states that it has its principal offices in Edmonton, Alberta, Canada.

16. **Eclipse Resources Inc.** ("Eclipse") is a Nevada corporation organized in May 2012. On December 3, 2012, Eclipse filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in an $18,000 public offering. Its registration statement states that it has its principal offices in Winnipeg, Manitoba, Canada.

17. **PRWC Energy Inc.** ("PRWC") is a Nevada corporation organized in May 2012. On December 6, 2012, PRWC filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. Its registration statement states that it has its principal offices in Salt Lake City, Utah.

RESPONDENTS CONDUCTED MATERIALLY DEFICIENT AUDITS

Background

18. In or about November 2011, Briner contacted M&K to conduct audits of certain issuers' financial statements that were to be included in Form S-1 registration statements. Manis was the engagement partner for audits of Stone Boat and Goldstream and the engagement quality review partner for audits of Chum, Eclipse, Kingman, Bonanza, CBL, Lost Hills, Yuma, and Seaview. Ridenour (together with Manis, the "Audit Partners") was the engagement partner for audits of Kingman, Bonanaza, CBL, Lost Hills, Yuma, and Seaview and the engagement quality review partner for audits of Stone Boat, Goldstream, and PRWC (together with Eclipse and Chum, the "Issuers").

19. The Audit Partners knew that Briner did the accounting and created the financial statements to be used in the Form S-1 registration statements for each of the Issuers. The Audit Partners also knew that Briner maintained all of the Issuers' purported funds "in trust" in an account Briner controlled (the "Master Trust Account").

20. Briner and his assistant were the exclusive contacts between M&K and each Issuer's officer. The Audit Partners did not directly communicate with any of the Issuers' officers. The Audit Partners knew that Briner provided all of the information concerning the Issuers and all of the supporting evidence for their audits.

21. The Issuers two largest transactions consisted of the officer's purchase of Issuer stock for $30,000 and the Issuer's purchase of British Columbia mineral claims for between $7,500 and $8,500 from Jervis.

22. The Audit Partners conducted the Issuers' audits, including auditing the above transactions, and consented to the inclusion of M&K's audit report in each of the Issuers' Form S-1 registration statements filed with the Commission. M&K was paid a total of $49,500 in fees for the Issuers' audits. Each audit report stated that "[w]e conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present the Issuers' financial position "in conformity with U.S. generally

accepted accounting principles."

Respondents Failed to Detect Red Flags in Accepting
<u>and Continuing with the Issuers as Clients</u>

23. Under PCAOB standard QC Section 20 (System of Quality Control for a CPA Firm's Accounting and Auditing Practice) ("QC 20"), "[p]olicies and procedures should be established for deciding whether to accept or continue a client relationship" and "[s]uch policies and procedures should provide the firm with reasonable assurance that the likelihood of association with a client whose management lacks integrity is minimized" (at .14).[2]

24. Under PCAOB Auditing Standard No. 12 (Identifying and Assessing Risks of Material Misstatement) ("AS 12"), auditors should "evaluate whether information obtained from the client acceptance and retention evaluation process or audit planning activities is relevant to identifying risks of material misstatement" (¶ 41).

25. Additionally, under PCAOB Auditing Standard No. 7 (Engagement Quality Review) ("AS 7"), among other things, engagement quality review partners, should "evaluate the significant judgments made by the engagement team," (¶ 9) including "consideration of the firm's recent engagement experience with the company and risks identified in connection with the firm's client acceptance and retention process" (¶ 10 a.).

26. Finally, auditors must meet PCAOB standard AU Section 230 (Due Professional Care in the Performance of Work) ("AU 230"), which requires that auditors "exercise professional skepticism" (at .07), "consider the competency and sufficiency of the evidence" (at .08), and "neither assume[] that management is dishonest nor assume[] unquestioned honesty" (at .09).

27. M&K's client acceptance policies and procedures in effect at the time it accepted the Issuers as clients required very little. M&K's policy called for "background checks on all significant owners and chief executives." In practice, such check consisted of a simple Internet search.

28. The Audit Partners failed to sufficiently question or otherwise investigate the Issuers' management, which would have revealed Briner's undisclosed role as a control person. Nor did they conduct a background check of Briner or Dalmy, which at minimum would have turned up, among other things, the Commission's complaint alleging fraud and suspension order against Briner, and that Briner had been on the OTC Market's Prohibited Attorney List since March 15, 2006, and that Dalmy had also been on the list since September 25, 2009.

29. Additionally, M&K's client acceptance policies and procedures failed to detect clues that should have raised concerns. Upon referring the Issuers, Briner's assistant provided M&K with the names of the officers, the inception dates, and the year-end dates for each of the Issuers. From this, M&K was on notice that two of the officers controlled four Issuers. M&K was also on notice that seven of the eleven Issuers were incorporated on the same day or within one day of each other (May 31, 2012 or June 1, 2012).

[2] The PCAOB standards referenced herein are the standards that were in effect during the time of relevant conduct.

30. This information should have at least caused M&K and the Audit Partners to question why the Issuers' dates of incorporation appeared to be coordinated. The Audit Partners failed to ask any questions with respect to this information.

31. For the above reasons, M&K's client acceptance policies and procedures failed to meet QC 20 and, in the course of utilizing these procedures during the engagements at issue, the Audit Partners failed to meet AS 7, AS 12, and AU 230.

The Audit Partners Failed to Obtain an Understanding of the Issuers

32. Under AS 12, auditors should "obtain an understanding of the company and its environment . . . to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement," including "[t]he nature of the company" (¶ 7.b.) and "[t]he company's objectives and strategies and those related business risks that might reasonably be expected to result in risks of material misstatement" (¶ 7.d.). Further, obtaining an understanding of the nature of the company includes understanding "[t]he company's organizational structure and management personnel; [t]he sources of funding of the company's operations and investment activities, including the company's capital structure[, t]he company's operating characteristics, including its size and complexity" (¶ 10), and "an understanding of internal control includes evaluating the design of controls that are relevant to the audit and determining whether the controls have been implemented" (¶ 20).

33. Additionally, auditors must meet AU 230, which requires that auditors "exercise professional skepticism" (at .07) and engagement partners "should be knowledgeable about the client" and are responsible for the "supervision of[] members of the engagement team" (.06).

34. The Audit Partners failed to obtain a sufficient understanding of the Issuers. What little understanding of the Issuers they obtained came almost entirely from draft Form S-1 registration statements and responses to certain questionnaires from the Issuers, both provided by Briner. The Audit Partners did not obtain an understanding of the Issuers through direct communication with the Issuers' officers.

35. In obtaining an understanding of the Issuers, the Audit Partners did not question the substantial similarities among the Issuers. The Issuers filed eleven nearly identical Form S-1 registration statements. Using almost exactly the same language, each stated the following: (1) the Issuers are not blank check companies; (2) the Issuers' officers purchased Issuer stock for $30,000; (2) the Issuers purchased British Columbia mineral claims from Jervis; (3) Jervis supplied nearly all the Issuers' with their business plans; (4) the officers "solely" control the company; (5) the officers planned to devote only 4 to 5 hours each week to the business; and (6) the officers have not inspected the land comprising the mineral claims.

36. Despite Manis reviewing ten of these Form S-1 registration statements and Ridenour reviewing nine, neither raised any concern about the similarities among the registration statements, or perform any enhanced procedures to respond to the level of risk presented.

37. For the above reasons, the Audit Partners failed to meet AS 12 and AU 230.

<u>The Audit Partners Failed to Properly Audit the Issuers' Cash</u>

38. Under PCAOB standard AU Section 330 (The Confirmation Process) ("AU 330"), when "information about the respondent's [i.e., the person or entity from which a confirmation is requested] competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity comes to the auditor's attention, the auditor should consider the effects of such information on designing the confirmation request and evaluating the results" and, in circumstances where "the respondent is the custodian of a material amount of the audited entity's assets," the auditor should exercise "a heightened degree of professional skepticism" and "should consider whether there is sufficient basis for concluding that the confirmation request is being sent to a respondent from whom the auditor can expect the response will provide meaningful and appropriate audit evidence" (at .27).

39. Additionally, under PCAOB Auditing Standard No. 15 (Audit Evidence) ("AS 15"), "[t]he auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion" (¶ 4). To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based. "The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained" (¶ 8). Under PCAOB Auditing Standard No. 13 (The Auditor's Responses to the Risks of Material Misstatement) ("AS 13"), "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence" (¶ 7).

40. The Audit Partners exhibited no concern about Briner's handling of the Issuers' alleged cash. The Audit Partners knew that Briner held all of the Issuers' purported funds in the Master Trust Account and that none of the Issuers had their own bank account. The Audit Partners also knew that Briner was a "consultant" to the Issuers and that MetroWest was a law firm. The Audit Partners did not seek any appropriate audit evidence about what, if any, limitations governed Briner's use of the cash in his Master Trust Account. Nor did they ask for a reconciliation between Briner's Master Trust Account and the schedules Briner provided purportedly showing how much cash in his account was attributable to each Issuer.

41. In addition, the Audit Partners violated the above standards by failing to apply professional skepticism in gathering and evaluating the evidence obtained, such as Briner's confirmation of Issuer cash, and consider Briner's "objectivity and freedom from bias with respect to the audited entity" in relation to the Issuers' cash confirmation Briner provided.

The Audit Partners Disregarded Red Flags that Briner's Services <u>to the Issuers Were Not Given Accounting Recognition</u>

42. Under PCAOB standard AU Section 334 (Related Parties) ("AU 334"), transactions that are indicative of the existence of related parties include, among other things, "transactions [that] are occurring, but are not being given accounting recognition, such as receiving or providing accounting, management or other services at no charge" (at .08(f)). Further, under AS 15, "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor

should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Finally, auditors must exercise professional skepticism throughout the course of the engagement consistent with standard AU 230.

43. The Audit Partners failed to question Briner's fee arrangement with the Issuers. Instead, they relied on legal confirmation letters from Briner that conflicted on their face with what ledgers in their possession showed to be true about the services Briner provided.

44. These letters each stated that "[a]s of the date of inception and up to the present date, the [Issuers were] not indebted to us for services and expenses (billed or unbilled) of which we are aware." The Audit Partners knew that Briner provided substantial services to the Issuers, such as, among other things, performing accounting functions (paying expenses and recording transactions), drafting the Issuers' registration statements, and preparing the Issuers' financial statements for their registration statements. The Audit Partners also knew that the Issuers' financial statements and general ledgers did not reflect payment for Briner's services. Despite this, the Audit Partners did not ask Briner for any invoices, agreements, engagement letters, or any details about his fee arrangements with the Issuers. Nor did they conduct any related party analysis.

45. For the above reasons, the Audit Partners failed to meet AU 334, AS 15, and AU 230.

The Audit Partners Disregarded Red Flags that the
<u>Issuers' Stock Sales to Their Officers Were Shams</u>

46. Under PCAOB Auditing Standard No. 10 (Supervision of the Audit Engagement) ("AS 10"), the engagement partner "is responsible for proper supervision of the work of engagement team members and for compliance with PCAOB standards" (¶ 3) and should "[d]irect engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards" (¶ 5 b.).

47. Briner provided an M&K staff member with schedules for each of the Issuers (prepared by Briner) purportedly listing all transactions that the M&K staff member reviewed (the same person reviewed the audit evidence for all of the Issuers' audits).

48. Each of the schedules appeared to indicate that individuals or entities named "Hyperion Mgmt.", "Luke Pretty", or "Dhaliwal" supplied the funds to pay for the officers' stock purchases and characterized these transactions as "investments." The Issuers' registration statements and stock purchase agreements (also reviewed by the same M&K staff member referred to above), by contrast, indicated that the Issuers' respective officers paid for and purchased the Issuers' stock.

49. Additionally, these schedules contained contradictions, such as dates listed for stock purchases that occurred (1) before the Issuers were incorporated or (2) after the Issuers purchased their mineral claims.

50. The Audit Partners disregarded these inconsistencies and contradictions in the audit evidence in violation of AS 15, AS 12, and AU 230. The Audit Partners also failed to meet AS 10 by failing to direct the M&K staff member reviewing the audit evidence to bring significant accounting and auditing issues to their attention and by otherwise failing to supervise the M&K Issuers' audits.

The Audit Partners Failed to Detect Basic Accounting Errors and Inconsistencies <u>Between the Financial Statements and the Registration Statements</u>

51. Under AU 230, "[a]n auditor should possess 'the degree of skill commonly possessed' by other auditors and should exercise it with 'reasonable care and diligence' (that is, with due professional care)" (at .05). Further, under AS 7, an engagement quality review partner should "review the financial statements" and "read other information in documents containing the financial statements to be filed with the Securities and Exchange Commission . . . and evaluate whether the engagement team has taken appropriate action with respect to any material inconsistencies with the financial statements or material misstatements of fact of which the engagement quality reviewer is aware" (¶ 10 f. and g.).

52. During the audits and engagement quality reviews, the Audit Partners failed to detect basic mistakes in the Issuers' financial statements and inconsistencies between the financial statements and information contained in other parts of the registration statements as reflected in the chart under Appendix A.

53. Mistakes in the financial statements include, among other things, balance sheets that do not foot and conflicts between balance sheets and the notes to the financial statements. Inconsistences between the financial statements and other information in the registration statements include, among other things, the disclosure of a net loss in the registration statement that conflicts with what should be the same disclosure in the Statement of Operations in the financial statements. These errors may constitute material misstatements and reflect the Audit Partners apparent lack of due care in conducting their audits and engagement quality reviews, respectively.

54. For the reasons contained in the attached Chart under Appendix A, the Audit Partners failed to meet AU 230 and AS 7.

<u>Manis Did Not Investigate Failures to Account For Audit Fees</u>

55. Under AS 15, "[t]he auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion" (¶ 4). In doing so, the auditor must exercise professional skepticism throughout the course of the engagement consistent with AU 230.

56. Additionally, under PCAOB Auditing Standard No. 14 (Evaluating Audit Results) ("AS 14"), the "auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements" (¶ 3) and should take into account "[t]ransactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or company policy" (Appendix C, C1.a.(1)).

57. Manis did not question the Issuers' failures to account for audit fees paid during the audit period. Specifically, M&K requested retainers from Stone Boat and Goldstream, which were paid via wire transfers from Briner's Master Trust Account during the audit period for these Issuers. But the retainers M&K received from these Issuers were not reflected in the corresponding schedules that Briner prepared from his Master Trust Account and provided to M&K.

58. For the above reasons, Manis failed to meet AS 14, AS 15, and AU 230.

Manis Accepted Accounting that Violated GAAP

59. From November 2011 through June 2013, Manis served as the engagement partner in charge of auditing Stone Boat's financial statements, the first of the eleven Issuers that M&K would audit. On or about July 27, 2012, Manis consented to the inclusion of M&K's audit report in Stone Boat's Form S-1 registration statement.

60. Manis accepted without question Briner's improper accounting of certain material transactions. Specifically, Briner deleted Stone Boat transactions that purportedly occurred during the audit period on grounds that Stone Boat had purportedly "rescind[ed]" the transactions after the audit period.

61. On June 11, 2012, Briner's assistant sent to M&K, among other things, a schedule purportedly reflecting cash attributable to Stone Boat in the Master Trust Account and financial statements for Stone Boat reflecting all transactions as of May 31, 2012 (Stone Boat's period end). These documents reflected, among other things, (1) a $250,000 private placement for the sale of Stone Boat stock, (2) payments of $75,000 and $67,500 for property, and (3) a $10,000 legal retainer. Briner's assistant also sent a cash confirmation, dated June 11, 2012, signed by Briner confirming that as of May 31, 2012, Briner held $106,105 in cash attributable to Stone Boat in the Master Trust Account.

62. On June 27, 2012, approximately one month after the period's end, Briner sent an email to an M&K employee working on the Stone Boat audit stating the following:

> There have been some dramatic changes with the company over the past two weeks. The Company was forced to rescind the private placement it received for $250,000. As such, it has reversed the two property payments it made as well as the legal retainer for $10,000.
>
> Accordingly, I have reversed all of the transactions required by these changes and am sending you the updated financials and [general ledger].

63. According to Briner's email, the purported rescission apparently occurred after Briner sent the first set of Stone Boat financial statements on June 11, 2012 and therefore, after the period ending May 31, 2012. These subsequent events, therefore, should be treated as non-recognized subsequent events and should not result in adjustment of the financial statements. <u>See</u> ASC 855-10-25-3 (Evidence about Conditions That Did Not Exist at the Date of the Balance Sheet). Briner's accounting on behalf of Stone Boat, therefore, violated GAAP. Manis did not

question the business rationale or motive behind the rescission or Stone Boat's ability to back-out of the transactions such as by conducting an "examination of data to assure that proper cutoffs have been made and . . . information to aid the auditor in his evaluation of the assets and liabilities as of the balance-sheet date," as required under PCAOB standard AU Section 560 (Subsequent Events) ("AU 560") (at .11).

64. Yet Manis accepted this accounting without question. Further, Manis raised no concern with the new documents Briner provided that excluded the above transactions as well as a second cash confirmation dated July 20, 2012 and signed by Briner confirming that, as of May 31, 2012, Briner held $9,570.00 of cash attributable to Stone Boat in his Master Trust Account. Manis failed to resolve the material difference between the June 11, 2012 cash confirmation of $106,105 and the July 20, 2012 cash confirmation of $9,570.

65. In addition to consenting to the filing of his firm's audit report where the Issuers' underlying accounting violated GAAP, Manis failed to meet AS 15, AS 12, AS 3, AU 560, and AU 230 for failing to obtain sufficient appropriate evidence, exercise professional skepticism, and document the consideration of Briner's accounting with respect to the alleged rescission. Manis also failed to meet PCAOB standard AU Section 316 (Consideration of Fraud in a Financial Statement Audit) ("AU 316") for not gaining "an understanding of the business rationale for [a significant transaction that is outside of the normal course of business for the entity] and whether that rationale (or the lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets" (at .66).

66. Further, Ridenour, as the engagement quality review partner for Stone Boat, violated AS 7, which provides that an engagement quality review partner should "evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement" (¶ 9). Manis's decision not to evaluate the manner in which Briner, on behalf of Stone Boat, accounted for the purported rescission was a significant judgment Ridenour should have, but failed, to evaluate.

Manis Ignored Red Flags Indicating that Briner May Have Engaged in a Related Party Transaction With Stone Boat

67. Under AU 334, transactions that because of their nature may be indicative of the existence of related parties include, among other things, "[b]orrowing or lending on an interest-free basis" and "[m]aking loans with no scheduled terms for when or how the funds will be repaid" (at .03(a) and (d)). Further, under AS 15, "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Finally, auditors must exercise professional skepticism throughout the course of the engagement consistent with AU 230.

68. Manis ignored evidence indicating that Stone Boat may have engaged in a related party transaction with Briner and therefore failed to meet the above standards.

69. On June 13, 2012, Briner's assistant sent an email to an M&K employee with two

documents: (1) a related party worksheet listing no related parties for the period ending May 31, 2012 that was signed by Stone Boat's officer, and (2) a confirmation that as of May 31, 2012, MetroWest issued a $100,000 "non-interest bearing demand loan" to Stone Boat.

70. Despite the apparent contradiction between the MetroWest loan to Stone Boat and Stone Boat's officer's assertion that that there were no related party transactions during the audit period, the M&K employee did not investigate the nature of the alleged noninterest bearing loan from MetroWest, including whether it constituted a related party transaction. As a result, Manis violated AU 334, AS 15, AU 230, and AS 10 by failing to direct the M&K staff member reviewing the audit evidence to bring this significant accounting and auditing issue to his attention and by otherwise failing to supervise the Stone Boat audit.

RESPONDENTS VIOLATED SECTION 17(a) OF THE SECURITES ACT, RULE 2-02 OF REGULATION S-X, AND ENGAGED IN IMPROPER PROFESSIONAL CONDUCT

71. As a result of the conduct described above, Respondents violated Sections 17(a)(2) and (3) of the Securities Act by claiming that they conducted the Issuers' audits in accordance with PCAOB standards when in fact they did not.

72. Additionally, for failing to meet the PCAOB audit standards identified above in auditing the Issuers, Respondents engaged in improper professional conduct pursuant to the Commission's Rules of Practice Rule 102(e)(1)(ii) by each engaging in at least one instance of highly unreasonable conduct or at least two instances of unreasonable conduct under Rule 102(e)(1)(iv). Further, M&K violated Rule 2-02(b)(1) of Regulation S-X by providing audit reports included in the Issuers' Form S-1 Registration statements that state that the Issuers' audits were conducted in accordance with PCAOB standards when in fact they were not. Manis and Ridenour caused M&K's violations of Rule 2-02(b)(1) of Regulation S-X by consenting to the filing of such audit reports.

73. Further, as described above, Respondents willfully violated Sections 17(a)(2) and (3) of the Securities Act thereby engaging in conduct subject to the Commission's Rules of Practice Rule 102(e)(1)(iii).

COMMISSION FINDINGS

Based on the foregoing, the Commission finds that:

A. Respondents willfully violated Sections 17(a)(2) and (3) of the Securities Act;

B. Respondents engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice;

C. M&K violated Rule 2-02(b)(1) of Regulation S-X;

D. Manis and Ridenour caused violations of Rule 2-02(b)(1) of Regulation S-X; and

E. Respondents willfully violated Sections 17(a)(2) and (3) of the Securities Act thereby engaging in conduct subject to Section 4C(a)(3) of the Exchange Act and Practice Rule

102(e)(1)(iii) of the Commission's Rules of Practice.

UNDERTAKINGS

Respondent M&K has undertaken to:

A. Acceptance of New Audit Clients. M&K will not accept any new audit client (i) registered with the Commission or (ii) seeking an audit for the purpose of registering securities with the Commission (together, "New Clients") between the date of entry of this Order and the later of twelve months or the date that an independent consultant, described in paragraph B below, certifies in writing that the undertakings discussed herein have been completed to the satisfaction of the independent consultant, as described in paragraph D(5) below.

B. Independent Consultant.

(1) M&K will retain, within thirty days after the entry of this Order, an independent consultant ("Independent Consultant"), not unacceptable to the Commission staff. M&K shall provide to the Commission staff a copy of the engagement letter detailing the scope of the Independent Consultant's responsibilities. The Independent Consultant's compensation and expenses shall be borne exclusively by M&K.

(2) To ensure the independence of the Independent Consultant, M&K: (1) shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant, without the prior written approval of the Commission staff; and (2) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

(3) M&K will require the Independent Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with M&K, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with M&K, or any of its present or former affiliates, directors, officers, partners, 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.

C. Areas Independent Consultant Is To Review. Within the periods specified in paragraph D below, the Independent Consultant will review and evaluate M&K's audit and interim review policies and procedures regarding:

(1) fraud detection;

(2) the exercise of due professional care and professional skepticism;

(3) client acceptance and retention;

(4) obtaining sufficient appropriate audit evidence;

(5) third-party confirmations;

(6) the identification and consideration of disclosures of related parties and related party transactions;

(7) evaluation of and reliance upon management representations;

(8) supervision of individuals working on audits; and

(9) adequate audit documentation, including work paper sign-off, archiving, and dating.

M&K shall cooperate fully with the Independent Consultant and shall provide reasonable access to firm personnel, information, and records as the Independent Consultant may reasonably request for the Independent Consultant's review and evaluation described herein and the reports specified in paragraph D below.

D. Independent Consultant Reports and Certifications.

(1) Within five months of the Independent Consultant being retained, M&K shall require the Independent Consultant to issue a detailed written report ("Report") to M&K: (a) summarizing the Independent Consultant's review and evaluation of the areas identified in paragraph C above; and (b) making recommendations, where appropriate, reasonably designed to ensure that audits conducted by M&K comply with Commission regulations and with PCAOB standards and rules. M&K shall require the Independent Consultant to provide a copy of the Report to the Commission staff when the Report is issued.

(2) M&K will adopt, as soon as practicable, all recommendations of the Independent Consultant in the Report. Provided, however, that within thirty days of issuance of the Report, M&K may advise the Independent Consultant in writing of any recommendation that it considers to be unnecessary, unduly burdensome, or impractical. M&K need not adopt any such recommendation at that time, but instead may propose in writing to the Independent Consultant and the Commission Staff an alternative policy or procedure designed to achieve the same objective or purpose. M&K and the Independent Consultant will engage in good-faith negotiations in an effort to reach agreement on any recommendations objected to by M&K.

(3) In the event that the Independent Consultant and M&K are unable to agree on an alternative proposal within thirty days, M&K either will abide by the determinations of the Independent Consultant or seek approval from the Commission staff pursuant to paragraph B(2) above to engage, at M&K's expense, a qualified third party acceptable to the Commission Staff to promptly resolve the issue(s).

(4) Within sixty days of issuance of the Report, but not sooner than thirty days after a copy of the Report is provided to the Commission staff, M&K will certify to the

Commission staff in writing that it has adopted and has implemented or will implement all recommendations of the Independent Consultant ("Certification of Compliance"). M&K will provide a copy of the Certification of Compliance to the Commission staff.

(5) Within six months of the issuance of the Report, M&K shall require the Independent Consultant to test whether M&K has implemented and enforced its written policies and procedures concerning the areas specified in paragraph C above and assess the effectiveness of those policies and procedures. M&K shall require the Independent Consultant to issue a written final report summarizing the results of the Independent Consultant's test and assessment ("Final Report") and to provide a copy of the Final Report to the Commission Staff. At this time, if the Independent Consultant determines that the undertakings discussed herein have been completed to the satisfaction of the Independent Consultant, M&K shall require the Independent Consultant to certify in writing that the undertakings have been so completed ("Independent Consultant Certification") and provide a copy of this certification to the Commission staff. M&K's undertaking to not accept any New Clients, as described in paragraph A above, shall continue until the Independent Consultant has issued the Independent Consultant Certification.

E. The Report, Final Report, Certification of Compliance, Independent Consultant Certification, and any related correspondence or other documents shall be submitted to Lara Shalov Mehraban, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281, with a copy to the Office of Chief Counsel of the Enforcement Division.

F. 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.

G. M&K agrees that if the Division of Enforcement believes that M&K has not satisfied these undertakings, it may petition the Commission to reopen the matter to determine whether additional sanctions are appropriate.

H. In determining whether to accept M&K's Offer, the Commission has considered these undertakings.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 4C and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondents shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act and Rule 2-02(b)(1) of Regulation S-X.

B. Respondent M&K is censured.

C. Respondent M&K shall pay disgorgement of $49,500.00 and prejudgment interest of $3,833.00, which represents profits gained as a result of the conduct described herein, and civil penalties of $50,000.00 for a total of $103,333.00 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). Payment shall be made in the following installments: (1) $20,666.60, within 10 days of the entry of this Order, (2) $20,666.60, within 90 days of the entry of this Order, (3) $20,666.60, within 180 days of the entry of this Order, (4) $20,666.60, within 270 days of the entry of this Order, and (5) $20,666.60, within 360 days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately at the discretion of the staff of the Commission, without further application.

D. Respondent Manis is denied the privilege of appearing or practicing before the Commission as an accountant.

E. Respondent Manis shall pay civil penalties of $20,000.00 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). Payment shall be made in the following installments: (1) $4,000.00, within 10 days of the entry of this Order, (2) $4,000.00, within 90 days of the entry of this Order, (3) $4,000.00, within 180 days of the entry of this Order, (4) $4,000.00, within 270 days of the entry of this Order, and (5) $4,000.00, within 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 at the discretion of the staff of the Commission, without further application.

F. Respondent Ridenour is denied the privilege of appearing or practicing before the Commission as an accountant.

G. Respondent Ridenour shall pay civil penalties of $15,000.00 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). Payment shall be made in the following installments: (1) $3,000.00, within 10 days of the entry of this Order, (2) $3,000.00, within 90 days of the entry of this Order, (3) $3,000.00, within 180 days of the entry of this Order, (4) $3,000.00, within 270 days of the entry of this Order, and (5) $3,000.00, within 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 at the discretion of the staff of the Commission, without further application.

H. Payment of disgorgement and civil penalties as described in Section IV, paragraphs C, E, and G herein 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 the Respondent by name 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 Lara Shalov Mehraban, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, NY 10281.

I. 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.

J. 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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 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

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Appendix A

Issuer	Engagement Partner	EQR Partner	Audited Financial Statement Errors/ Conflict Between Audited Financial Statements and Other Registration Statement Information
Stone Boat	Manis	Ridenour	<u>Audited Financial Statement Errors</u> • The amounts for Net Cash Used in Operating Activities of $(20,430), Net Cash Used in Investing Activities of $(20,000) and Net Cash Provided by Financing Activities of $30,000 do not foot to the amount presented as Net Change in Cash of $9,570 on the Statement of Cash Flows on Page F-6. The accurately footed amount is $(10,430). • The Net Change in Cash of $9,570 reported on Page F-6 of the Statements of Cash Flows and the Cash at beginning of period of $30,000 do not foot to the Cash at End of Period reported as $9,570. The accurately footed amount is $19,570. • The Recognition of an Impairment Loss (Mineral Claims) of $0 in the Statement of Cash Flows on Page F-6 does not match the Recognition of an Impairment Loss (Property Expenses) of $20,000 on the Statement of Operations on Page F-4. The Statement of Cash Flows is effectively prepared incorrectly. The Net Cash Used in Operating Activities of ($20,430) is overstated for both periods presented. • The Cash at beginning of period of $30,000 "For the period ending" May 31, 2012 does not match the amount of $0 in the column From Inception (September 28, 2011) to May 31, 2012, both amounts appear on the Statement of Cash Flows on Page F-6. The amounts in both columns on page F-6 appear to be the same for both periods presented until the $30,000 amount at the beginning of period in "For the period ending May 31, 2012" column. There is no balance sheet presented that shows the $30,000 opening balance for cash. <u>Conflict Between Audited Financial Statements and Other Registration Statement Information</u> • The Weighted average shares outstanding basic of 16,175,342 under Consolidated Statements of Income and Summary Financial Information on Page 5 does not match the amount of 24,000,000 listed on the Statement of Operations on Page F-4.
Kingman	Ridenour	Manis	<u>Audited Financial Statement Errors</u> • The Net Cash Used in Operating Activities of $0 does not foot to the amount of Net Change in Cash of $(1,995) on the Statement of Cash Flows for the 3 months ended November 30, 2012 (Page F-16). The Cash at the End of Period of $14,330 on page F-16 does not match cash of $16,325 as of November 30, 2012 on the Balance Sheet on page F-14. • The NOL listed in Note 2 as $13,675 is not consistent with Note 7, which lists the NOL as $6,175. <u>Conflict Between Audited Financial Statements and Other Registration Statement Information</u>

Issuer	Engagement Partner	EQR Partner	Audited Financial Statement Errors/ Conflict Between Audited Financial Statements and Other Registration Statement Information
			• "The Company has incurred a net loss of $15,670 for the period from inception to August 31, 2012" as disclosed on Page 34 under Liquidity and Capital Resources, does not match the amount in the Statement of Operations for the same period, which is $(13,675) (Page F-4).
Bonanza	Ridenour	Manis	Audited Financial Statement Error • The NOL listed in Note 2 on page F-7 as $13,675 is not consistent with Note 7 on page F-12, which lists the NOL as $6,175. Conflict Between Audited Financial Statements and Other Registration Statement Information • "The Company has current assets of $14,330… as of November 30, 2012" as disclosed on Page 30 under Liquidity and Capital Resources does not match the amount of Total current assets as of November 30, 2012 on the Balance Sheet, which is $16,325 (Page F-14).
CBL	Ridenour	Manis	Audited Financial Statement Error • The NOL listed in Note 2 on page F-7 as $13,675 is not consistent with Note 7 on page F-12, which lists the NOL as $6,175. Conflict Between Audited Financial Statements and Other Registration Statement Information • "The Company has incurred a net loss of $13,675 for the period from inception to November 30, 2012" as disclosed on Page 32 under Liquidity and Capital Resources does not match the amount in the Statement of Operations for the same period, which is $(15,670) (Page F-15).
Lost Hills	Ridenour	Manis	Audited Financial Statement Error • The NOL listed in Note 2 on page F-7 as $13,675 is not consistent with Note 7 on page F-12, which lists the NOL as $6,175.
Yuma	Ridenour	Manis	Audited Financial Statement Error • The NOL listed in Note 2 on page F-7 as $13,675 is not consistent with Note 7 on page F-12, which lists the NOL as $6,175.
Eclipse	Another M&K Partner	Manis	Audited Financial Statement Error • The NOL listed in Note 2 on page F-7 as $11,175 is not consistent with Note 7 on page F-11, which lists the NOL as $2,675.
Chum	Another M&K Partner	Manis	Audited Financial Statement Error • The NOL listed in Note 2 on page F-7 as $10,175 is not consistent with the table in Note 7 on page F-12, which lists the net loss before taxes as $2,675.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9919 / September 18, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75949 / September 18, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3701 / September 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16339

In the Matter of **JOHN BRINER, ESQ.,** **DIANE DALMY, ESQ.,** **DE JOYA GRIFFITH, LLC,** **ARTHUR DE JOYA, CPA,** **JASON GRIFFITH, CPA,** **CHRIS WHETMAN, CPA,** **PHILIP ZHANG, CPA,** **M&K CPAS, PLLC,** **MATT MANIS, CPA,** **JON RIDENOUR, CPA, and** **BEN ORTEGO, 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 BEN ORTEGO, CPA**

I.

On January 15, 2015, the Securities and Exchange Commission ("Commission") deeming it appropriate, instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 102(e) of the Commission's Rules of Practice against Ben Ortego ("Ortego" or "Respondent").

II.

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

III.

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

RESPONDENT

1. **Ortego**, 35, of Houston, Texas, is a CPA licensed in the state of Texas and, for the relevant time period, a partner of M&K.

RELEVANT ENTITIES AND INDIVIDUALS

2. **John Briner** ("Briner"), 35, is an attorney and a Canadian citizen who resides in Vancouver, British Columbia. Briner's law firm was MetroWest Law Corporation ("MetroWest"). Briner also controlled Jervis Explorations Inc. ("Jervis"), a British Columbia corporation. In 2010, to resolve a Commission action against him alleging a pump-and-dump and market manipulation scheme, Briner consented to the entry of a federal court judgment that enjoined him from violating the antifraud and securities registration provisions of the federal securities laws; barred him for five years from participating in penny stock offerings; and ordered him to disgorge ill-gotten gains of $52,488.32 plus prejudgment interest and pay a civil penalty of $25,000. SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB). The Commission subsequently suspended Briner from appearing or practicing before it as an attorney, with a right to apply for reinstatement after five years. John Briner, Exchange Act Release No. 63371, 2010 WL 4783445 (Nov. 24, 2010).

3. **Diane Dalmy** ("Dalmy"), 58, is an attorney who resides in Denver, Colorado and is admitted to practice law in Colorado. Dalmy issued opinion letters for the issuers identified below.

4. **Jervis** is a British Columbia corporation whose sole director is John Briner. Jervis purportedly sold certain British Columbia mineral claims to each of the issuers.

5. **M&K CPAS, PLLC** ("M&K") is a registered public accounting firm based in Houston, Texas. For all relevant times, Ortego was a partner of M&K.

6. **Chum Mining Group Inc.** ("Chum") is a Nevada corporation organized in June 2012. On November 30, 2012, Chum filed a Form S-1 registration statement with the Commission

[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.

seeking to register management's common shares for resale in a $20,000 public offering. Its registration statement states that it has its principal offices in Edmonton, Alberta, Canada.

7. **<u>Eclipse Resources Inc.</u>** ("Eclipse") is a Nevada corporation organized in May 2012. On December 3, 2012, Eclipse filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in an $18,000 public offering. Its registration statement states that it has its principal offices in Winnipeg, Manitoba, Canada.

8. **<u>PRWC Energy Inc.</u>** ("PRWC") is a Nevada corporation organized in May 2012. On December 6, 2012, PRWC filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. Its registration statement states that it has its principal offices in Salt Lake City, Utah.

9. The issuers identified in paragraphs 6 through 8 are collectively defined herein as the "Issuers."

<u>ORTEGO CONDUCTED MATERIALLY DEFICIENT AUDITS</u>

<u>Background</u>

10. In or about November 2011, Briner contacted M&K to conduct audits of certain issuers' financial statements that were to be included in Form S-1 registration statements. Ortego was the engagement partner for the Issuers' audits.

11. Ortego knew that Briner did the accounting and created the financial statements to be used in the Form S-1 registration statements for each of the Issuers. Ortego also knew that Briner maintained all of the Issuers' purported funds "in trust" in an account Briner controlled (the "Master Trust Account").

12. Briner and his assistant were the exclusive contacts between M&K and each Issuer's officer. Ortego did not directly communicate with any of the Issuers' officers. Ortego knew that Briner provided all of the information concerning the Issuers and all of the supporting evidence for their audits.

13. The Issuers two largest transactions consisted of the officer's purchase of Issuer stock for $30,000 and the Issuer's purchase of British Columbia mineral claims for between $7,500 and $8,500 from Jervis.

14. Ortego conducted the Issuers' audits, including auditing the above transactions, and consented to the inclusion of M&K's audit report in each of the Issuers' Form S-1 registration statements filed with the Commission. M&K was paid a total of $49,500 in fees for the audits, including $9,900 for the Issuers' audits. Each audit report stated that "[w]e conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present the Issuers' financial position "in conformity with U.S. generally accepted accounting principles."

Ortego Failed to Detect Red Flags in Accepting
<u>and Continuing with the Issuers as Clients</u>

15. Under PCAOB Auditing Standard No. 12 (Identifying and Assessing Risks of Material Misstatement) ("AS 12"), auditors should "evaluate whether information obtained from the client acceptance and retention evaluation process or audit planning activities is relevant to identifying risks of material misstatement" (¶ 41).[2]

16. Also, auditors must meet PCAOB standard AU Section 230 (Due Professional Care in the Performance of Work) ("AU 230"), which requires that auditors "exercise professional skepticism" (at .07), "consider the competency and sufficiency of the evidence" (at .08), and "neither assume[] that management is dishonest nor assume[] unquestioned honesty" (at .09).

17. M&K's policy called for "background checks on all significant owners and chief executives." In practice, such check consisted of a simple Internet search.

18. Ortego failed to sufficiently question or otherwise investigate the Issuers' management, which would have revealed Briner's undisclosed role as a control person. Nor did he conduct a background check of Briner or Dalmy, which at minimum would have turned up, among other things, the Commission's complaint alleging fraud and suspension order against Briner, and that Briner had been on the OTC Market's Prohibited Attorney List since March 15, 2006, and that Dalmy had also been on the list since September 25, 2009.

19. Upon referring the Issuers, Briner's assistant provided M&K with the names of the officers, the inception dates, and the year-end dates for each of the Issuers. From this, Ortego was on notice that the three Issuers were incorporated the same day or within one day of each other (May 31, 2012 or June 1, 2012).

20. This information should have at least caused Ortego to question why the Issuers' dates of incorporation appeared to be coordinated. Ortego failed to ask any questions with respect to this information.

21. For the above reasons, Ortego failed to meet AS 12 and AU 230.

<u>Ortego Failed to Obtain an Understanding of the Issuers</u>

22. Under AS 12, auditors should "obtain an understanding of the company and its environment . . . to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement," including "[t]he nature of the company" (¶ 7.b.) and "[t]he company's objectives and strategies and those related business risks that might reasonably be expected to result in risks of material misstatement" (¶ 7.d.). Further, obtaining an understanding of the nature of the company includes understanding "[t]he company's organizational structure and management personnel; [t]he sources of funding of the company's operations and investment activities, including the company's capital structure[, t]he company's operating characteristics, including its size and complexity" (¶ 10), and "an

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[2] The PCAOB standards referenced herein are the standards that were in effect during the time of relevant conduct.

understanding of internal control includes evaluating the design of controls that are relevant to the audit and determining whether the controls have been implemented" (¶ 20).

23. Additionally, auditors must meet AU 230, which requires that auditors "exercise professional skepticism" (at .07) and engagement partners "should be knowledgeable about the client" and are responsible for the "supervision of[] members of the engagement team" (.06).

24. Ortego failed to obtain a sufficient understanding of the Issuers. What little understanding of the Issuers he obtained came almost entirely from draft Form S-1 registration statements and responses to certain questionnaires from the Issuers, both provided by Briner. Ortego did not obtain an understanding of the Issuers through direct communication with the Issuers' officers.

25. In obtaining an understanding of the Issuers, Ortego did not question the substantial similarities among the Issuers. The Issuers filed three nearly identical Form S-1 registration statements. Using almost exactly the same language, each stated the following: (1) the Issuers are not blank check companies; (2) the Issuers' officers purchased Issuer stock for $30,000; (2) the Issuers purchased British Columbia mineral claims from Jervis; (3) Jervis supplied nearly all the Issuers' with their business plans; (4) the officers "solely" control the company; (5) the officers planned to devote only 4 to 5 hours each week to the business; and (6) the officers have not inspected the land comprising the mineral claims.

26. Despite reviewing all three of the Issuers' registration statements within a six-week period, Ortego did not raise any concern about the similarities among the registration statements, or perform any enhanced procedures to respond to the level of risk presented.

27. For the above reasons, Ortego failed to meet AS 12 and AU 230.

Ortego Failed to Properly Audit the Issuers' Cash

28. Under PCAOB standard AU Section 330 (The Confirmation Process) ("AU 330"), when "information about the respondent's [i.e., the person or entity from which a confirmation is requested] competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity comes to the auditor's attention, the auditor should consider the effects of such information on designing the confirmation request and evaluating the results" and, in circumstances where "the respondent is the custodian of a material amount of the audited entity's assets," the auditor should exercise "a heightened degree of professional skepticism" and "should consider whether there is sufficient basis for concluding that the confirmation request is being sent to a respondent from whom the auditor can expect the response will provide meaningful and appropriate audit evidence" (at .27).

29. Additionally, under PCAOB Auditing Standard No. 15 (Audit Evidence) ("AS 15"), "[t]he auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion" (¶ 4). To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based. "The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained" (¶ 8). Under PCAOB Auditing Standard No. 13 (The Auditor's Responses to the Risks of Material Misstatement) ("AS 13"),

"[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence" (¶ 7).

30. Ortego exhibited no concern about Briner's handling of the Issuers' alleged cash. Ortego knew that Briner held all of the Issuers' purported funds in the Master Trust Account and that none of the Issuers had their own bank account. Ortego also knew that Briner was a "consultant" to the Issuers and that MetroWest was a law firm. Ortego did not seek any appropriate audit evidence about what, if any, limitations governed Briner's use of the cash in his Master Trust Account. Nor did he ask for a reconciliation between Briner's Master Trust Account and the schedules Briner provided purportedly showing how much cash in his account was attributable to each Issuer.

31. In addition, Ortego violated the above standards by failing to apply professional skepticism in gathering and evaluating the evidence obtained, such as Briner's confirmation of Issuer cash, and consider Briner's "objectivity and freedom from bias with respect to the audited entity" in relation to the Issuers' cash confirmation Briner provided.

Ortego Disregarded Red Flags that Briner's Services to the Issuers Were Not Given Accounting Recognition

32. Under PCAOB standard AU Section 334 (Related Parties) ("AU 334"), transactions that are indicative of the existence of related parties include, among other things, "transactions [that] are occurring, but are not being given accounting recognition, such as receiving or providing accounting, management or other services at no charge" (at .08(f)). Further, under AS 15, "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Finally, auditors must exercise professional skepticism throughout the course of the engagement consistent with standard AU 230.

33. Ortego failed to question Briner's fee arrangement with the Issuers. Instead, he relied on legal confirmation letters from Briner that conflicted on their face with what ledgers in his possession showed to be true about the services Briner provided.

34. These letters each stated that "[a]s of the date of inception and up to the present date, the [Issuers were] not indebted to us for services and expenses (billed or unbilled) of which we are aware." Ortego knew that Briner provided substantial services to the Issuers, such as, among other things, performing accounting functions (paying expenses and recording transactions), drafting the Issuers' registration statements, and preparing the Issuers' financial statements for their registration statements. Ortego also knew that the Issuers' financial statements and general ledgers did not reflect payment for Briner's services. Despite this, Ortego did not ask Briner for any invoices, agreements, engagement letters, or any details about his fee arrangements with the Issuers. Nor did he conduct any related party analysis.

35. For the above reasons, Ortego failed to meet AU 334, AS 15, and AU 230.

<u>Ortego Did Not Investigate the Issuers' Failures to Account For Audit Fees</u>

36. Under AS 15, "[t]he auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion" (¶ 4). In doing so, the auditor must exercise professional skepticism throughout the course of the engagement consistent with AU 230.

37. Additionally, under PCAOB Auditing Standard No. 14 (Evaluating Audit Results) ("AS 14"), the "auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements" (¶ 3) and should take into account "[t]ransactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or company policy" (Appendix C, C1.a.(1)).

38. Ortego did not question the Issuers' failures to account for audit fees paid during the audit period, or failures to account for audit fees paid during the subsequent events period.

39. Specifically, Ortego failed to investigate conflicting evidence regarding the audit fees received for the Issuers: Chum, Eclipse, and PRWC. Even though M&K received $9,900 on August 14, 2012 from Briner to cover the Issuers' audit fees ($3,300 each), Ortego did not question why Briner accounted only for the payment he made for Chum in the schedules he provided and not the payments he made for Eclipse and PRWC. Ortego was the engagement partner for all three Issuers. Yet he did not investigate this discrepancy.

40. For the above reasons, Ortego failed to meet AS 14, AS 15, and AU 230.

Ortego Failed to Detect Basic Accounting Errors and Inconsistencies <u>Between the Financial Statements and the Registration Statements</u>

41. Under AU 230, "[a]n auditor should possess 'the degree of skill commonly possessed' by other auditors and should exercise it with 'reasonable care and diligence' (that is, with due professional care)" (at .05).

42. During the audits, the Ortego failed to detect inconsistencies between the financial statements and information contained in other parts of the registration statements. Specifically, in the Eclipse Form S-1 registration statement, the NOL listed in Note 2 on page F-7 as $11,175 is not consistent with Note 7 on page F-11, which lists the NOL as $2,675. Additionally, in the Chum Form S-1 registration statement, the NOL listed in Note 2 on page F-7 as $10,175 is not consistent with the table in Note 7 on page F-12, which lists the net loss before taxes as $2,675. These errors may constitute material misstatements and reflect Ortego's apparent lack of due care in conducting the Issuers' audits.

43. For these reasons, Ortego failed to meet AU 230.

Ortego Disregarded Red Flags that the Issuers' <u>Stock Sales to Their Officers Were Shams</u>

44. Under PCAOB Auditing Standard No. 10 (Supervision of the Audit Engagement)

("AS 10"), the engagement partner "is responsible for proper supervision of the work of engagement team members and for compliance with PCAOB standards" (¶ 3) and should "[d]irect engagement team members to bring significant accounting and auditing issues arising during the audit to the attention of the engagement partner or other engagement team members performing supervisory activities so they can evaluate those issues and determine that appropriate actions are taken in accordance with PCAOB standards" (¶ 5 b.).

45. Briner provided an M&K staff member with schedules for each of the Issuers (prepared by Briner) purportedly listing all transactions that the M&K staff member reviewed (the same person reviewed the audit evidence for all of the Issuers' audits).

46. Each of the schedules appeared to indicate that individuals or entities named "Luke Pretty" or "Dhaliwal" supplied the funds to pay for the officers' stock purchases and characterized these transactions as "investments." The Issuers' registration statements and stock purchase agreements (also reviewed by the same M&K staff member referred to above), by contrast, indicated that the Issuers' respective officers paid for and purchased the Issuers' stock.

47. Additionally, these schedules contained contradictions, such as dates listed for stock purchases that occurred (1) before the Issuers were incorporated or (2) after the Issuers purchased their mineral claims.

48. Ortego disregarded these inconsistencies and contradictions in the audit evidence in violation of AS 15, AS 12, and AU 230. Ortego also failed to meet AS 10 by failing to direct the M&K staff member reviewing the audit evidence to bring significant accounting and auditing issues to his attention and by otherwise failing to supervise the M&K Issuers' audits.

ORTEGO VIOLATED SECTION 17(a) OF THE SECURITES ACT, RULE 2-02 OF REGULATION S-X, AND ENGAGED IN IMPROPER PROFESSIONAL CONDUCT

49. As a result of the conduct described above, Ortego violated Sections 17(a)(2) and (3) of the Securities Act by claiming that the audits he conducted the Issuers audits in accordance with PCAOB standards when in fact he did not.

50. Additionally, for failing to meet the PCAOB audit standards identified above in auditing the Issuers, Ortego engaged in improper professional conduct pursuant to the Commission's Rules of Practice Rule 102(e)(1)(ii) by each engaging in at least one instance of highly unreasonable conduct or at least two instances of unreasonable conduct under Rule 102(e)(1)(iv). Ortego also caused violations of Rule 2-02(b)(1) of Regulation S-X by consenting to the provision of audit reports included in the Issuers' Form S-1 Registration statements that state that the Issuers' audits were conducted in accordance with PCAOB standards when in fact they were not.

51. Further, as described above, Ortego willfully violated Sections 17(a)(2) and (3) of the Securities Act thereby engaging in conduct subject to the Commission's Rules of Practice Rule 102(e)(1)(iii).

COMMISSION FINDINGS

Based on the foregoing, the Commission finds that Respondent:

A. willfully violated Sections 17(a)(2) and (3) of the Securities Act;

B. engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice;

C. caused violations of Rule 2-02(b)(1) of Regulation S-X; and

D. willfully violated Sections 17(a)(2) and (3) of the Securities Act thereby engaging in conduct subject to Section 4C(a)(3) of the Exchange Act and Practice Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 4C and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act and Rule 2-02(b)(1) of Regulation S-X.

B. Respondent 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 Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

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

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

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

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

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

D. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the Securities and Exchange Commission 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

Ortego 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 Lara Shalov Mehraban, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, NY 10281.

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

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, 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. 9921 / September 18, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75951 / September 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16339

In the Matter of **JOHN BRINER, ESQ.,** **DIANE DALMY, ESQ.,** **DE JOYA GRIFFITH, LLC,** **ARTHUR DE JOYA, CPA,** **JASON GRIFFITH, CPA,** **CHRIS WHETMAN, CPA,** **PHILIP ZHANG, CPA,** **M&K CPAS, PLLC,** **MATT MANIS, CPA,** **JON RIDENOUR, CPA, and** **BEN ORTEGO, CPA,** **Respondents.**	**ORDER DISMISSING** **CHRIS WHETMAN, CPA** **FROM PROCEEDING**

On January 15, 2015, the Securities and Exchange Commission ("Commission") instituted the instant public administrative and cease-and-desist proceedings against, among others, Chris Whetman, CPA ("Whetman"). The proceedings are currently before an administrative law judge.

Whetman has offered to settle the charges in these proceedings and charges arising from Whetman's conduct in connection with audits of Idle Media, Inc., conduct that was not alleged in the instant proceedings. Whetman, therefore, submitted an offer of settlement, which the Commission determined to accept, in which Whetman consented to a Commission order, captioned In the Matter of Chris Whetman, Admin. Proc. No. 3-16821, making findings of fact and imposing remedial sanctions in connection with the conduct alleged in these proceedings and the conduct relating to Idle Media, Inc.

Accordingly, IT IS ORDERED that Chris Whetman be dismissed from the instant proceedings.

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. 9920 / September 18, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75950 / September 18, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3702 / September 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16821

In the Matter of CHRISTOPHER D. WHETMAN, CPA, Respondent.	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE AND DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, 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, Sections 4C, and 21C of the Securities Exchange Act, and Rule 102(e) of the Commission's Rules of Practice against Christopher D. Whetman ("Whetman" or "Respondent").

II.

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

III.

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

SUMMARY

1. On or about July 17, 2012, Whetman consented to the inclusion of an audit report reflecting an audit he conducted of La Paz Mining Corp.'s ("La Paz") financial statements in a Form S-1 registration statement filed with the Commission. This audit report falsely stated that "[w]e conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present La Paz's financial position "in conformity with U.S. generally accepted accounting principles." Additionally, in or about November 2012, while auditing La Paz's interim financial statements, Whetman failed to appropriately respond to an employee's concerns that La Paz was part of a fraudulent scheme. As described below, the audit Whetman conducted was so deficient that it amounted to no audit at all, and Whetman ignored red flags that La Paz was part of a fraud.

2. Whetman also engaged in improper professional conduct by failing to comply with Public Company Accounting Oversight Board ("PCAOB") Standards when leading certain of his firm's audits of Idle Media, Inc.'s ("Idle Media") 2010 and 2011 fiscal year-end consolidated financial statements, which Idle Media restated multiple times.

3. On January 15, 2015, the Commission instituted public administrative and cease-and-desist proceedings captioned In the Matter of John Briner, Esq., et al., Admin. Proc. File No. 3-16339 against Whetman (the "Briner Action"), among others, in connection with Whetman's audit of La Paz's financial statements, described above. The Commission dismissed Whetman from that proceeding in connection with instituting the instant proceeding that makes findings of fact concerning Whetman's audits of both La Paz and Idle Media and imposes remedial sanctions.

RESPONDENTS

4. **Whetman**, 47, of Las Vegas, Nevada, is a CPA licensed in the state of Nevada and a partner at De Joya Griffith, LLC ("De Joya"). Whetman served as the engagement partner for an audit of La Paz Mining Corp. ("La Paz"). Whetman also served as the audit manager for De Joya's original audit of Idle Media's 2010 fiscal year-end financial statements and for De Joya's quarterly review of Idle Media's financial statements for the quarter ended December 31, 2010. After March 2012, when Whetman became partner at De Joya, Whetman served as De Joya's engagement partner on all later engagements to perform audits and quarterly reviews of Idle Media's financial statements, including all engagements to audit or review Idle Media's restated financial statements.

[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.

RELEVANT ENTITIES AND INDIVIDUALS

5. **John Briner** ("Briner"), 35, is an attorney and a Canadian citizen who resides in Vancouver, British Columbia. Briner's law firm was MetroWest Law Corporation ("MetroWest"). Briner also controlled Jervis Explorations Inc. ("Jervis"), a British Columbia corporation. In 2010, to resolve a Commission action against him alleging a pump-and-dump and market manipulation scheme, Briner consented to the entry of a federal court judgment that enjoined him from violating the antifraud and securities registration provisions of the federal securities laws; barred him for five years from participating in penny stock offerings; and ordered him to disgorge ill-gotten gains of $52,488.32 plus prejudgment interest and pay a civil penalty of $25,000. SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB). The Commission subsequently suspended Briner from appearing or practicing before it as an attorney, with a right to apply for reinstatement after five years. John Briner, Exchange Act Release No. 63371, 2010 WL 4783445 (Nov. 24, 2010).

6. **Diane Dalmy** ("Dalmy"), 58, is an attorney who resides in Denver, Colorado and is admitted to practice law in Colorado. Dalmy issued opinion letters for eighteen issuers referred to her by Briner.

7. **Jervis** is a British Columbia corporation whose sole director is John Briner. Jervis purportedly sold certain British Columbia mineral claims to twenty issuers, including La Paz.

8. **De Joya Griffith** is a registered public accounting firm based in Henderson, Nevada. De Joya issued audit reports for nine issuers referred to it by Briner. For all relevant times, Whetman was a partner of De Joya. De Joya has also been Idle Media's auditor from December 2010 to the present. De Joya also performed quarterly reviews for Idle Media.

9. **La Paz** is a Nevada corporation organized in November 2011. On July 19, 2012, La Paz filed a Form S-1 registration statement with the Commission seeking to register management's common shares for resale in a $20,000 public offering. On September 25, 2012, La Paz filed an amendment to its Form S-1 registration statement. La Paz's registration statement states that it has its principal offices in Peoria, Arizona.

10. **Idle Media** is a Nevada corporation based in Leesport, Pennsylvania. Idle Media develops and operates several websites focusing on music, music videos and gaming. Idle Media became a publicly traded company in May 2010 through a reverse merger with another corporation. Idle Media's stock was voluntarily registered with the Commission pursuant to Section 12(g) of the Exchange Act from August 2012 to December 2013. During that period, Idle Media's stock was quoted on the OTC Bulletin Board under the ticker symbol "IDLM." The stock is currently quoted on the OTC Link, which is operated by OTC Markets Group Inc. Approximately 65% of Idle Media's outstanding stock is owned by its parent company, Zoeter (f/k/a Idle Media, LLC).

11. **Marcus Frasier**, 30, is a resident of Shoemakersville, Pennsylvania. Frasier is the founder of Idle Media and is its CEO. Frasier also owns Zoeter and is its only member.

WHETMAN CONDUCTED A MATERIALLY DEFICIENT AUDIT OF LA PAZ

Background

12. Beginning in or about November 2011, Briner contacted De Joya to conduct audits of nine issuers' financial statements that were to be included in Form S-1 registration statements. Whetman was the engagement partner for the audit of La Paz, one of the nine issuers, from March 2012 through June 2013 (when De Joya resigned from the engagement).

13. Whetman knew that Briner did the accounting and created the financial statements to be used in La Paz's Form S-1 registration statement. Whetman also knew that Briner maintained all of La Paz's purported funds "in trust" in an account Briner controlled (the "Master Trust Account").

14. Briner and his assistant were the exclusive contacts between De Joya and La Paz's sole officer. Whetman did not directly communicate with La Paz's sole officer. Whetman knew that Briner provided all of the information concerning La Paz and all of the supporting evidence for its audit.

15. La Paz's two largest transactions consisted of the officer's purchase of La Paz stock for $30,000 and the La Paz's purchase of a British Columbia mineral claim for $20,000 from Jervis.

16. Whetman conducted La Paz's audit, including auditing the above transactions, and consented to the inclusion of De Joya's audit report in La Paz's Form S-1 registration statement filed with the Commission on or about July 17, 2012. De Joya was paid a total approximately $4,000 for the La Paz audit. La Paz's audit report stated that "[w]e conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present La Paz's financial position "in conformity with U.S. generally accepted accounting principles." As described below, the audit was so deficient that it amounted to no audit at all, and Whetman ignored red flags.

Whetman Failed to Appropriately Identify and Assess Risks in Accepting and Continuing with La Paz as a Client

17. Under PCAOB Auditing Standard No. 12 (Identifying and Assessing Risks of Material Misstatement) ("AS 12"), auditors should "evaluate whether information obtained from the client acceptance and retention evaluation process or audit planning activities is relevant to identifying risks of material misstatement" (¶ 41).[2]

18. Also, auditors must meet PCAOB standard AU Section 230 (Due Professional Care in the Performance of Work) ("AU 230"), which requires that auditors "exercise professional skepticism" (at .07), "consider the competency and sufficiency of the evidence" (at .08), and "neither assume[] that management is dishonest nor assume[] unquestioned honesty" (at .09).

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[2] The PCAOB standards referenced herein are the standards that were in effect during the time of relevant conduct.

19. De Joya's client acceptance policy instructed its staff to "confirm individuals" and, if there was something to report, to "summarize findings, site [sic] sources, and email Partner." In practice, such check consisted of a simple Internet search.

20. Whetman failed to sufficiently question or otherwise investigate La Paz's management, which would have revealed Briner's undisclosed role as a control person. Nor did he conduct a background check of Briner or Dalmy, which at minimum would have turned up, among other things, the Commission's complaint alleging fraud and suspension order against Briner, and that Briner had been on the OTC Market's Prohibited Attorney List since March 15, 2006, and that Dalmy had also been on the list since September 25, 2009.

21. For the above reasons, Whetman failed to meet AS 12 and AU 230.

Whetman Disregarded Red Flags that La Paz's Stock Sale to Its Officer Was a Sham

22. Under PCAOB Auditing Standard No. 15 (Audit Evidence) ("AS 15"), "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Under AS 12, the auditor should obtain "an understanding of the nature of the company include[ing]...the sources of funding of the company's operations" (¶ 10) and "[w]hen the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments" (¶ 74). Further, under PCAOB Auditing Standard No. 14 (Evaluating Audit Results) ("AS 14"), auditors should consider "[t]he sufficiency and appropriateness of the audit evidence obtained" (¶ 4.f.). In meeting these standards, auditors must apply professional skepticism and due care consistent with AU 230.

23. Whetman failed to resolve significant contradictions and inconsistencies in the audit evidence supporting La Paz's stock sale to its officer in violation of these standards.

24. Specifically, Whetman received contradicting accounting support as to who paid $30,000 for La Paz's stock. On or about May 29, 2012, Briner sent a purported schedule for La Paz (prepared by Briner purportedly reflecting cash attributable to La Paz in the Master Trust Account) that conflicted with the stock purchase agreement for La Paz stock. The schedule showed that the $30,000 for the purchase of La Paz stock was paid for by an entity called "Hyperion [Management]." The stock purchase agreement (and La Paz's registration statement), by contrast, described the stock purchase as a transaction between La Paz and La Paz's officer. Despite this red flag, Whetman never resolved the issue of who paid for the La Paz stock.

25. In fact, the back-up documentation Briner provided to support the stock purchase further confused the issue. It showed that another entity apparently provided the funds for the stock purchase. On July 4, 2012, in response to De Joya staff requests for support for the stock purchase, Briner sent an email with information reflecting an alleged deposit into the Master Trust Account on December 29, 2011 for $39,280.60 from an entity referred to as Ft-Green Omega, Inc. In the email, Briner stated that "$30,000 was earmarked for the project [i.e., La Paz]."

26. The La Paz audit team then requested the corresponding bank statements. In response, on July 11, 2012, Briner sent an email containing what appear to be computer screen shots reflecting transactions in the Master Trust Account. Briner indicated these screen shots were "bank statements." No actual bank statements were received by De Joya in connection with the La Paz audit. The computer screen shot Briner provided appeared to show a deposit by Ft-Green Omega, Inc. on December 29, 2011 for $39,280.60. In this same email, Briner also sent a revised schedule for La Paz changing the date of the stock purchase from November 23, 2011 to December 29, 2011, apparently to make it consistent with the computer screen shots. Briner left the name "Hyperion [Management]" in this later version of the La Paz schedule. Despite the contradicting evidence regarding who paid for (and owned) La Paz's stock, Whetman took no further action with respect to the stock purchase.

27. For these reasons, Whetman failed to meet AS 14, AS 15, AS 12, and AU 230.

<u>Whetman Disregarded Red Flags that La Paz's Mineral Claim Purchase Was a Sham</u>

28. Like the evidence supporting the stock purchase, the La Paz schedule and the computer screen shots Briner provided to Whetman in support of the mineral claim purchase (the same documents used to support the stock purchase) conflicted with one another. As described below, Whetman failed to resolve these conflicts and therefore violated AS 15, AS 12, and AU 230.

29. First, the La Paz schedule Briner provided to De Joya described the mineral claim purchase as a $20,000 wire transfer occurring on December 12, 2011. The transaction in the computer screen shots was a $20,000 debit (not a wire) occurring on December 30, 2011. Further, in the computer screen shot also provided by Briner, this transaction is characterized in the description as "Business Investment Savings." No mention in the description was made to Jervis or how the cash was transferred. From this, it is impossible to determine whether La Paz actually paid Jervis for the mineral claim. Moreover, if the funds were in fact transferred via a wire, there is no sufficient explanation for the discrepancy between December 12 (the date listed in the La Paz schedule that funds were sent) and December 30 (the date listed in the computer screen shots that funds were sent). Later, in an apparent attempt to cover up the date discrepancies, Briner changed the dates of the mineral claim purchase from December 12 to December 30, 2011 when he sent De Joya a revised schedule for La Paz (like he did for the dates of the alleged stock purchase).

30. Second, on July 17, 2012, Whetman requested additional support for La Paz's mineral claim purchase. In response, on July 18, 2012, Briner provided a check, numbered 350, that was from MetroWest to Jervis for $20,000 and was dated December 30, 2011. "La Paz Mining" was written in the memo line. Briner included copies of both the front and back of the check, but the back of the check was obscured such that it was impossible to tell whether the check had been cashed. The $20,000 transaction listed in the computer screen shots that Briner indicated was for the mineral claim purchase, however, did not reference a check number 350, or any check for $20,000. The check numbers on the computer screen shots ranged from 1 to 253. Whetman failed to question this discrepancy, despite the fact that the computer screen shots reference approximately thirty other transactions that each appear to identify the check numbers associated with cashed checks.

31. Finally, Briner provided evidence to Whetman indicating that La Paz's mineral claim purchase may not have been the result of arms-length negotiation because Briner appeared to have been behind the sale. Specifically, the purchase agreement Whetman relied on to support La Paz's mineral claim purchase contained an invoice for the claim listing Briner's name (in typeface) as the signatory on behalf of Jervis. Whetman did not do any additional investigation into whether the purchase was a related party transaction.

32. In this regard, Whetman also violated PCAOB standard AU Section 334 (Related Parties) ("AU 334") (because Briner appeared to control Jervis and Whetman failed to, among other things, "review the extent and nature of business transacted with [Jervis] for indications of previously undisclosed relationships" (.08(e))), and PCAOB Auditing Standard No. 13 (The Auditor's Responses to the Risks of Material Misstatement) ("AS 13"), which states that "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence" (¶ 7).

Whetman Failed to Resolve Discrepancies in the
<u>Audit Evidence Supporting the Officer's Fee</u>

33. Whetman accepted evidence that purported to support fees paid to La Paz's officer that did not in fact provide support. On or about October 28, 2012, a De Joya staff accountant asked for documents reflecting the payment of fees to, among others, La Paz's officer. The next day, Briner's assistant sent documents appearing to reflect wire transfers from MetroWest to, among others, Crown Capital Partners for $6,000. The La Paz schedule indicated that its officer was paid $2,000 and does not mention Crown Capital Partners. Although Briner's assistant indicated in an email that the wire to Crown Capital Partners was for La Paz's officer (for services to three companies), she did not provide any other evidence of this or how the $6,000 was allocated. And Whetman did not ask La Paz's officer whether he was paid his fee or how the $6,000 was allocated among the issuers he served as the officer. Nonetheless, Whetman accepted these documents as support for La Paz's officer's fees.

34. Whetman failed to resolve these conflicts or obtain sufficient appropriate audit evidence to support De Joya's opinion and therefore violated AS 15, AS 12, and AU 230.

<u>Whetman Failed to Properly Audit La Paz's Cash</u>

35. Under PCAOB standard AU Section 330 (The Confirmation Process) ("AU 330"), when "information about the respondent's [i.e., the person or entity from which a confirmation is requested] competence, knowledge, motivation, ability, or willingness to respond, or about the respondent's objectivity and freedom from bias with respect to the audited entity comes to the auditor's attention, the auditor should consider the effects of such information on designing the confirmation request and evaluating the results" and, in circumstances where "the respondent is the custodian of a material amount of the audited entity's assets," the auditor should exercise "a heightened degree of professional skepticism" and "should consider whether there is sufficient basis for concluding that the confirmation request is being sent to a respondent from whom the auditor can expect the response will provide meaningful and appropriate audit evidence" (at .27).

36. Additionally, under AS 15, "[t]he auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion" (¶ 4). To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based. "The reliability of evidence depends on the nature and source of the evidence and the circumstances under which it is obtained" (¶ 8). Under AS 13, "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence" (¶ 7).

37. Whetman exhibited no concern about Briner's handling of La Paz's alleged cash. Whetman knew that Briner held all of La Paz's purported funds in his Master Trust Account and that La Paz did not have its own bank account. Whetman also knew that Briner was a "consultant" to La Paz and that MetroWest was a law firm. Whetman did not seek any appropriate audit evidence about what, if any, limitations governed Briner's use of the cash in his Master Trust Account. Nor did he ask for a reconciliation between Briner's Master Trust Account and the schedules Briner provided purportedly showing how much cash in his account was attributable to La Paz.

38. In addition, Whetman violated the above standards by failing to apply professional skepticism in gathering and evaluating the evidence obtained, such as Briner's confirmation of La Paz's cash, and consider Briner's "objectivity and freedom from bias with respect to the audited entity" in relation to the cash confirmation Briner provided.

Whetman Disregarded Red Flags that Briner's Services to La Paz Were Not Given Accounting Recognition

39. Under AU 334, transactions that are indicative of the existence of related parties include, among other things, "transactions [that] are occurring, but are not being given accounting recognition, such as receiving or providing accounting, management or other services at no charge" (at .08(f)). Further, under AS 15, "[i]f audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit" (¶ 29). Finally, auditors must exercise professional skepticism throughout the course of the engagement consistent with standard AU 230.

40. During the La Paz audit, the audit team requested details concerning Briner's fee arrangement with La Paz. In a November 29, 2012 email response, Briner indicated that he would charge between $10,000 and $25,000 for his services, but was not "comfortable" estimating his bill because he told his "client" he "would work out a fair bill at the end of the project and [his client] would find interim billing in the financials without their prior approval to be offensive." Whetman failed to investigate further and allowed this material liability to remain undisclosed.

41. For the above reasons, Whetman failed to meet AU 334, AS 15, and AU 230.

Whetman Failed to Adequately Respond to Concerns that
Briner and Dalmy May Have Been Engaging in Fraud

42. In early November 2012, while Whetman was reviewing La Paz's interim financial statement, a De Joya staff member raised concerns to Whetman and another De Joya partner, who was auditing the other eight Briner-referred issuers, that Briner and Dalmy may be engaging in fraud with respect to the issuers they were auditing, including La Paz.

43. Under AS 12, "[t]he auditor's assessment of the risks of material misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments" (¶ 74).

44. Further, under AS 13, "[t]he auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence [including] . . . modifying the planned audit procedures to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management's explanations or representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor, or examination of documentation from independent sources" (¶ 7).

45. Whetman failed to (a) properly consider the risks associated with La Paz's audit, (b) apply professional skepticism in evaluating audit evidence indicating Briner and Dalmy may be engaging in fraud, and (c) re-evaluate his risk assessments for the La Paz audit in light of such evidence in violation of AS 12 and AS 13.

46. On or about November 5, 2012, a De Joya staff member became concerned that Briner might be engaging in fraud in connection with the issuers referred from Briner. Her concern stemmed from conversations she had with certain issuers' officers in which nearly all her questions about the issuers were deferred to Briner. These conversations caused her to conduct an internet search on Briner. She found, among other things, the Commission's complaint against him. Additional searches yielded news articles describing Briner and Dalmy as repeat securities fraud offenders.

47. As a result, the De Joya staff member sent four emails over three days sharing the negative information she found concerning Briner and Dalmy. First, on November 5, 2012, she sent Whetman and the other De Joya partner an email containing links to the Commission's complaint against Briner (SEC v. Golden Apple Oil and Gas, Inc., et al., 09-Civ-7580 (S.D.N.Y.) (HB)) and a Canadian news article stating, among other things, that the British Columbia Securities Commission issued an order (reciprocal to the Commission's order suspending Briner) banning Briner from trading shares in British Columbia or "acting in a management or consultative capacity in any securities related matter."[3] In the email, she asked Whetman and the other De Joya partner to "review the links" and stated that she "will call [the other De Joya partner] tonight."

[3] http://www.canadianjusticereviewboard.ca/article-securities%20lawyer.htm

48. Second, that same day, the De Joya staff member sent another email to Whetman and the other De Joya partner with a link to an article posted on Pumpsanddumps.com stating that Briner and Dalmy "together and apart, the pair has been involved in dozens of schemes on the Vancouver market as well as the Pink sheets and OTC Bulletin Board, writing many a dubious legal opinion resulting in millions of dollars lost by thousands of investors."[4]

49. Third, on November 7, 2012, the De Joya staff member sent yet another email to Whetman and the other De Joya partner attaching an article about a De Joya client, MoneyMinding International Corp., and its counsel, Dalmy, who was described as having "a reputation for helping scoundrel promoters take dubious companies public on the U.S. over-the-counter markets." The article also specifically mentions De Joya as having "similarly helped many dubious companies go public on the bulletin board."[5]

50. Finally, the same day, the De Joya staff member forwarded the email and article to one of De Joya's two managing partners stating, "I thought I should forward this to you as well. I was doing research on Diane Dalmy and John Briner as we are working on some of their jobs and that's how I can [sic] across this article." The managing partner then forwarded her email with the attached article to De Joya's other managing partner without comment.

51. In light of the negative background the De Joya staff member found and the officers' apparent inability to answer questions about the issuers, the staff member found it suspicious that Briner and Dalmy were working together on eight of the nine De Joya issuers. The staff member discussed her concerns with the other De Joya partner. Whetman and that De Joya partner then discussed the staff member's concerns and resolved that the other De Joya partner would raise them with De Joya's two managing partners, which he did.

52. Whetman did not follow-up with the De Joya partner on the matter, nor did he do anything further regarding the La Paz audit, such as considering whether to withdraw the audit reports on La Paz's financial statements that had been filed. Nor did Whetman do anything further with respect to La Paz's interim financial statements, which he was reviewing at the time. Whetman, therefore failed to meet PCAOB standard AU Section 561 (Subsequent Discovery of Facts Existing at the Date of the Auditor's Report) ("AU 561"), which provides that "[w]hen the auditor becomes aware of information which relates to financial statements previously reported on by him, but which was not known to him at the date of his report, and which is of such a nature and from such a source that he would have investigated it had it come to his attention during the course of his audit, he should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of his report" (at .04).

53. None of the above purported discussions were documented in any workpaper, or otherwise, in violation of PCAOB Auditing Standard No. 3 (Audit Documentation) ("AS 3"), which provides that auditors "must document significant findings or issues, actions taken to

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[4] http://www.pumpsanddumps.com/2011/06/all-that-glitters-is-not-greenwood-gold.html

[5] http://blogs.vancouversun.com/2011/03/17/david-baines-two-victoria-startups-wade-into-bulletin-board-swamp/

address them (including additional evidence obtained), and the basis for the conclusions reached in connection with each engagement" (¶ 12).

WHETMAN CONDUCTED MATERIALLY DEFICIENT AUDITS OF IDLE MEDIA

Background

54. In 2005, Marcus Frasier formed Zoeter, a company he wholly owned, to hold and run certain web development projects he created. Zoeter held datpiff.com, a website that enabled customers to upload and share music. In 2008, Frasier formed Datpiff, LLC ("Datpiff"), to hold and run the datpiff.com website.

55. Although Frasier intended Datpiff to operate separately from Zoeter, Frasier used accounts in Zoeter's name to receive cash and pay expenses for Datpiff.

56. In May 2010, Idle Media was formed following a reverse merger with a shell company. At the same time, Frasier made Datpiff a wholly-owned subsidiary of Idle Media. Zoeter received 40 million shares of Idle Media stock, representing a 65% share, and thereby became the parent company of Idle Media. After the merger, Frasier continued to own 100% of Zoeter, and he became Idle Media's chief executive officer. Datpiff was the primary revenue generating business of Idle Media.

57. Following Idle Media's formation, Zoeter and Datpiff continued to share employees, including Frasier, and commingled their funds in Zoeter accounts. Payroll expenses for shared employees and certain operating expenses for both companies were paid using Zoeter accounts.

58. In December 2010, Idle Media engaged De Joya to perform independent public accountant services. The company filed its Form 10-K for the fiscal year ended September 30, 2010 on January 13, 2011, and its Form 10-Q for the quarter ended December 31, 2010 on February 22, 2011. Six days after issuing the Form 10-Q, on February 28, 2011, Idle Media filed a Form 8-K announcing that its previously issued financial statements should not be relied upon due to unspecified accounting errors that may require adjustments.

59. These accounting errors stemmed from Idle Media's misallocation of revenue and expenses between Datpiff and Zoeter.

60. Whetman served as the audit manager on the engagements to audit or review the financial statements contained in the filings referenced in the February 28, 2011 Form 8-K. During the quarterly review for the quarter ended December 31, 2010, Idle Media informed Whetman that it had failed to record certain of Datpiff's revenue and expenses that were processed through Zoeter's accounts. Around the same time, through discussions with Idle Media's bookkeeper, Whetman became aware of Idle Media's significant books and records deficiencies in allocating revenue and expenses between Idle Media and Zoeter as a result of their failure to segregate funds, among other things.

61. More than a year later, and without having issued restated financial statements, Idle Media filed a Form 15 on March 8, 2012, terminating its voluntary SEC registration. Also in March 2012, De Joya promoted Whetman from manager to partner. Whetman became the new engagement partner for Idle Media engagements.

62. Three months later, Idle Media filed a Form 10 to recommence its voluntary registration. In this Form 10, filed on June 13, 2012, the company issued restated financial statements for the fiscal year ended September 30, 2010 and for the first time issued financial statements for its fiscal year ended September 30, 2011.

63. In the Form 10, the company did not correct its accounting deficiencies resulting from the misallocation of revenue and expenses between Datpiff and Zoeter. Rather, the company stated that the balances it reported in its financial statements consolidated Zoeter's financial statements with those of Idle Media because Zoeter was a VIE and Idle Media was its primary beneficiary. On July 31, 2012, September 25, 2012, September 26, 2012, and October 29, 2012, Idle Media issued amendments to the Form 10 on Forms 10/A for various reasons, but each included Idle Media's financial statements consolidating Zoeter. Through Whetman, De Joya consented to the inclusion of its audit report for each of these filings opining that Idle Media's consolidated financial statements were presented fairly, in all material respects, in conformity with GAAP (hereafter collectively referred to as the "Consolidation Timeframe Audits").

64. Idle Media's consolidated financial statements in its Form 10 and in its first Form 10/A amended filing did not consolidate Zoeter's accounts despite purporting to do so. In addition, when presenting the amount of the consolidated company's net income that belonged to Idle Media's shareholders, Idle Media's income statement improperly *added*, rather than subtracted, the amount of net income attributable to Zoeter's owner. Idle Media's second Form 10/A filing on September 25, 2012, restated the presentation of the consolidated financial statements to correct these fundamental errors.

65. Despite issuing consolidated financial statements in its Form 10 and in four Forms 10/A, each audited by Whetman, Idle Media filed a Form 8-K on January 15, 2013, announcing it would restate its financial statements again, this time to deconsolidate Zoeter. Idle Media acknowledged that its consolidation of Zoeter had never been proper. Almost a year after this announcement, Idle Media filed restated financial statements deconsolidating Zoeter in a fifth amendment to the Form 10, filed on December 30, 2013, for its fiscal years 2010 and 2011 and related quarterly periods. This amendment to the Form 10 was also audited by Whetman. The restatement demonstrated that, as a result of Idle Media's improper consolidation of Zoeter and revenue and expense allocation errors, the company had materially misstated revenue and net income by 18% and 24%, respectively, for 2010. Idle Media had also materially misstated net income by 24% for 2011.

66. For the Consolidation Timeframe Audits, the engagement team consisted of Whetman as the engagement partner and a staff auditor. There was also a concurring review

partner.[6] The staff auditor performed the audit fieldwork and created the workpapers for the Consolidation Timeframe Audits. As the engagement partner, Whetman was responsible for planning and performing the audits to obtain reasonable assurance about whether Idle Media's financial statements were free of material misstatement. Since no manager was assigned to the engagement team, Whetman also directly supervised the staff auditor and was responsible for her work. At the time of the first Consolidation Timeframe Audit, the staff auditor had barely a year of audit experience and had not yet earned a CPA license. Whetman was fully aware of the staff auditor's inexperience.

Whetman's Deficient Audits of Idle Media's Consolidation Approach Under VIE Accounting Standards

67. The GAAP standards for consolidation of a VIE are contained in Accounting Standards Codification ("ASC") 810, Consolidation. Under ASC 810, among other requirements, three conditions must be met in order for a reporting entity to consolidate another entity as a VIE: (1) the reporting entity must hold a variable interest in the other entity; (2) that other entity must be a VIE; and (3) the reporting entity must be the primary beneficiary of that VIE.

68. Whetman appreciated the significance of the VIE consolidation issue and characterized it as a "critical audit objective" during the planning stage of the Consolidation Timeframe Audits. He continued to characterize the VIE consolidation issue as a "critical matter" throughout the course of the Consolidation Timeframe Audits.

69. Among other things, in the audit of Idle Media's consolidation of Zoeter's financial statements, Whetman considered the conclusions that: (1) Idle Media held a variable interest in Zoeter because of a related party receivable; (2) Zoeter was a VIE because it required Idle Media's subordinated financial support; and (3) Idle Media was the primary beneficiary of Zoeter. As explained below, Whetman failed to perform sufficient procedures to obtain sufficient evidence about any of these conclusions.

Whetman Did Not Perform Adequate Procedures to Assess the Conclusion that Idle Media Held a Variable Interest in Zoeter

70. Pursuant to ASC 810-10, the reporting company must hold a "variable interest" in an entity before that entity is subject to potential consolidation as a variable interest entity. Generally, a variable interest arises from an ownership, or other contractual or pecuniary, interest which requires the holder to absorb fluctuations in value of that entity that are exclusive of fluctuations in the ownership or contractual interest.

[6] PCAOB Auditing Standard No. 7 (Engagement Quality Review) did not become effective until Idle Media's fiscal year 2011, which began October 1, 2010. Beginning on this date, the concurring review function was performed by an "engagement quality review" partner.

71. At the time Idle Media consolidated Zoeter's financial statements, Idle Media held a purported related party receivable for amounts due from Zoeter. Whetman's audit identified this related party receivable as Idle Media's variable interest in Zoeter.

72. The purported related party receivable balance was asserted to be a result of material transactions between Zoeter and Idle Media's subsidiary, Datpiff. Because this related party receivable was Idle Media's singular variable interest in Zoeter identified by Whetman, it was fundamental to the variable interest entity consolidation analysis.

73. Whetman knew that Zoeter and Datpiff commingled their funds in Zoeter accounts, that no promissory note existed between Zoeter and either Datpiff or Idle Media, and that Zoeter had no obligation to use its future profits to pay back any funds it received from Datpiff or Idle Media. However, during the audit, Whetman's procedures confirmed only that the receivable's balance eliminated in consolidation. Whetman failed to perform any procedures to determine the purpose, nature, and extent of the transactions making up the purported related party receivable, nor did he obtain sufficient, competent evidence to show that a receivable actually existed.

74. Had Whetman performed sufficient audit procedures, he would have likely discovered that Idle Media had improperly recorded these amounts on its balance sheet as a receivable. In fact, when Whetman later re-audited Idle Media's fiscal year-end 2010 financial statements upon Idle Media's deconsolidation of Zoeter, Whetman concluded that Idle Media had properly reclassified these amounts as Idle Media's expenses and not a receivable due from Zoeter.

75. As a result of the above failures, Whetman's procedures provided no reasonable basis for concluding that the related party receivable existed. The existence of the receivable as a variable interest was the fundamental basis Whetman relied upon to support that Idle Media should potentially consolidate Zoeter's financial statements. As a result, Whetman obtained insufficient evidence to assess the conclusion that Idle Media indeed held a variable interest in Zoeter.

Whetman Did Not Perform Adequate Procedures to Assess the Conclusion That Zoeter was a VIE

76. Whetman's procedures to test the conclusion that Zoeter qualified as a variable interest entity also were inadequate. Whetman concluded that Zoeter was a variable interest entity under ASC 810-10-15-14a because, by design, the total equity investment at risk was not sufficient to permit Zoeter to finance its activities without additional subordinated financial support provided by Idle Media or Datpiff. When testing the assertion that Zoeter was a VIE, Whetman considered whether Zoeter required subordinated financial support: (1) as of the date of Datpiff's inception in September 2008; and (2) during subsequent fiscal periods.

77. With respect to the first analysis, Whetman failed to adequately test whether, by design, Zoeter required subordinated financial support as of September 2008. In fact, financial

information included in Whetman's audit workpapers indicated that Zoeter earned sufficient revenue to support its own activities at that time.

78. With respect to the second analysis, Whetman concluded that subsequent transfers of funds between Zoeter and Datpiff, as evidenced by the purported related party receivable, demonstrated Zoeter's continuing need for financial support. However, Whetman's audit did not provide adequate support for these conclusions since Whetman did not test whether Zoeter's revenue was sufficient to cover its expenses or, as discussed above, whether the related party receivable existed. Indeed, since Idle Media had not accurately allocated revenue and expenses between Zoeter and Idle Media at the time of the Consolidation Timeframe Audits, the conclusion that Zoeter required Datpiff's financial support was not substantiated.

Whetman Did Not Perform Adequate Procedures to Assess the Conclusion That Idle Media Was the Primary Beneficiary of Zoeter

79. Whetman's procedures to test whether Idle Media was the primary beneficiary of Zoeter similarly were inadequate. In order for Idle Media to be the primary beneficiary and therefore consolidate Zoeter under the VIE consolidation guidance, Idle Media must have had both (1) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (2) the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant. ASC 810-10-05 and ASC 810-10-15-14b.

80. Whetman did not obtain sufficient evidence to determine whether Idle Media had an obligation to provide potentially significant funding to Zoeter or to determine whether Idle Media had the right to potentially benefit significantly from Zoeter's activities. Whetman did not test whether Idle Media had power over the most significant economic activities of Zoeter. Finally, it was evident to Whetman that Idle Media and Zoeter were under the common control of Frasier, which should have resulted in additional testing. As a result, Whetman failed to obtain sufficient competent evidence supporting the conclusion that Idle Media was the primary beneficiary of Zoeter.

<u>**Whetman's Deficient Audit of the Noncontrolling Interest**</u>

81. Notwithstanding the flaws in the consolidation analysis described above, Idle Media's presentation of consolidated financial statements was not in conformity with GAAP. Whetman missed these clear presentation errors in certain audits of Idle Media's financial statements, as discussed below.

Whetman Failed to Sufficiently Test Whether Idle Media's Revenue, Expenses, and Net Income Were Reported as Consolidated Amounts

82. A reporting company's revenue, expenses, and net income should "be reported in the consolidated financial statements at the consolidated amounts, which include the amounts attributable to the owners of the parent and the noncontrolling interest." ASC 810-10-45-19.

Accordingly, when Idle Media claimed to consolidate Zoeter's financial results, it should have combined Zoeter's account balances within the appropriate line items of the consolidated income statement and then separately reported the noncontrolling interest of the net income or loss.

83. When Idle Media first presented consolidated financial statements in the Form 10 filed on June 13, 2012 and in the first Form 10/A filed on July 31, 2012, Idle Media failed to combine Zoeter's account balances within the appropriate line items of its consolidated income statement, including the consolidated net income line item. Instead, Idle Media reported account balances for Idle Media only.

84. When auditing the financial statements contained in these two filings, Whetman reviewed the audit workpaper containing the company's consolidating trial balance. However, Whetman failed to perform a fundamental audit procedure: that is, recalculation to verify that the rows of numbers were properly totaled. Had Whetman simply added up rows of numbers on the workpaper, he would have noticed that the totals for the consolidated amounts improperly excluded Zoeter's accounts. Since he failed to perform this fundamental procedure, Whetman failed to identify the fact that the account balances Idle Media reported in its consolidated financial statements did not actually include Zoeter's accounts and thus did not reconcile with the supporting documents. Whetman also failed to properly supervise his staff auditor by not addressing these important omitted procedures.

85. Whetman failed to identify these fundamental misstatements despite reviewing a different audit workpaper that stated that "[Zoeter] is not included [in these line items] because they are reported separately within the income statement as part of VIE reporting requirements." This workpaper specifically highlighted the fact that Zoeter's revenue and expenses were excluded from the applicable line items of the consolidated financial statements.

Whetman Failed to Test Whether Idle Media's Consolidated Net Income Was Properly Apportioned Between Idle Media's Shareholders and the Noncontrolling Interest

86. GAAP requires that, after a company reports its consolidated net income, the "[n]et income or loss… shall be attributed to the parent and the noncontrolling interest." ASC 810-10-45-20. Accordingly, after presenting the net income for the consolidated company on its income statement, Idle Media should have then subtracted the portion of the consolidated net income belonging to Zoeter's owner (Frasier) as being allocated to the noncontrolling interest since Idle Media did not own Zoeter. Idle Media should have then shown the remaining portion of the consolidated net income as belonging to Idle Media's shareholders.

87. In the financial statements included in its Form 10 filed on June 13, 2012 and its first Form 10/A filed on July 31, 2012, Idle Media reported a consolidated net income amount that did not include Zoeter's net income. Below the consolidated net income line, Idle Media presented Zoeter's net income as an amount attributable to the noncontrolling interest. Idle Media then *added* this figure to the net income amount, rather than *subtracting* it, when Idle Media reported the amount of net income attributed to Idle Media's shareholders. These clear,

fundamental errors resulted in a substantial overstatement of the consolidated net income apportioned to Idle Media's shareholders.

88. Whetman's procedures failed to identify these errors even though the income statement reported that the net income allocated to Idle Media shareholders was substantially greater than the total consolidated net income – a treatment that was clearly not in conformance with GAAP.

89. Whetman's deficient procedures relating to the allocation of revenue and expenses between Zoeter and Idle Media also impacted his ability to audit the amount of income Idle Media apportioned to the noncontrolling interest. Since Whetman did not perform sufficient procedures to assess the accuracy of Zoeter's accounts, Whetman's procedures could not provide a reasonable basis for assessing the accuracy of the net income Idle Media attributed to the noncontrolling interest.

Whetman's Deficient Documentation of the Idle Media Audits

90. In addition to the failures discussed above, Whetman failed to adequately document and retain requisite documentation related to certain of his audits.

Whetman Failed to Prepare Adequate Audit Documentation

91. On December 30, 2013, Idle Media filed a Form 10/A containing restated financial statements to correct: 1) errors relating to the allocation of revenue and expenses between Zoeter and Datpiff, and 2) the improper consolidation of Zoeter's financial statements. Whetman's audit workpapers relating to the deconsolidation stated that "V.I.E. consolidation was not appropriate since Zoeter, LLC did not need subordinated financial support to fund its activities[.]" However, the workpapers did not present any analysis or reference evidence to support this revised conclusion that no subordinated financial support was needed. For example, the workpapers did not demonstrate that the auditor had examined any evidence indicating that Zoeter generated sufficient revenue to fund its level of activity at the assessment date.

92. At the time of Idle Media's deconsolidation of Zoeter, the audit workpaper referenced a change in the date for the transfer of the datpiff.com website as support for Idle Media's deconsolidation decision. However, to the extent the transfer date for the datpiff.com website was significant to the deconsolidation decision, Whetman's audit workpapers did not explain that significance. While the audit workpapers explained how the new date impacted the allocation of revenue and expenses between Zoeter and Datpiff, the workpapers notably failed to analyze why the new date impacted the separate issue of whether Idle Media should consolidate Zoeter. Moreover, the workpapers showed multiple inconsistencies regarding what the transfer date actually was.

93. Whetman's deconsolidation workpaper also quoted Idle Media's disclosure that "it is no longer able to conclude that Zoeter constitutes a variable interest entity, necessitating the restatement of its financial statements" under GAAP. However, the workpapers did not clarify, much less explain, whether Zoeter had previously been a VIE but was no longer a VIE going

forward, or whether Zoeter had never been a VIE. This analysis would have been necessary in order to determine whether it was appropriate for Idle Media to restate its historical financial statements.

94. Whetman also failed to properly supervise his audit staff with respect to procedures to evaluate and document the deconsolidation analysis.

Whetman Failed to Retain Audit Documentation

95. When preparing workpapers for the Consolidation Timeframe Audits, Whetman's audit team incorporated, but did not retain, the workpapers from the original audit of Idle Media's fiscal year 2010 financial statements. As a result, workpapers which reflect the planning and performance of the work and the procedures performed, the evidence obtained, and the conclusions reached as of the time that De Joya issued its audit report on January 12, 2011 no longer exist.

Whetman's Violations of Professional Standards In Performing the Idle Media Audits

Failure to Exercise Due Professional Care

96. AU 230 requires that "[d]ue professional care is to be exercised in the planning and performance of the audit and the preparation of the report" (at .01). The engagement partner should know, at a minimum, the relevant professional accounting and auditing standards and should be knowledgeable about the client. The engagement partner is responsible for the assignment of tasks to, and supervision of, the members of the engagement team (at .06). Also, "[d]ue professional care requires the auditor to exercise professional skepticism. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence" (at .07). "Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process" (at .08). "The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest" (at .09).

97. As the engagement partner, Whetman was responsible for each of the relevant audit engagements and their performance, for proper supervision of the work of the engagement team members, and for compliance with PCAOB standards.

98. Whetman violated AU 230 by conducting the Consolidation Timeframe Audits without exercising due professional care or professional skepticism. Whetman did not perform sufficient procedures or analysis to support his audit conclusions that Idle Media's consolidation of Zoeter conformed with GAAP. Whetman also violated AU 230 when he failed to notice that Idle Media had not actually consolidated Zoeter's accounts in the first set of consolidated financial statements it filed, and that Idle Media had clearly improperly presented the amount of the consolidated company's net income attributable to Idle Media's shareholders. He also failed to exercise due professional care in failing to document the analysis and conclusions supporting the deconsolidation approach for Idle Media's deconsolidated financial statements. Additionally,

Whetman failed to supervise his audit staff with respect to the sufficiency of the procedures performed and whether those procedures were adequately documented.

Failure to Obtain Sufficient Competent Evidential Matter

99. PCAOB standard AU Section 326, (Evidential Matter) ("AU 326") requires that "[s]ufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit" (at .01). "The auditor tests underlying accounting data by (a) analysis and review, (b) retracing the procedural steps followed in the accounting process and in developing the allocations involved, (c) recalculation, and (d) reconciling related types and applications of the same information... Additionally, the auditor's substantive procedures must include reconciling the financial statements to the accounting records" (at .19). "To be competent, evidence, regardless of its form, must be both valid and relevant" (at .21).

100. Whetman violated AU 326 by concluding the Consolidation Timeframe Audits without obtaining sufficient competent evidential matter through his audit procedures. Notably, Whetman failed to obtain sufficient, competent evidential matter during his procedures to assess whether Idle Media's consolidation conclusions were appropriate under the relevant accounting standards for VIE consolidation. Whetman also violated AU 326 by failing to obtain sufficient, competent evidential matter in the form of a correctly totaled consolidating trial balance. Whetman further failed to recalculate the underlying accounting data contained in the consolidating trial balance and reconcile this data to the financial statements. Because of this, he failed to identify Idle Media's fundamental errors in presenting consolidated financial statements – by failing to actually consolidate Zoeter's accounts in its consolidated income statement line items and by failing to present the noncontrolling interest as a deduction from the consolidated net income figure -- when Idle Media first filed its consolidated financial statements filed on Form 10 on June 13, 2012 and the first Form 10/A filed on July 31, 2012.

Failure to Apply Heightened Scrutiny to Related Party Transactions

101. AU 334 requires that "[t]he auditor should place emphasis on testing material transactions with parties he knows are related to the reporting entity" (at .07). "After identifying related party transactions, the auditor should apply the procedures he considers necessary to obtain satisfaction concerning the purpose, nature, and extent of these transactions and their effect on the financial statements. The procedures should be directed toward obtaining and evaluating sufficient competent evidential matter and should extend beyond inquiry of management" (at.09).

102. Whetman violated AU 334 during the Consolidation Timeframe Audits when he failed to place emphasis on testing material transactions between related parties, including his failures to apply heightened scrutiny to analysis of the purported related party receivable balance, Zoeter's purported need for subordinated financial support from Idle Media, and which related party would be Zoeter's primary beneficiary if Zoeter was a VIE. Although the consolidation analysis as a whole was characterized in the workpapers as both a "critical audit objective" and

as a "critical issue," and involved related party transactions, Whetman failed to apply heightened scrutiny when he audited any of the three bases for the consolidation conclusion.

Failure to Maintain Requisite Audit Documentation

103. AS 3 requires that "[a]mong other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor" (¶ 2). "Audit documentation must clearly demonstrate that the work was in fact performed... Audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement...to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached" (¶ 6). "The auditor must retain audit documentation for seven years from the date the auditor grants permission to use the auditor's report in connection with the issuance of the company's financial statements (report release date), unless a longer period of time is required by law" (¶ 14). "Audit documentation must not be deleted or discarded after the documentation completion date, however, information may be added" (¶ 16).

104. Whetman violated AS 3 during his audit of the restatement to deconsolidate Zoeter when he failed to document his analysis in a manner which would allow an experienced auditor having no previous connection with the engagement to understand the evidence obtained or audit conclusions. Notably, the workpapers did not explain the analysis underlying the decision to deconsolidate Zoeter or the decision to restate historical financial statements for the deconsolidation of Zoeter. Additionally, Whetman violated AS 3 in his failure to retain workpapers related to the original audit of fiscal year 2010.

Failure to Issue Accurate Audit Reports

105. PCAOB standard AU Section 508, Reports on Audited Financial Statements ("AU 508"), states that "[j]ustification for the expression of the auditor's opinion rests on the conformity of his or her audit with generally accepted auditing standards and on the findings" (at .03). "The auditor's standard report states that the financial statements present fairly, in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an audit performed in accordance with generally accepted auditing standards" (at .07).

106. Whetman violated AU 508 when he signed, on behalf of his audit firm, audit reports contained in Idle Media's Forms 10, 10A/1, 10A/2, 10A/3, 10A/4, and 10A/5, filed on June 13, 2012, July 31, 2012, September 25, 2012, September 26, 2012, October 29, 2012, and December 30, 2013, respectively, falsely stating that De Joya had conducted its audits in accordance with the standards of the PCAOB. The audits referenced in these audit reports were not conducted in accordance with PCAOB standards, as evidenced by Whetman's failures to exercise due professional care in the planning and performance of the audit, to obtain sufficient competent evidential matter, to apply heightened scrutiny to related party transactions, and to maintain requisite audit documentation.

WHETMAN VIOLATED SECTION 17(a) OF THE SECURITES ACT, RULE 2-02 OF REGULATION S-X, AND ENGAGED IN IMPROPER PROFESSIONAL CONDUCT

107. De Joya falsely stated in its audit report filed with La Paz's Form S-1 registration statement that it "conducted [its] audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)" and that the financial statements present La Paz's financial position "in conformity with U.S. generally accepted accounting principles." Whetman signed or consented to the filing of this audit report.

108. For this false audit report, De Joya collected approximately $4,000 in fees.

109. Whetman knew, or was reckless in not knowing, that La Paz was a device, scheme, or artifice to defraud in violation of Section 17(a)(1) of the Securities Act. Further, by providing La Paz's audit report, Whetman acted unreasonably and caused La Paz's violations of Sections 17(a)(1), (2), and (3) of the Securities Act. Whetman also violated Sections 17(a)(2) and (3) of the Securities Act by falsely claiming that the La Paz audit complied with PCAOB standards.

110. Additionally, for failing to meet the PCAOB audit standards identified above in auditing La Paz and Idle Media, Whetman engaged in improper professional conduct pursuant to the Commission's Rules of Practice Rule 102(e)(1)(ii) by engaging in at least one instance of highly unreasonable conduct or repeated instances of unreasonable conduct under Rule 102(e)(1)(iv).

111. Whetman also caused a violation of Rule 2-02(b)(1) of Regulation S-X by consenting to the filing of an audit report included in La Paz's Form S-1 Registration statement that falsely states that La Paz's audit was conducted in accordance with PCAOB standards.

112. Further, as described above, Whetman willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act thereby engaging in conduct subject to the Commission's Rules of Practice Rule 102(e)(1)(iii).

IV.

COMMISSION FINDINGS

Based on the foregoing, the Commission finds that Respondent:

A. willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act;

B. engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice;

C. caused a violation of Rule 2-02(b)(1) of Regulation S-X; and

D. willfully violated Sections 17(a)(1), (2), and (3) of the Securities Act thereby engaging in conduct subject to Section 4C(a)(3) of the Exchange Act and Practice Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

V.

UNDERTAKINGS

Respondent has undertaken to:

A. appear and be interviewed by Commission staff at such reasonable times and places as the staff requests upon reasonable notice in connection with the Briner Action;

B. 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 investigation by Commission staff related to the Briner Action;

C. appoint Respondent's attorney, Sean T. Prosser, as agent to receive service of such notices and subpoenas;

D. with respect to such notices and subpoenas, waive any objections to such notices and subpoenas, the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and

E. consent to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept Respondent's Offer, the Commission has considered these undertakings.

VI.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 4C and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(1), (2), and (3) of the Securities Act and Rule 2-02(b)(1) of Regulation S-X.

B. Respondent is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After five years from the date of entry of this Order, Whetman 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:

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

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

i. A public accounting firm with which Respondent 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;

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

iii. 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

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

D. The Commission will consider an application by Whetman 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 board of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider his application on 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. Whetman shall pay a civil penalty of $15,000.00, 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), which shall be paid in the following installments: $3,000.00 within 10 days of the entry of this Order, and $12,000.00 in four installments of $3,000.00 due on October 1, 2015, January 1, 2016, April 1, 2016, and one year from entry of this Order. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

F. Payment of civil penalties must be made in one of the following ways:

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

b) 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

c) 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 the Respondent by name 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 Lara Shalov Mehraban, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, NY 10281.

G. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent 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.

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

VII.

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, 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. 75953 / September 18, 2015

ADMINISTRATIVE PROCEEDINGS
File Nos. 3-12671 and 16822

In the Matter of **ARTHUR B. CARLSON, III,** **Respondent.**	**ORDER VACATING COMMISSION ORDER DATED AUGUST 14, 2007, FILE NO. 3-12671, AND INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Arthur B. Carlson, III ("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 IV, Respondent consents to the entry of this Order Instituting Administrative And Cease-And-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and Cease-And-Desist Order ("Order"), as set forth below.

III.

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

1. This proceeding arises from an offering fraud involving the sale of Security Asset Capital Corporation ("Security Asset") promissory notes. From December 1998 through January 2001, Security Asset raised a total of $7 million from several hundred investors. Security Asset claimed to be in the debt service business involved in buying portfolios of distressed consumer debt for resale or refinancing. The promissory notes issued by Security Asset stated that the proceeds would be used to purchase consumer debt, pay commissions and pay costs associated with management and collection on consumer debt obligations. Instead, a significant portion of the proceeds were used to pay the personal expenses of company management, business expenses and to repay earlier investors. Investors lost all or most of their money.

Respondent

2. Arthur B. Carlson, III, age 63, lives in St. Paul, Minnesota. At the time of the Security Asset offering, Respondent was Chief Executive Officer ("CEO") and majority shareholder of Continental Capital. Respondent was associated with Advance Capital Advisors, Inc., ("Advanced Capital") beginning in January 2002 and was CEO and Chief Financial Officer ("CFO") of Advanced Capital in February 2002, which was located in Minneapolis, Minnesota. From February 22, 2002 to August 14, 2007, Advanced Capital was registered with the Commission as an investment adviser but was not involved in the sale of Security Asset promissory notes. From 1977 through 2000, Respondent was licensed as a Certified Public Accountant ("CPA") in Minnesota. From 2000 to the present, Respondent has not held a CPA license in any state.

Overview

3. On February 18, 2004, the Commission filed a civil action charging Respondent and other defendants with participating in an offering fraud involving, among other things, the sale of Security Asset promissory notes. On June 12, 2007, default judgment was entered against Respondent, which included a permanent injunction against future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, and he was ordered to pay disgorgement of $124,169, prejudgment interest of $58,824 and $120,000 in civil penalties.

4. On August 14, 2007, the Commission entered an Order on default barring Respondent from association with any broker, dealer or investment adviser pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act respectively. On August 28, 2015, upon the joint motion of the Commission and Respondent, the district court vacated the June 12, 2007 default judgment and dismissed the civil action with prejudice.

Respondent's Conduct

5. Security Asset retained Respondent, through his company Continental Capital Group, Ltd. ("Continental Capital"), to be the exclusive distributor of Security Asset promissory notes. In turn, Respondent hired another company to sell the promissory notes through a network of independent insurance agents. Respondent forwarded the offering documents to the other company for use in the solicitation of investors.

6. Respondent did not personally solicit the Security Asset promissory notes to investors. Rather, he facilitated investor solicitations by informing the sales force about Security Asset and passing on the offering materials that he had reviewed.

7. Respondent received transaction based compensation from the sale of Security Asset promissory notes through his company Continental Capital.

8. At no point between December 1998 through January 2001 was Respondent registered with the Commission as a broker, nor was he associated with a registered broker-dealer.

Violation of Section 15(a)(1) of the Exchange Act by Respondent

9. Section 15(a)(1) of the Exchange Act, among other things, prohibits a broker or a natural person not associated with a broker (other than such a broker whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) 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 (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker is registered in accordance with Section 15(b). Scienter is not an element of a violation of Section 15(a). SEC v. Rabinovich & Assocs., LP, 2008 U.S. Dist. LEXIS 93595, at *14 (S.D.N.Y. 2008).

10. As a result of the conduct described above, Respondent willfully violated Section 15(a)(1) of the Exchange Act.[1]

IV.

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

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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)).

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

A. The Commission's Order dated August 14, 2007, File No. 3-12671, relating to Respondent Arthur B. Carlson, III, is vacated and dismissed.

B. Respondent cease-and-desist from committing or causing any violations and any future violations of Section 15(a)(1) of the Exchange Act.

C. Respondent be, and hereby is barred from association with any broker, dealer and investment adviser, with the right to apply for reentry at any time after the date of this Order, to the appropriate self-regulatory organization or, if there is none, to the Commission.

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

E. Respondent shall pay disgorgement in the amount of $5,191.36. Such payment will be deemed satisfied by Respondent's payment to the U.S. Treasury of $5,191.36 made prior to the date of this 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

INVESTMENT ADVISERS ACT OF 1940
Release No. 4199 / September 21, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31832 / September 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16823

In the Matter of **FIRST EAGLE INVESTMENT MANAGEMENT, LLC** **and** **FEF DISTRIBUTORS, LLC,** **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 First Eagle Investment Management, LLC and FEF Distributors, LLC (together, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting 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' Offer, the Commission finds[1] that:

SUMMARY

These proceedings arise from the improper use of approximately $25 million in mutual fund assets to pay for the distribution and marketing of fund shares outside of a written, approved Rule 12b-1 plan. Registered investment adviser First Eagle Investment Management, LLC ("First Eagle") and its wholly-owned broker-dealer subsidiary, FEF Distributors, LLC ("FEF"), caused the First Eagle Funds (the "Funds") to make payments to two financial intermediaries for distribution-related services. The distribution payments were not paid pursuant to a written, approved Rule 12b-1 plan, and were not paid by First Eagle out of its own resources (e.g., as so-called "revenue sharing payments"). In addition, use of the Funds' assets to pay for these distribution-related services rendered the Funds' disclosures concerning payments for distribution-related services inaccurate.

RESPONDENTS

1. **First Eagle Investment Management, LLC ("First Eagle")** is a Delaware limited liability company located in New York, New York. First Eagle has been registered with the Commission as an investment adviser since 1995 and serves as the adviser to the First Eagle Funds.

2. **FEF Distributors, LLC ("FEF")** is a Delaware limited liability company located in New York, New York. FEF is a wholly-owned subsidiary of First Eagle and serves as the First Eagle Funds' principal underwriter and distributor. FEF has been registered with the Commission as a broker-dealer since July 1999.

OTHER RELEVANT ENTITIES

3. **First Eagle Funds (the "Funds")** is a Delaware statutory trust registered with the Commission as an open-end diversified investment company. During the relevant time period, the trust included as many as seven funds. The trust's investment adviser is First Eagle and its principal underwriter is FEF.

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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.

4. **Intermediary One** is dually registered with the Commission as a broker-dealer and investment adviser. Intermediary One provided distribution, marketing, and sub-transfer agent ("sub-TA") services to the Funds.

5. **Intermediary Two** is dually registered with the Commission as a broker-dealer and investment adviser. Intermediary Two provided distribution, marketing, and sub-TA services to the Funds.

FACTS

6. Prior to December 1999, First Eagle advised two mutual funds and directly distributed shares of those two funds through a predecessor to FEF. In December 1999, First Eagle acquired a family of funds from another adviser and sought to expand the distribution of its funds' shares by having FEF enter into distribution relationships with various financial intermediaries. Among others, FEF entered into a new relationship with Intermediary One in June 2000. Later, FEF entered into a relationship with Intermediary Two. The contract at issue with Intermediary Two was not formally documented until December 2007, although Intermediary Two began receiving payments from the Funds in 2005.

7. Financial intermediaries often provide both distribution and shareholder services to mutual funds. As to distribution services, Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder make it unlawful to use fund assets to "engage[] directly or indirectly in financing any activity which is primarily intended to result in the sale of [fund] shares" outside of a written Rule 12b-1 plan approved by the fund's board.[2] As a result, if there is no approved Rule 12b-1 plan that permits the fund's adviser to use fund assets to pay for distribution, then fund assets cannot be used to pay for such distribution. The adviser, however, may pay for those distribution services out of its own resources.

8. In addition to providing distribution services, intermediaries often provide shareholder services that typically would otherwise be provided by the fund's transfer agent. These services are commonly referred to as "sub-TA services" and are often paid out of the fund's assets.

9. Despite the fact that one of FEF's two agreements with Intermediary One and its agreement with Intermediary Two called for the provision of distribution and marketing services, First Eagle and FEF treated the agreements as being for sub-TA services, and caused the Funds to pay for those services outside of a Rule 12b-1 plan, with its attendant controls and board oversight, through March 2014. From January 1, 2008 through March 31, 2014, First Eagle and FEF caused approximately $25 million of the Funds' assets to be used to make payments to these intermediaries for distribution and marketing services outside of a Rule 12b-1 plan. These payments were in addition to payments made to Intermediary One and Intermediary Two pursuant to the Funds' written Rule 12b-1 plans.

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[2] A fund's Rule 12b-1 plan must also be approved by a majority of its shareholders, if the plan is adopted after any public offering of the fund's shares.

Intermediary One Agreements

10. In June 2000, FEF entered into two agreements with Intermediary One: a Financial Services Agreement and a Selected Dealer Agreement. Prior to entering into the agreements, FEF consulted its outside counsel.

The Financial Services Agreement

11. Pursuant to the terms of the Financial Services Agreement, Intermediary One agreed to provide a variety of sub-TA services that are typically paid for out of fund assets, including the following: (i) maintaining separate records for each customer in the omnibus account for each fund; (ii) transmitting purchase and redemption orders to the Funds; (iii) preparing and transmitting account statements for each customer; (iv) transmitting proxy statements, periodic reports, and other communications to customers; (v) providing periodic reports to the Funds to enable each fund to comply with state Blue Sky requirements; and (vi) providing standard monthly contingent deferred sales charge reports.

12. In exchange for providing these services, Intermediary One charged per-account fees ranging between $16-19. The Funds paid these fees.

The Selected Dealer Agreement

13. The Selected Dealer Agreement states in its opening paragraph that FEF "[has] invited [Intermediary One] to become a selected dealer *to distribute shares* of the [Funds]." (Emphasis added). The agreement describes the services to be provided under the contract, including "due diligence, legal review, training, [and] marketing," as well as the following fees, which the agreement states are in addition to any Rule 12b-1 plan fees paid to Intermediary One by the Funds:

(i) a one-time fee of $50,000;

(ii) 25 basis points of total new gross sales of shares of any class sold by Intermediary One, paid monthly; and

(iii) 10 basis points of the value of fund shares sold by Intermediary One that are held for more than one year, payable quarterly ("for our continuing due diligence, training and marketing").

14. First Eagle and FEF caused the Funds to pay total fees of approximately $24.6 million to Intermediary One pursuant to the Selected Dealer Agreement, during the period January 1, 2008 through March 31, 2014. The services to be provided under the Selected Dealer Agreement were generally marketing and distribution, not sub-TA services. As a result, Respondents were prohibited from using the Funds' assets to make payments to Intermediary One under this agreement, unless such payments were made pursuant to the Funds' written, approved Rule 12b-1 plan (which they were not).

Intermediary Two Agreement

15. FEF entered into a Correspondent Marketing Program Participation Agreement ("CMPPA") with Intermediary Two, dated as of December 3, 2007. However, the Funds had been paying Intermediary Two for substantially the same services provided under the CMPPA since 2005. The CMPPA states that Intermediary Two will do the following: (i) provide email distribution lists of correspondent broker-dealers that have requested "sales and marketing concepts" from Intermediary Two; (ii) market the Funds on its internal website; (iii) invite the Funds to participate in special marketing promotions and offerings to correspondent broker-dealers; (iv) invite First Eagle to participate in Intermediary Two's annual conference; (v) provide quarterly statements detailing which correspondent broker-dealers are selling the Funds; and (vi) waive all trading fees charged to correspondent broker-dealers relating to the Funds.

16. In exchange for providing these services, Intermediary Two charged an annual fee equal to 5 basis points of the net asset value of outstanding shares of the Funds sold by Intermediary Two, billed quarterly.

17. First Eagle and FEF caused the Funds to pay approximately $290,000 to Intermediary Two pursuant to the CMPPA, during the period January 1, 2008 through March 31, 2014. As with Intermediary One's Selected Dealer Agreement, because the services referenced under the CMPPA were generally marketing and distribution, not sub-TA services, Respondents were prohibited from using the Funds' assets to make payments to Intermediary Two under the CMPPA, unless such payments were made pursuant to the Funds' written, approved Rule 12b-1 plan (which they were not).

First Eagle's Disclosures to the Funds' Board of Trustees

18. First Eagle periodically consulted with its outside counsel and reported to the Funds' board of trustees (the "board") regarding payments for distribution and sub-TA services. In the board reports, the fees under the Selected Dealer Agreement and the CMPPA were inaccurately included as sub-TA fees. In 2008, First Eagle engaged outside counsel to review its practices with regard to payments for sub-TA services. First Eagle shared the results of that review – which indicated that all of the fees paid to Intermediary One and Intermediary Two under the Financial Services Agreement, Selected Dealer Agreement, and CMPPA were for sub-TA services – with the board.

Fund Disclosures Regarding Distribution Expenses

19. The Funds' prospectus disclosure regarding distribution expenses stated that "FEF Distributors or its affiliates bear distribution expenses to the extent they are not covered by payments under the [Rule 12b-1] Plans." However, in connection with the Selected Dealer Agreement and CMPPA, the Funds, and not FEF or its affiliates, bore the additional distribution and marketing expenses not covered by the Funds' Rule 12b-1 plans.

VIOLATIONS

20. Section 206(2) of the Advisers Act 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." A violation of Section 206(2) of the Advisers Act 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)). Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, First Eagle willfully violated Section 206(2) of the Advisers Act.[3]

21. Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder make it unlawful for any registered open-end investment management company to "engage[] directly or indirectly in financing any activity which is primarily intended to result in the sale of shares issued by such company" unless such financing is made pursuant to a written plan that meets the requirements of Investment Company Act Rule 12b-1(b). As a result of the conduct described above, First Eagle and FEF caused the Funds to violate Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder.

22. Section 34(b) of the Investment Company Act makes it unlawful for any person "to make any untrue statement of a material fact in any registration statement . . . filed or transmitted pursuant to [the Investment Company Act]" or "to omit to state therein any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being materially misleading." As a result of the conduct described above, First Eagle willfully violated Section 34(b) of the Investment Company Act.

UNDERTAKINGS

Respondent FEF undertakes to complete the following actions:

23. Independent Compliance Consultant. Respondent FEF shall retain, within 30 days of the issuance of this Order, the services of an Independent Compliance Consultant ("Consultant") not unacceptable to the staff of the Commission. The Consultant's compensation and expenses shall be borne exclusively by FEF. FEF shall require the Consultant to conduct a comprehensive review of FEF's supervisory, compliance, and other policies and procedures designed to prevent and detect the prohibited use of the Funds' assets to engage, directly or indirectly, in financing any activity which is primarily intended to result in the sale of shares issued by the Funds.

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

a. Respondent FEF shall provide to the Commission staff, within 30 days of retaining the Consultant, a copy of an engagement letter detailing the Consultant's responsibilities, which shall include the reviews described above in paragraph 23.

b. At the end of the review, which in no event shall be more than 180 days after the date of the entry of this Order, Respondent FEF shall require the Consultant to submit a report to FEF and the staff of the Commission ("Report"). The Report shall address the issues described above in paragraph 23, and shall include a description of the review performed, the names of the individuals who performed the review, the conclusions reached, the Consultant's recommendations for changes in or improvements to FEF's policies and procedures, and a procedure for implementing the recommended changes in or improvements to those policies and procedures.

c. Respondent FEF shall adopt all recommendations contained in the Report; provided, however, that within 210 days after the entry of this Order, or within 30 days after delivery of the report to FEF (whichever date is later), FEF shall, in writing, advise the Consultant and the staff of the Commission of any recommendations that it considers unnecessary, unduly burdensome, impractical, or inappropriate. With respect to any such recommendation, FEF 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 FEF and the Consultant do not agree, such parties shall attempt in good faith to reach an agreement within 30 days after FEF serves the advice described above. In the event that FEF and the Consultant are unable to agree on an alternative proposal, FEF and the Consultant shall jointly confer with the Commission staff to resolve the matter. In the event that, after conferring with the Commission staff, FEF and the Consultant are unable to agree on an alternative proposal, FEF will abide by the recommendations of the Consultant.

d. Within 90 days of Respondent FEF's adoption of all of the recommendations in the Consultant's Report, as determined pursuant to the procedures set forth herein, FEF 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 Anthony Kelly, 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. Respondent FEF shall cooperate fully with the Consultant and shall provide the Consultant with access to files, books, records, and personnel as reasonably requested for the Consultant's review.

f. To ensure the independence of the Consultant, FEF: (i) shall not have the authority to terminate the Consultant or substitute another independent compliance consultant for the initial Consultant without the prior written approval of the Commission staff; and (ii) shall compensate the Consultant and persons engaged to assist the consultant for services rendered pursuant to this Order at their reasonable and customary rates.

g. Respondent FEF shall require the Consultant to enter into an agreement that provides that for the period of the engagement and for a period of two years from completion of the existing engagement, the consultant shall not enter into any new employment, consultant, attorney-client, auditing, or other professional relationship with FEF, 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 FEF, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the existing agreement.

24. Recordkeeping. Respondent FEF shall preserve for a period of not less than six years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of their compliance with the undertakings set forth above.

25. Deadlines. The staff of the Commission may extend any of the procedural dates set forth above for good cause shown. The procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

26. Certification of Compliance by Respondent FEF. Respondent FEF shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission's staff may make reasonable requests for further evidence of compliance, and FEF agrees to provide such evidence. The certification and supporting material shall be submitted to Anthony Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-5010, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than 60 days from the date of the completion of the undertakings.

27. In determining whether to accept the Offer, the Commission has considered these undertakings.

RESPONDENTS' REMEDIAL EFFORTS

28. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff. Respondents voluntarily provided information and produced documents to the staff. In addition, First Eagle immediately began to make payments under the Selected Dealer Agreement and CMPPA from its own revenues, ceased using the Funds' assets to make any portion of such payments, and offered to return the amount of money improperly paid from the Funds' assets.

IV.

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

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. First Eagle cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act, Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder, and Section 34(b) of the Investment Company Act.

B. First Eagle is censured.

C. FEF cease and desist from causing any violations and any future violations of Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder.

D. Respondents First Eagle and FEF shall pay disgorgement, prejudgment interest, and a civil monetary penalty totaling $39,747,879.75 as follows:

(i) Respondent First Eagle shall pay disgorgement of $24,907,354.00 and prejudgment interest of $2,340,525.75, consistent with the provisions of this Subsection D.

(ii) Respondents First Eagle and FEF shall jointly and severally pay a civil monetary penalty in the amount of $12,500,000.00, consistent with the provisions of this Subsection D.

(iii) Within 10 days of the entry of this Order, Respondents shall deposit $39,747,879.75 (the "Distribution Fund") into an escrow account acceptable to the Commission staff and Respondents shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 [17 C.F.R. § 201.600] or 31 U.S.C. § 3717.

(iv) Respondents shall be responsible for administering the Distribution Fund and may hire a professional to assist them in the administration of the distribution. Respondents shall pay from the Distribution Fund to each current and former shareholder account[4] that held shares of the Funds at any time during the period January 1, 2008 through March 31, 2014 (the "Relevant Period") (collectively, the "affected shareholder accounts"), an amount representing the full amount of each affected shareholder account's proportion of fees paid by the Funds during the Relevant Period pursuant to the Selected Dealer Agreement and the CMPPA, foregone appreciation in the relevant Fund portfolio during the period shares were held, and reasonable interest at the Federal Short-Term rate from the date shares of the Funds were sold through the estimated date of the distribution, pursuant to a disbursement calculation (the "Calculation") that will be submitted to,

[4] The majority of the Funds' shares were held in omnibus accounts, in which the intermediary is the shareholder of record, holding shares on behalf of clients who are the beneficial owners.

reviewed, and approved by the Commission staff in accordance with this Subsection D. Such calculation shall be subject to a *de minimis* threshold, as described in paragraph (v), below. No portion of the Distribution Fund shall be paid to any affected shareholder account in which Respondents First Eagle or FEF, or any of their officers or directors, has a financial interest.

(v) Respondents shall, within 180 days from the date 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 shareholder account, (ii) the exact amount of the payment to be made from the Distribution Fund to each affected shareholder account, and (iii) the amount of any *de minimis* threshold to be applied. Respondents also shall 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 Respondents' proposed Calculation or any of its information or supporting documentation, Respondents shall submit a revised Calculation for the review and approval of the Commission staff or additional information or supporting documentation within 10 days of the date that Respondents are notified of the objection, which revised Calculation shall be subject to all of the provisions of this Subsection D.

(vi) Respondents shall complete the disbursement of all amounts payable to affected shareholder accounts within 90 days of the date that the Commission staff approves the Calculation, unless such time period is extended as provided in Paragraph xi of this Subsection D.

(vii) If Respondents are unable to distribute or return any portion of the Distribution Fund for any reason, including an inability to locate an affected shareholder account or a beneficial owner in an affected shareholder account or any factors beyond Respondents' control, Respondents shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury in accordance with Section 21F(g)(3) of the Securities Exchange Act of 1934 after the final accounting provided for in Paragraph ix of this Subsection D is submitted to the Commission staff. 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 First Eagle Investment Management, LLC, and FEF Distributors, LLC 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 Anthony Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

(viii) Respondents shall be responsible for any and all tax compliance responsibilities associated with the Distribution Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and shall not be paid out of the Distribution Fund.

(ix) Within 45 days after Respondents complete the disbursement of all amounts payable to affected shareholder accounts, Respondents shall submit to the Commission staff a final accounting and certification of the disposition of the Distribution Fund, which final accounting and certification shall be in a format to be provided by the Commission staff. The final accounting and certification shall include, but not be limited to: (1) the amount paid to each payee; (2) the date of each payment; (3) the check number or other identifier of money transferred; (4) the amount of any returned payment and the date received; (5) a description of any effort to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; (6) the total amount, if any, to be forwarded to the Commission for transfer to the United States Treasury; and (7) an affirmation that Respondents have made payments from the Distribution Fund to affected shareholder accounts in accordance with the Calculation approved by the Commission staff. Respondents shall submit proof and supporting documentation of such payment (whether in the form of electronic payments or cancelled checks) in a form acceptable to the Commission staff under a cover letter that identifies First Eagle Investment Management, LLC and FEF Distributors, LLC as Respondents and the file number of these proceedings to Anthony Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5010. Respondents 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.

(x) After Respondents 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 undistributed amount to the United States Treasury.

(xi) The Commission staff may extend any of the procedural dates set forth in this Subsection D for good cause shown. Deadlines for dates relating to the Distribution 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.

E. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties, disgorgement, and prejudgment interest described above for distribution to affected shareholder accounts. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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.

F. Respondent FEF shall comply with the undertakings enumerated above in paragraphs 23 through 26 of this Order.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By Jill M. Peterson
Assistant Secretary

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75954 / September 21, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4200 / September 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16824

In the Matter of **DANIEL PAEZ,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Daniel Paez ("Respondent" or "Paez").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From 2010 through at least 2012, Respondent was the president of Fly High Investments Inc. ("Fly High"), a purported hedge fund that is now defunct and was formerly located in Miami, Florida. Respondent, 28 years old, was a resident of Miami, Florida. During the relevant time period, Respondent acted as an investment adviser and as a broker-dealer, although he was not registered as such.

B. ENTRY OF RESPONDENT'S CRIMINAL CONVICTION

2. On November 26, 2013, Paez entered a guilty plea in the U.S. District Court for the Southern District of Florida to one count of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff(a) and 78 C.F.R. § 240.10b-5 in connection with his involvement in an investment scheme that raised over $500,000 from at least 17 individuals between September 2010 and April 2012. U.S. v. Daniel Paez, Case No. 13-20789-CR-DIMITROULEAS/SNOW (S.D. Fla. Nov. 26, 2013). On February 21, 2014, Paez was sentenced to 37 months in prison and 3 years of supervised release. Paez was ordered to pay restitution in the amount of $476,545. Paez is serving his sentence at a federal prison in Sumterville, Florida.

3. The count of the criminal information to which Paez pleaded guilty alleged, among other things, that Paez falsely promised investors high rates of return, that investors could take out profits at any time, and that monies would be placed in specific investments or categories of investments such as securities related to precious metals and real estate. Paez claimed that Fly High was a hedge fund valued in excess of $50 million. Paez used a small percentage of investor funds to invest in penny stocks and other high risk investments that were materially different than the specific investment he promised to investors. Also, contrary to his promises, Paez misappropriated the majority of investor funds from the purported investment account to gamble at casinos and for his personal use. Paez actively solicited investors through the phone and other means and obtained money from investors through false representations, promises, omissions, and other acts. Paez engaged in the same day purchase and sale of securities to make it appear to investors that funds were used for trading, when in fact he was diverting investor funds for his personal benefit.

III.

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

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

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

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

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an

Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

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

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

This Order shall be served forthwith upon Respondent 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

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75955 / September 21, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4201 / September 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16825

In the Matter of Charles D. Jones, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Charles D. Jones ("Respondent" or "Jones"). The Commission also deems it appropriate to issue an order of forthwith suspension of Respondent pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].[1]

II.

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

[1] Rule 102(e)(2) provides in relevant part, "any . . . person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

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 Section III.2. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940 and Rule 102(e)(2) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Jones, 62 years old, is a resident of Waco, Texas. From at least November 2005 through February 2014, Jones was associated with Charles D. Jones Capital Management, Inc. ("CDJCM") as its Founder, President, and registered investment adviser representative. CDJCM, based in Waco, Texas, was established in 1989 and provided fee-only personalized financial planning and investment management services. CDJCM was a Commission-registered investment adviser from at least November 2005 through February 2014 and has ceased business operations.

2. On December 24, 2014, the Acting U.S. Attorney for the Western District of Texas filed a Criminal Information against Jones United States v. Charles D. Jones, Civ. Act. No. 6:14-cr-00284 (2014) ("Criminal Action"). On February 19, 2015, Jones pleaded guilty in the Criminal Action to one count of wire fraud in violation of 18 U.S.C. §1343. On June 2, 2014, the Supreme Court of Texas accepted Jones's offer to resign his bar membership in lieu of disciplinary action. Order of the Supreme Court of Texas, Misc. Doc. No. 14-9111 (June 2, 2014).

3. In connection with his guilty plea in the Criminal Action, Jones admitted that, between 2005 and 2012, he misappropriated approximately $1million from five client investment accounts he managed at CDJCM by, *inter alia*, (a) transferring money from certain client accounts to himself for personal use; (b) transferring money from certain client accounts to conceal stolen funds; (c) creating false account statements; and (d) utilizing false tax returns.

4. On July 15, 2015, Jones was sentenced to a prison term of six years followed by five years of supervised release and ordered to pay restitution in the amount of $9,252,316.89.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent Jones be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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

In view of the foregoing, the Commission also finds that Respondent has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is hereby ORDERED that Respondent Jones is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Corporate Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75958 / September 22, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3704 / September 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16826

In the Matter of **STEIN MART, 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 Stein Mart, Inc. ("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 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 at least 2010 to November 2012, Stein Mart, Inc. ("Stein Mart") materially misstated its pre-tax income in certain quarterly periods as a result of improperly valuing inventory that was subject to price discounts, or markdowns. During the relevant period, Stein Mart used three types of markdowns: a temporary markdown, which was a temporary price reduction for certain promotional sales; a permanent markdown, which was a permanent price reduction; and a "Perm POS" markdown, which also was a permanent price reduction but the merchandise subject to Perm POS markdowns was marketed in a manner similar to merchandise subject to temporary markdowns.

Stein Mart did not value the inventory associated with Perm POS markdowns in accordance with Generally Accepted Accounting Principles ("GAAP"). In particular – despite the fact that merchandise subject to Perm POS markdowns had a permanent price reduction – Stein Mart improperly valued the inventory associated with Perm POS markdowns by writing down the inventory values at the time the product was sold as opposed to immediately when the markdown was taken. Moreover, during the relevant period, Stein Mart had a number of other internal control deficiencies and accounting errors surrounding, among other things, software assets, credit card liabilities, and other inventory-related issues.

Ultimately, in May 2013, Stein Mart restated its financial results for the first quarter of 2012, all reporting periods in fiscal year 2011, and its annual reporting period in fiscal year 2010 primarily because of its accounting error involving Perm POS markdowns. As a result, of this error, in the first quarter of 2012, Stein Mart materially overstated its pre-tax income by almost 30%. Moreover, in connection with the restatement, the company acknowledged material weaknesses in internal control over financial reporting. By engaging in the foregoing conduct, Stein Mart violated the reporting, books and records, and internal controls provisions of the federal securities laws, namely Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

RESPONDENT

Stein Mart, Inc. ("Stein Mart"), a Delaware corporation headquartered in Jacksonville, Florida, is a national apparel retailer with 270 stores operating in 30 states. Stein Mart's

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

common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NASDAQ. Stein Mart's fiscal year ends at the end of business on the Saturday closest to January 31.

FACTS

A. Introduction

1. Stein Mart, as a retail company, carries inventory as one of its most significant assets. Under GAAP, companies value their inventory pursuant to FASB Accounting Standards Codification Topic 330 ("ASC 330") which requires valuing inventory at the lower of cost or market. To arrive at the lower of cost or market, Stein Mart utilized the Retail Inventory Method ("RIM"), an averaging method commonly used within the retail industry that is consistent with GAAP.

2. Stein Mart, a national retailer, often offers its merchandise to customers at retail price reductions referred to as "markdowns." As described in greater detail below, proper analysis of these markdowns is critical in properly determining the value of ending inventories.

3. Stein Mart has historically used three categories of markdowns for tracking merchandise: (i) temporary or point of sale ("POS") markdowns, (ii) permanent markdowns, and (iii) "Perm POS" markdowns.

4. Temporary Markdowns are a temporary reduction in the selling price of an item to stimulate demand or reduce the inventory. Stein Mart used these types of markdowns for certain promotional sales, like a Fourth of July weekend sale. Once the sale period ended, the merchandise subject to a temporary markdown returned to its original retail price.

5. Permanent Markdowns are a permanent reduction in the selling price of an item to stimulate demand and clear out seasonal inventory. Stein Mart referred to these markdowns as "hardmarks," because the original price on the price tag for merchandise subject to a permanent markdown was crossed out and replaced with the marked down price. Unlike temporary markdowns, merchandise subject to a permanent markdown never returned to its original retail price.

6. Stein Mart used a third type of markdown known as "Perm POS" markdowns. Like permanent markdowns, merchandise subject to a Perm POS markdown never reverted back its original retail price. Unlike merchandise subject to permanent markdowns, however, this permanent price change was reflected by store signage as opposed to a change in the price tag; and the merchandise subject to Perm POS markdowns was placed in the stores with merchandise subject to temporary markdowns while merchandise subject to permanent markdowns was placed separately in stores .

7. Prior to 2009, Stein Mart generally used three percentage discounts associated with merchandise subject to Perm POS markdowns – 30%, 50%, and 75%. After 2009, however, Stein Mart removed the 50% and 75% Perm POS markdowns, but maintained the 30% Perm POS markdown.

8. By 2009, Stein Mart changed its markdown strategy by increasing the number of permanent markdowns taken throughout the year and particularly by year-end, compared to other types of markdowns including Perm POS. As a result of the fact that merchandise subject to perm POS markdowns was permanently marked down and then marked out of stock by year-end, Perm POS markdowns did not significantly impact Stein Mart's full-year financial results. The manner in which Stein Mart accounted for Perm POS markdowns, however, could have still significantly impacted Stein Mart's quarterly inventory values and related financial results.

B. Stein Mart's Accounting for Perm POS Markdowns and Absence of Internal Controls

9. Despite the fact that the price associated with merchandise subject to Perm POS markdowns never reverted back to its original retail price, Stein Mart accounted for this merchandise in the same manner as it did merchandise subject to temporary markdowns.

10. The difference between temporary/Perm POS markdowns and permanent markdowns was significant from an accounting perspective, and more specifically, from an inventory valuation perspective. In particular, Stein Mart reduced the value of inventory subject to a temporary/Perm POS markdown at the time the item was **sold**, while Stein Mart reduced the value of inventory subject to a permanent markdown **immediately at the time the markdown was applied** (emphasis added).

11. Despite this significant difference in accounting treatment, Stein Mart did not – until at least the middle of 2011 – have adequate internal accounting controls concerning Perm POS markdowns.

12. For example, the decision to categorize a markdown as permanent, temporary, or Perm POS resided solely with Stein Mart's merchandising department, which had no knowledge of the impact that these markdowns had on the inventory valuation accounting.

13. Moreover, prior to at least the middle of 2011, Stein Mart had insufficient internal accounting controls that provided for its accounting department to review (i) how the merchants categorized markdowns as permanent, temporary, or Perm POS or (ii) whether the merchandise associated with Perm POS markdowns was accounted for properly.

C. Stein Mart's CFO Discovers Perm POS Markdowns and Consults With Others

14. In the summer of 2011, Stein Mart's Chief Financial Officer ("CFO") – who had been hired as CFO in August of 2009 – learned for the first time that Stein Mart used "Perm POS" markdowns. Prior to this time, and as a reflection of the insufficient internal accounting controls surrounding Perm POS markdowns, Stein Mart's CFO believed the company used only permanent and temporary markdowns.

15. Upon learning of these markdowns, Stein Mart's CFO gathered additional information by consulting with Stein Mart's merchandising department and others. Stein Mart's CFO understood after these consultations that – like permanent markdowns – the price associated with Perm POS markdowns did not revert to its original retail price.

16. Stein Mart's CFO subsequently had internal and external consultations concerning Stein Mart's accounting for Perm POS markdowns. Some, including Stein Mart's Audit Committee Chair, believed that Stein Mart's practice was an acceptable method while others provided information indicating that certain other retailers utilized different methods for valuing Perm POS-like merchandise. Following these consultations, Stein Mart's CFO ultimately concluded that Stein Mart's practice of writing down Perm POS inventory at the time the product was sold was an acceptable method under GAAP.

D. Discussion with Stein Mart's External Auditor

17. Despite the extensive internal and external discussions and additional steps noted above, Stein Mart did not consult with its external auditor concerning Perm POS markdowns until the fall of 2012.

18. In the fall of 2012, Stein Mart's Audit Committee Chair concluded that the company should account for Perm POS markdowns on the same basis as Permanent Markdowns, meaning that the company should write down the inventory associated with Perm POS markdowns at the time the markdown was taken instead of when the product was sold.

19. Stein Mart's CFO subsequently contacted the engagement partner for the company's external auditor to discuss this issue. Stein Mart's CFO informed the audit engagement partner that the company's proposed change in accounting treatment for Perm POS markdowns was a change from one acceptable GAAP method to another, as opposed to a change in method to correct for an accounting error under GAAP.

20. Stein Mart's external auditor disagreed with the company's view, and more specifically, believed that Stein Mart's current accounting for Perm POS Markdowns was not in accordance with GAAP, and in turn, represented an accounting error.

E. Stein Mart Restates and Discloses Accounting Error for Perm POS Markdowns

21. Subsequently, in May 2013, Stein Mart restated its financial statements for the first quarter of 2012, all quarterly and annual periods in fiscal year 2011, and the annual period for fiscal year 2010. In its restatement, Stein Mart stated that its original accounting for Perm POS markdowns was an accounting error and not in accordance with GAAP.

22. As a result of Stein Mart's accounting error for Perm POS markdowns and as reflected by the chart below (in 000s), Stein Mart materially overstated or understated pre-tax income in certain quarterly reporting periods. Most notably, Stein Mart reported an approximate 30% overstatement in its pre-tax income for its first quarter 2012 results because of its improper accounting for Perm POS markdowns.

	FY 2010	Q1 11	Q2 11	Q3 11	Q4 11	FY 2011	Q1 12
Pre-Tax Income/(Loss) – Originally Reported	53,192	26,215	2,250	(5,417)	8,923	31,971	20,372
Pre-Tax Income/(Loss) – Restated	52,426	23,164	4,154	(6,392)	11,740	32,667	15,685
Pre-Tax Income/(Loss) – Over/(Under) Statement	766	3,051	(1,904)	975	(2,817)	(696)	4,687
Percentage Over/(Under) Statement	**1.5%**	**13.2%**	**-45.8%**	**-15.3%**	**-24.0%**	**-2.1%**	**29.9%**

23. Moreover, in the restatement, Stein Mart acknowledged that it not only had a material weakness in its internal control over financial reporting surrounding Perm POS markdowns but also that it had a material weakness in "its control environment related to the level of information and communication between the finance department and other departmental functions."

F. Other Stein Mart Accounting and Internal Control Issues

24. In addition to the issues surrounding Perm POS markdowns, Stein Mart had a number of other accounting and internal controls related issues during the relevant period.

25. First, in the first quarter of 2011, Stein Mart identified an error related to its liability for credit card rewards earned under Stein Mart's co-brand credit program with a bank. This error was caused by two issues: (i) an operational error in the information technology systems used to calculate these liabilities and (ii) the reconciliation performed by Stein Mart's accounting department to detect these types of errors was done improperly. This error resulted in an approximate $2 million total understatement of Stein Mart's other income across certain periods, which the company corrected as an out-of-period adjustment in the first quarter of 2011.

26. Second, in the third quarter of 2011, Stein Mart identified an error in connection with the operation of its inventory retail stock ledger system. This error was also caused by two issues: (i) an operational error in the applicable informational technology systems and (ii) a failure to perform timely reconciliations in the accounting department. This error caused Stein Mart to overstate its gross margin and inventory by $2.2 million in its earnings release for the third quarter of 2011. The company disclosed the error and accounted for these items correctly in the financial statements filed with the company's third quarter 2011 Form 10-Q. The company subsequently disclosed in the fourth quarter of 2011 that this error resulted from a material weakness in its internal control over financial reporting.

27. Third, in the fourth quarter of 2011, the company identified during the reconciliation process an unsupported credit card variance for its outstanding credit card settlements. The company found that it was improperly relating these credit card variances to prior periods. This error resulted in a slight overstatement of pre-tax income across certain periods, which the company recorded as a cumulative adjustment in the fourth quarter of 2011. In its fiscal year-end 2011 annual report, Stein Mart acknowledged that this error reflected a material weakness in its internal control over financial reporting.

28. Fourth, in the middle of 2012, the company identified an error relating to incorrect capitalization and amortization of software in prior periods and software assets that should have been retired prior to 2012. This error resulted from both information technology and accounting personnel improperly interpreting certain software invoices received from a Stein Mart software service provider. This error resulted in Stein Mart understating its Selling, General and Administrative expenses by approximately $2 million over a certain period – an error that Stein Mart disclosed in its earnings release for the second quarter of 2012. In the May 2013 restatement, Stein Mart stated that this error reflected a material weakness in its internal control over financial reporting.

VIOLATIONS

29. Under Section 21C 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 Act 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.

30. Section 13(a) of the Exchange Act requires issuers to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rules 13a-1, 13a-11, and 13a-13 require the filing of annual, current, and quarterly reports, respectively. In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are

made not misleading. "The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports." *SEC v. Savoy Industries*, 587 F.2d 1149, 1165 (D.C. Cir. 1978) (citing *SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex. 1974)). A violation of the reporting provisions is established if a report is shown to contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975).

31. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles.

32. By engaging in the conduct above, Stein Mart violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, and Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

COOPERATION AND REMEDIAL ACTION

33. In determining to accept Respondent's Offer, the Commission considered remedial acts undertaken by Stein Mart, including its enhancement of internal controls, retention of additional accounting personnel, and Stein Mart's cooperation with the staff's investigation.

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 Section 13(a), 13(b)(2)(A), an 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $800,000 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 three ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request[2];

(2) Respondent 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) 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 Stein Mart 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 Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720.

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

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

By the Commission.

Brent J. Fields
Secretary

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

4845-7691-2677.4

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4204 / September 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16827

In the Matter of **R.T. Jones Capital Equities Management, Inc.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against R.T. Jones Capital Equities Management, Inc. ("R.T. Jones" or "Respondent").

II.

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

III.

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

Summary

These proceedings arise out of R.T. Jones's failure to adopt written policies and procedures reasonably designed to protect customer records and information, in violation of Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)) (the "Safeguards Rule"). From at least September 2009 through July 2013, R.T. Jones stored sensitive personally identifiable information ("PII") of clients and other persons on its third party-hosted web server without adopting written policies and procedures regarding the security and confidentiality of that information and the protection of that information from anticipated threats or unauthorized access. In July 2013, the firm's web server was attacked by an unauthorized, unknown intruder, who gained access rights and copy rights to the data on the server. As a result of the attack, the PII of more than 100,000 individuals, including thousands of R.T. Jones's clients, was rendered vulnerable to theft.

Respondent

1. R.T. Jones, located in St. Louis, Missouri, is an investment adviser registered with the Commission that has approximately 8400 client accounts and about $480 million in regulatory assets under management. The firm does not have custody of client assets.

Background

2. Through agreements with a retirement plan administrator and various retirement plan sponsors, R.T. Jones provides investment advice to individual plan participants using a managed account option called Artesys. Artesys offers a variety of model portfolios that range in investment objectives and risk profiles. Plan participants can access the Artesys program through R.T. Jones's public website. Plan participants who elect to enroll in the program are instructed to fill out a questionnaire on the website regarding their investment objectives and risk tolerance. Based on information provided in the questionnaire, R.T. Jones recommends a particular portfolio allocation from among the Artesys models to the client. If the client agrees to the recommended allocation, R.T. Jones provides trade instructions to the retirement plan administrator, which then effects the transactions. R.T. Jones does not control or maintain client accounts or client account information.

3. During the relevant period, in order to verify eligibility to enroll in Artesys, R.T. Jones required prospective clients to log on to its website by entering their name, date of birth and social security number. The login information was then compared against the PII of eligible plan participants, which was provided to R.T. Jones by its plan sponsor partners. R.T. Jones stored this PII, without modification or encryption, on its third party-hosted web server. To facilitate the verification process, the plan sponsors provided R.T. Jones with information about all of their plan participants. Thus, even though R.T. Jones had fewer than 8000 plan participant clients, its web server contained the PII of over 100,000 individuals.

4. R.T. Jones limited access to the PII stored on the server to two individuals who held administrator status. In July 2013, R.T. Jones discovered a potential cybersecurity breach at its third party-hosted web server. R.T. Jones promptly retained more than one cybersecurity consulting firm to confirm the attack and assess the scope of the breach. One of the forensic cybersecurity firms reported that the cyberattack had been launched from multiple IP addresses, all of which traced back to mainland China, and that the intruder had gained full access rights and copy rights to the data stored on the server. However, the cybersecurity firms could not determine the full nature or extent of the breach because the intruder had destroyed the log files surrounding the period of the intruder's activity.

5. Soon thereafter, R.T. Jones retained another cybersecurity firm to review the initial report and independently assess the scope of the breach. Ultimately, the cybersecurity firms could not determine whether the PII stored on the server had been accessed or compromised during the breach.

6. Shortly after the breach incident, R.T. Jones provided notice of the breach to all of the individuals whose PII may have been compromised and offered them free identity monitoring through a third-party provider. To date, the firm has not learned of any information indicating that a client has suffered any financial harm as a result of the cyber attack.

<u>R.T. Jones Failed to Adopt Written Policies and Procedures Reasonably Designed to Safeguard Customer Information</u>

7. The Safeguards Rule, which the Commission adopted in 2000, requires that every investment adviser registered with the Commission adopt policies and procedures reasonably designed to: (1) insure the security and confidentiality of customer records and information; (2) protect against any anticipated threats or hazards to the security or integrity of customer records and information; and (3) protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer. The Commission adopted amendments to the Safeguards Rule, effective January 2005, to require that the policies and procedures adopted thereunder be in writing.

8. During the relevant period, R.T. Jones maintained client PII on its third party-hosted web server. However, the firm failed to adopt any written policies and procedures reasonably designed to safeguard its clients' PII as required by the Safeguards Rule. R.T. Jones's policies and procedures for protecting its clients' information did not include, for example: conducting periodic risk assessments, employing a firewall to protect the web server containing client PII, encrypting client PII stored on that server, or establishing procedures for responding to a cybersecurity incident. Taken as a whole, R.T. Jones's policies and procedures for protecting customer records and information were not reasonable to safeguard customer information.

Violations of the Federal Securities Laws

9. As a result of the conduct described above, R.T. Jones willfully[1] violated Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a)), which requires registered investment advisers to adopt written policies and procedures that are reasonably designed to safeguard customer records and information.

Remedial Efforts

10. To mitigate against any future risk of cyber threats, R.T. Jones has appointed an information security manager to oversee data security and protection of PII, and adopted and implemented a written information security policy. Among other things, the firm no longer stores PII on its webserver and any PII stored on its internal network is encrypted. The firm has also installed a new firewall and logging system to prevent and detect malicious incursions. Finally, R.T. Jones has retained a cybersecurity firm to provide ongoing reports and advice on the firm's information technology security.

11. In determining to accept R.T. Jones's Offer, the Commission considered the remedial acts promptly undertaken by R.T. Jones and the cooperation R.T. Jones afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in R.T. Jones's Offer. Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent R.T. Jones cease and desist from committing or causing any violations and any future violations of Rule 30(a) of Regulation S-P (17 C.F.R. § 248.30(a));

B. Respondent R.T. Jones is censured; and

C. Respondent R.T. Jones shall pay, within 10 (ten) days of the entry of this Order, a civil money penalty 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. 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;

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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) 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 R.T. Jones 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, Asset Management Unit, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois, 60604.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Corporate Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75963 / September 22, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3705 / September 22, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16828

In the Matter of

IDLE MEDIA, INC. and
MARCUS FRASIER,

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Idle Media, Inc. ("Idle Media") and Marcus Frasier ("Frasier") (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 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of Idle Media's numerous reporting, books and records, and internal control violations during the period it was a reporting company from August 2012 through December 2013. Because of Idle Media's accounting errors, Idle Media restated its financial statements multiple times during this period. First, Idle Media determined that its financial statements for the 2010 fiscal year required restatement because the company failed to record revenue and expenses generated by its subsidiary, Datpiff, LLC ("Datpiff"), that were processed through accounts of its parent, Zoeter, LLC ("Zoeter"). However, rather than correcting these revenue and expense line items, Idle Media improperly consolidated Zoeter as a variable interest entity. When Idle Media reported these consolidated financial statements, it failed to include Zoeter's accounts within each financial statement line item, leading to another restatement. Idle Media eventually acknowledged that its consolidation of Zoeter was incorrect, resulting in a final restatement to deconsolidate Zoeter's financial statements and recognize all of Datpiff's revenue and expenses in its own financial statements.

Marcus Frasier, Idle Media's founder and Chief Executive Officer ("CEO"), signed the company's relevant SEC filings and a certification. Although Frasier was responsible for maintaining Idle Media's books and records and implementing adequate internal accounting controls, he failed to do so. As a result, Frasier caused Idle Media's reporting, books and records, and internal accounting controls violations and improperly certified Idle Media's Form 10-Q filing.

Respondents

1. Idle Media, Inc., is a Nevada corporation based in Leesport, Pennsylvania. Idle Media develops and operates several websites focusing on music, music videos and gaming. Idle Media became a publicly traded company in May 2010 through a reverse merger with another corporation. Idle Media's stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act from August 2012 to December 2013. During that period, its stock was quoted on the OTC Bulletin Board under the ticker symbol "IDLM." The stock is currently quoted on the OTC Link, which is operated by OTC Markets Group Inc. Approximately 65% of Idle Media's outstanding stock is owned by Zoeter. Idle Media operates through Datpiff, a wholly owned subsidiary.

2. Marcus Frasier, age 30, is a resident of Shoemakersville, Pennsylvania. Frasier is the founder of Idle Media and is its CEO. Frasier also owns Zoeter and is its only member.

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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.

Background

3. In 2005, Frasier created Zoeter to hold and run certain web development projects. Zoeter held datpiff.com, a website that enabled customers to upload and share music.

4. In 2008, Frasier formed Datpiff to hold and run the datpiff.com website. Although Frasier intended Datpiff to operate separately from Zoeter, Frasier used accounts in Zoeter's name to receive revenue and pay expenses for Datpiff.

5. In May 2010, Frasier formed Idle Media and caused it to merge with a shell company. At the same time, Frasier made Datpiff a wholly owned subsidiary of Idle Media. Zoeter received 40 million shares of Idle Media stock, representing a 65% share, and thereby became the parent company of Idle Media. Frasier became Idle Media's CEO. Datpiff was the primary revenue generating business of Idle Media.

6. Following Idle Media's formation, Zoeter and Datpiff shared employees, including Frasier. Zoeter continued to pay the payroll expenses for Datpiff employees and paid operating expenses, such as costs of servers, for both companies.

Idle Media's Restatement to Consolidate its Parent Company

7. Subsequent to the company issuing financial statements in its Form 10-K for its 2010 fiscal year and in its Form 10-Q for the first quarter ended December 31, 2010, Idle Media discovered that it failed to record certain revenue and expenses generated by Datpiff but processed through Zoeter's accounts. On February 28, 2011, Idle Media issued a Form 8-K announcing its previously issued financial statements for the fiscal year ended September 30, 2010 and the quarter ended December 31, 2010 should not be relied upon.

8. Nearly a year later and without having issued restated financial statements, the company filed a Form 15 on March 8, 2012, terminating its SEC registration. Three months later, however, the company filed a Form 10 to recommence registration. In the Form 10 filed June 13, 2012, the company issued restated financial statements for the fiscal year ended September 30, 2010. However, the company did not correct its accounting deficiencies resulting from the misallocation of revenues and expenses between Datpiff and Zoeter. Rather, the company consolidated Zoeter's financial statements into those of Idle Media, claiming Zoeter was a variable interest entity ("VIE") requiring consolidation by Idle Media.

10. Idle Media issued consolidated financial statements in its Form 10-Q for the quarter ended June 30, 2012, filed on August 17, 2012, and in its Forms 10 and 10/A filed on June 13, 2012, July 31, 2012, September 25, 2012, September 26, 2012, and October 29, 2012, respectively. Frasier signed and/or certified each of these reports.

Idle Media's Restatement to Correct Consolidation Errors

11. When Idle Media originally reported its consolidated financial statements, it improperly failed to consolidate Zoeter's accounts within each financial statement line item and incorrectly presented the impact of the noncontrolling interest on Idle Media's income. Idle Media amended its Form 10 on September 25, 2012 to restate the form and contents of its consolidated financial statements.

Idle Media's Deconsolidation of its Parent Company

12. Idle Media's consolidation of Zoeter was improper because Idle Media did not have a variable interest in Zoeter. Idle Media filed a Form 8-K on January 15, 2013, announcing it would restate its financial statements again to deconsolidate Zoeter and acknowledging that its VIE accounting was incorrect.

13. In December 2013, Idle Media issued restated financial statements for fiscal years 2010 and 2011 and related quarterly periods. As a result of Idle Media's improper consolidation of Zoeter and its earlier revenue and expense allocation errors between Datpiff and Zoeter, the company had materially misstated revenue and net income by 18% and 24%, respectively, for 2010. Idle Media had also materially misstated net income by 24% for 2011.

Idle Media's Failure to Maintain Adequate Books and Records

14. Throughout the relevant period, Idle Media failed to maintain adequate books and records. For example, Idle Media used Zoeter accounts for Datpiff's operations without correctly allocating revenue and expenses between the two companies. Idle Media's improper recording of revenue and expenses contributed to its incorrect determination that Zoeter's financial statements should be consolidated with those of Idle Media.

15. Frasier knew that Idle Media failed to segregate its accounts from Zoeter's accounts but failed to ensure that Idle Media properly allocated revenues and expenses to the correct entity.

Idle Media's Failure to Establish and Implement Adequate Internal Accounting Controls

16. Throughout the relevant period, Idle Media did not maintain adequate internal accounting controls. The company failed to maintain any written policies or take other meaningful steps to ensure that the company reported its financial results accurately.

17. Idle Media announced in its Form 8-K filed on March 30, 2011 the existence of material weaknesses in the company's internal control over financial reporting and that an assessment of those controls was being conducted. The company, however, failed to take adequate steps to improve its internal control over financial reporting.

18. Frasier was aware that the company failed to assess, implement, evaluate, or maintain adequate internal accounting controls. Although these controls were his responsibility,

he failed to take any action to address this issue and therefore caused Idle Media's internal accounting controls violations.

Frasier Violated the Certification Provisions

19. As Idle Media's CEO, Frasier was required to sign certifications each fiscal quarter and fiscal year pursuant to Sarbanes-Oxley Act Section 302 and Exchange Act Rule 13a-14. Frasier executed the certification attached to Idle Media's quarterly report for the period ended June 30, 2012.

20. In the certification, Frasier stated that he had designed, or caused others to design, internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reports and the presentation of financial statements.

21. Frasier's certification was untrue because Frasier did not design, or cause others to design, internal control over financial reporting.

Violations

22. As a result of the conduct described above, Idle Media violated Sections 12(g) and 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder. Section 12(g), which contains an express voluntary registration provision, requires that every issuer who seeks to register a class of equity securities pursuant to Section 12(g) must file a registration statement (*e.g.,* on Form 10) containing such information and documents as the Commission may specify. In addition, every issuer of such a registered class of securities that is required to file annual reports on Form 10-K pursuant to Section 13(a) is also required to file quarterly reports on Form 10-Q pursuant to the provisions of Rule 13a-13 thereunder. Finally, Rule 12b-20 under the Exchange Act requires that such registration statements and quarterly reports contain such further material information as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.

23. As a result of the conduct described above, Idle Media committed violations of 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.

24. As a result of the conduct described above, Idle Media violated Section 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 conformity with generally accepted accounting principles.

25. As a result of the conduct described above, Frasier caused Idle Media's violations of Sections 12(g), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-13 and 12b-20 thereunder. Also as a result of the conduct described above, Frasier violated Rule 13a-14,

which requires each principal executive officer of an issuer to include certain certifications in filings made pursuant to Section 13(a) of the Exchange 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 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Idle Media cease and desist from committing or causing any violations and any future violations of Sections 12(g), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-13 and 12b-20 thereunder.

B. Respondent Frasier cease and desist from committing or causing any violations and any future violations of Sections 12(g), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-13, 13a-14 and 12b-20 thereunder.

C. Respondents Idle Media and Frasier shall each, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the Securities and Exchange Commission 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) 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 Idle Media and Frasier 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 M. Metcalfe, Division of

Enforcement, Securities and Exchange Commission, 1961 Stout Street, Suite 1700, Denver, CO 80294.

D. Such civil money penalties may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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, 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 Frasier, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Frasier 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 Frasier 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 210, 270, 274

[Release Nos. 33-9922; IC-31835; File No. S7-16-15]

RIN 3235-AL61, RIN 3235-AL42

Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; re-opening of comment period.

SUMMARY: The Securities and Exchange Commission is proposing a new rule and amendments to its rules and forms designed to promote effective liquidity risk management throughout the open-end fund industry, thereby reducing the risk that funds will be unable to meet redemption obligations and mitigating dilution of the interests of fund shareholders in accordance with section 22(e) and rule 22c-1 under the Investment Company Act. The proposed amendments also seek to enhance disclosure regarding fund liquidity and redemption practices. The Commission is proposing new rule 22e-4, which would require each registered open-end fund, including open-end exchange-traded funds ("ETFs") but not including money market funds, to establish a liquidity risk management program. The Commission also is proposing amendments to rule 22c-1 to permit a fund, under certain circumstances, to use "swing pricing," the process of adjusting the net asset value of a fund's shares to effectively pass on the costs stemming from shareholder purchase or redemption activity to the shareholders associated with that activity, and amendments to rule 31a-2 to require funds to preserve certain records related to swing pricing. With respect to reporting and disclosure, the Commission is proposing amendments to Form N-1A regarding the disclosure of fund policies concerning the redemption

86 of 147

of fund shares, and the use of swing pricing. The Commission also is proposing amendments to proposed Form N-PORT and proposed Form N-CEN that would require disclosure of certain information regarding the liquidity of a fund's holdings and the fund's liquidity risk management practices. In connection with these proposed amendments, the Commission is re-opening the comment period for Investment Company Reporting Modernization, Investment Company Act Release No. 31610 (May 20, 2015) [80 FR 33589 (June 12, 2015)].

DATES: Comments on this release and on Investment Company Act Release No. 31610 should be received on or before [*insert date 90 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 email to rule-comments@sec.gov. Please include File Number S7-16-15 or S7-08-15 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File Number S7-16-15 or S7-08-15. The file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (*http://www.sec.gov/rules/proposed.shtml*).

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 Commission'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: Melissa S. Gainor, Senior Special Counsel; Naseem Nixon, Senior Counsel; Amanda Hollander Wagner, Senior Counsel; Sarah A. Buescher, Branch Chief; or Sarah G. ten Siethoff, Assistant Director, Investment Company Rulemaking Office, at (202) 551-6792, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the "Commission") is proposing for public comment amendments to rules 22c-1 [17 CFR 270.22c-1] and 31a-2 [17 CFR 270.31a-2], and new rule 22e-4 [17 CFR 270.22e-4], under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] ("Investment Company Act" or "Act"); amendments to Form N-1A [referenced in 17 CFR 274.11A] under the Investment Company Act and the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77a *et seq.*]; amendments to Article 6 [17 CFR 210.6-01 *et seq.*] of Regulation S-X [17 CFR 210]; and amendments to proposed

Form N-PORT [referenced in 17 CFR 274.150] and proposed Form N-CEN [referenced in 17 CFR 274.101] under the Investment Company Act.[1]

TABLE OF CONTENTS

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[1] Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act will be to Title 17, Part 270 of the Code of Federal Regulations [17 CFR 270].

I. INTRODUCTION

Daily redeemability is a defining feature of open-end management investment companies ("open-end funds" or "funds") such as mutual funds.[2] As millions of Americans have come to rely on open-end funds as an investment vehicle of choice, the role of fund liquidity management in reducing the risk that a fund will be unable to meet its obligations to redeeming shareholders while also minimizing the impact of those redemptions on the fund (*i.e.*, mitigating investor

2 An open-end fund is required by law to redeem its securities on demand from shareholders at a price approximating their proportionate share of the fund's net asset value at the time of redemption. Section 22(d) of the Act prohibits a dealer from selling a redeemable security that is being offered to the public by or through an underwriter other than at a current public offering price described in the fund's prospectus. Rule 22c-1 under the Act requires open-end funds, their principal underwriters, and dealers in fund shares (and certain others) to sell and redeem fund shares at a price determined at least daily based on the current net asset value next computed after receipt of an order to buy or redeem. Together, these provisions require that fund shareholders be treated equitably when buying and selling their fund shares. While a money market fund is an open-end management investment company, money market funds generally are not subject to the amendments we are proposing (except certain amendments to proposed Form N-CEN) and thus are not included when we refer to "funds" or "open-end funds" in this release except where specified. The term "mutual fund" is not defined in the 1940 Act.

dilution) is becoming more important than ever. The U.S. fund industry has experienced significant growth in the last 20 years,[3] markets have grown more complex, and funds pursue more complex investment strategies, including fixed income and alternative investment strategies that are focused on less liquid asset classes. Yet, it has been over twenty years since we have provided guidance regarding the liquidity of open-end funds other than money market funds.[4]

We remain committed, as the primary regulator of open-end funds, to designing regulatory programs that respond to the risks associated with the increasingly complex portfolio composition and operations of the asset management industry. Commission staff engaged with large and small fund complexes to better understand funds' management of liquidity risk. Through these outreach efforts our staff has learned that, while some funds and their managers have developed comprehensive liquidity risk management programs, others have dedicated significantly fewer resources to managing liquidity risk in a formalized way. We believe proposing to address these variations in practices is appropriate and that it is in the interest of funds and fund investors to create a regulatory framework that would reduce the risk that a fund will be unable to meet its redemption obligations and minimize dilution of shareholder interests by promoting stronger and more effective liquidity risk management across open-end funds.

We are proposing a set of comprehensive reforms that would provide for: (i) liquidity risk management standards that address issues arising from modern portfolio construction; (ii) a new pricing method that, if funds choose to use it, could better allocate costs to shareholders

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3 As of the end of 2014, there were 8,734 open-end funds (excluding money market funds, but including ETFs), as compared to 2,960 at the end of 1992. *See* Investment Company Institute, 2015 Investment Company Fact Book (2015), *available at* http://www.ici.org/pdf/2015_factbook.pdf ("2015 ICI Fact Book"), at 177 and 184.

4 Revisions of Guidelines to Form N-1A, Investment Company Act Release No. 18612 (Mar. 12, 1992) [57 FR 9828 (Mar. 20, 1992)] ("Guidelines Release").

entering or exiting the fund; and (iii) fuller disclosure of information regarding the liquidity of fund portfolios and how funds manage liquidity risk and redemption obligations. To accomplish this, first, we are proposing new rule 22e-4 under the Act, which would require funds to establish liquidity risk management programs. Under the proposed rule, the principal components of a liquidity risk management program would include a fund's classification and monitoring of each portfolio asset's level of liquidity, as well as designation of a minimum amount of portfolio liquidity, which funds would tailor to their particular circumstances after consideration of a set of market-related factors established by the Commission.

Second, in order to provide funds with an additional tool to mitigate potential dilution and to manage fund liquidity, we are proposing amendments to rule 22c-1 under the Act to permit funds (except money market funds and ETFs) to use "swing pricing," a process of adjusting the net asset value of a fund's shares to pass on to purchasing or redeeming shareholders more of the costs associated with their trading activity. Lastly, in order to give investors, market participants, and Commission staff improved information on fund liquidity and redemption practices, we are proposing amendments to our disclosure requirements and recently proposed data reporting forms. We discuss these proposals as well as why liquidity management is so vital to investors in open-end funds and the developments that have led us to this proposal further below. Taken together, these reforms are designed to provide investors with increased protections regarding how liquidity in their open-end funds is managed, thereby reducing the risk that funds will be unable to meet redemption obligations and mitigating dilution of the interests of fund shareholders. These reforms are also intended to give investors better information with which to make investment decisions, and to give the Commission better information with which to conduct comprehensive monitoring and oversight of an ever-evolving fund industry.

II. BACKGROUND

A. Open-End Funds

Over the past few decades, investors increasingly have come to rely on investments in open-end funds to meet their financial needs and access the capital markets. Individuals invest in these funds for a variety of reasons, from investing for retirement and their children's college education to providing a source of financial security for emergencies and other lifetime events. Institutions also invest significantly in open-end funds as part of basic or sophisticated trading and hedging strategies or to manage cash flows.

There are currently two kinds of open-end funds: mutual funds and ETFs.[5] At the end of 2014, 53.2 million households, or 43.3 percent of all U.S. households owned mutual funds.[6] Mutual funds allow investors to pool their investments with those of other investors so that they may together benefit from fund features such as professional investment management, diversification, and liquidity. Fund shareholders share the gains and losses of the fund, and also share its costs. Investors in mutual funds can redeem their shares on each business day and, by law, must receive their pro rata share of the fund's net assets (or its cash value) within seven calendar days after delivery of a redemption notice.[7]

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5 ETFs registered with the Commission are organized either as open-end management investment companies or unit investment trusts. *See* section 4(2) of the Act (defining "unit investment trust" as an investment company which (i) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (ii) does not have a board of directors, and (iii) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities, but does not include a voting trust). Most ETFs are organized as open-end management investment companies and, except where specified, when we refer to ETFs in this release, we are referring to ETFs that are organized as open-end management investment companies.

6 *See* 2015 ICI Fact Book, *supra* note 3, at 114.

7 *See* section 2(a)(32) of the Act (defining a "redeemable security" as any security, other than short-term paper, that entitles its holder to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof), and section 22(e) of the Act (providing, in part, that no open-end fund shall suspend the right of redemption, or postpone the date of payment upon redemption of any redeemable security in accordance with its terms for more than seven days after tender of the security

ETFs also offer investors an undivided interest in a pool of assets. Since 2003, the number of ETFs traded in U.S. markets has increased by more than 1,200 funds, and the assets held by ETFs have increased from $151 billion at the end of 2003 to $1.9 trillion at the end of 2014.[8] ETF shares, similar to stocks, are bought and sold throughout the day by investors on an exchange through a broker-dealer.[9] In addition, like mutual funds, ETFs provide redemption rights on a daily basis, but, pursuant to exemptive orders, such redemption rights may only be exercised by certain large market participants – typically broker-dealers – called "authorized participants." Authorized participants may purchase and redeem ETF shares at the ETF's net asset value per share ("NAV") from the ETF.[10] When an authorized participant transacts with an ETF to purchase and sell ETF shares, these share transactions are structured in large blocks called "creation units." Most ETFs are structured so that an authorized participant will purchase a creation unit with a "portfolio deposit," which is a basket of assets (and sometimes cash) that generally reflects the composition of the ETF's portfolio.[11] The ETF makes public the contents of the portfolio deposit before the beginning of the trading day.[12] After purchasing a creation unit, an authorized participant may hold the ETF shares or sell (or lend) some or all of them to investors in the secondary market.

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absent specified unusual circumstances).

8 *See* 2015 ICI Fact Book, *supra* note 3, at 60.

9 *See* Exchange-Traded Funds, Investment Company Act Release No. 28193 (Mar. 11, 2008) [73 FR 14618 (Mar. 18, 2008)] ("ETF Proposing Release").

10 Authorized participants purchase ETF shares at the ETF's NAV through the ETF's underwriter or other service provider.

11 *See* Request for Comment on Exchange-Traded Products, Securities Exchange Act Release No. 75165 (June 12, 2015) [80 FR 34729 (June 17, 2015)] ("2015 ETP Request for Comment"), at n.19 and accompanying text.

12 *See id.* at n.20 and accompanying text.

Similarly, for most ETFs, when an authorized participant wishes to redeem ETF shares, it presents a creation unit of ETF shares to the ETF for redemption and receives in return a "redemption basket," the contents of which are made public by the ETF before the beginning of the trading day. The redemption basket (which is usually, but not always, the same as the portfolio deposit) typically consists of securities and a small amount of cash.[13] In addition, while less common, some ETFs represent to the Commission that they ordinarily intend to conduct all purchase and redemption transactions with authorized participants in cash instead of an in-kind basket of assets, and all ETFs reserve the right to transact with authorized participants in cash. The ability of these authorized participants to purchase and redeem creation units at each day's NAV enables authorized participants (or market makers that trade through authorized participants) to exercise arbitrage opportunities that are generally expected to have the effect of keeping the market price of ETF shares at or close to the NAV of the ETF.[14]

Recently, the Commission has also approved exchange-traded managed funds ("ETMFs").[15] ETMFs are a hybrid between a traditional mutual fund and an ETF. Like ETFs,

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13 *See id.* at n.21 and accompanying text.

14 For example, if ETF shares begin trading on national securities exchanges at a price below the ETF's NAV, authorized participants can purchase ETF shares in secondary market transactions and, after accumulating enough shares to comprise a creation unit, redeem them from the ETF in exchange for the more valuable securities in the ETF's redemption basket. Those purchases create greater market demand for the ETF shares, and thus tend to drive up the market price of the shares to a level closer to NAV. Conversely, and again by way of example, if the market price for ETF shares exceeds the NAV of the ETF itself, an authorized participant can deposit a basket of securities in exchange for the more valuable creation unit of ETF shares, and then sell the individual shares in the market to realize its profit. These sales would increase the supply of ETF shares in the secondary market, and thus tend to drive down the price of the ETF shares to a level closer to the NAV of the ETF share. In each case, the authorized participant (or its market maker customer) may hedge its exposure to cover the risk from the time the arbitrage opportunity is exercised through the time it can deliver shares or assets to the ETF, at which time it will unwind its hedge. *See* ETF Proposing Release, *supra* note 9, at nn.25-30 and accompanying text; *see also* 2015 ETP Request for Comment, *supra* note 11, at section I.C.2.

15 *See* Eaton Vance Management, et al., Investment Company Act Release Nos. 31333 (Nov. 6, 2014) (notice) ("ETMF Notice") and 31361 (Dec. 2, 2014) (order). For the purposes of the proposed amendments to rule 22c-1, the definition of "exchange-traded fund" shall include ETMFs.

ETMFs would have shares listed and traded on a national securities exchange; directly issue and redeem shares in creation units only; impose fees on creation units issued and redeemed to authorized participants to offset the related costs to the ETMFs; and primarily utilize in-kind transfers of portfolio deposits in issuing and redeeming creation units. Like mutual funds, ETMFs would be bought and sold at prices linked to NAV and would seek to maintain the confidentiality of their current portfolio positions. While no ETMF has been launched yet, the proposed rule and amendments (except the proposed amendments to rule 22c-1) would also apply to ETMFs to the same extent as to other open-end funds whose shares are redeemable on a daily basis.

Open-end funds are an attractive investment option for many different types of investors because they provide diversification, economies of scale, and professional management. They also facilitate retail investors' access to certain investment strategies or markets that might be difficult (if not impossible) or time consuming for investors to replicate on their own.[16] Additionally, open-end funds have become a popular investment vehicle because they may provide a cost-efficient way for investors to track a benchmark index or strategy.[17]

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16 For example, many retail investors would have difficulty investing in certain foreign and emerging market securities given local requirements for purchasing and holding such securities. In addition, some securities may only be sold in large blocks that retail investors would be unlikely to be able to purchase. Many retail investors also may not have the expertise to construct investment strategies followed by, for example, alternative funds on their own. *See also* Notice Seeking Comment on Asset Management Products and Activities, Docket No. FSOC-2014-0001 ("FSOC Notice"); Comment Letter of the Asset Management Group of SIFMA and the Investment Adviser Association on the FSOC Notice (Mar. 25, 2015) ("SIFMA IAA FSOC Notice Comment Letter"), at 12 ("Pooled funds provide many individual investors exposure to asset classes that they could not reach without investing collectively."); Comment Letter of the Investment Company Institute on the FSOC Notice (Mar. 25, 2015) ("ICI FSOC Notice Comment Letter"), at 11 ("The vast majority of [mutual fund] investors would be unable to replicate such investment exposure by directly holding securities themselves.").

17 *See e.g.*, Rick Ferri, *Index Funds Gain Momentum (Part 1 of 2)*, FORBES (July 29, 2013), *available at* http://www.forbes.com/sites/rickferri/2013/07/29/index-funds-gain-momentum-part-1-of-2/ (discussing the growth of passively managed index funds and ETFs that follow indexes).

B. The Role of Liquidity in Open-End Funds

1. Introduction

A hallmark of open-end funds is that they must be able to convert some portion of their portfolio holdings into cash on a frequent basis because they issue redeemable securities,[18] and are required by section 22(e) of the Investment Company Act to make payment to shareholders for securities tendered for redemption within seven days of their tender.[19] As a practical matter, many investors expect to receive redemption proceeds in less than seven days as some mutual funds disclose in their prospectuses that they will generally pay redemption proceeds on a next-business day basis.[20] Furthermore, open-end funds that are redeemed through broker-dealers must meet redemption requests within three business days because broker-dealers are subject to rule 15c6-1 under the Securities Exchange Act of 1934 (the "Exchange Act"), which establishes a three-day (T+3) settlement period for security trades effected by a broker or a dealer.[21] Given the statutory and regulatory requirements for meeting redemption requests, as

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18 *See* sections 5(a)(1) and 2(a)(32) of the Act. All other management companies are closed-end ("closed-end funds"). Closed-end fund shareholders do not have redemption rights and closed-end funds are usually traded on secondary markets, either on exchanges or over the counter, at prices that may be at a premium or a discount to the fund's NAV.

19 Section 22(e) of the Act provides, in part, that no registered investment company shall suspend the right of redemption or postpone the date of payment upon redemption of any redeemable security in accordance with its terms for more than seven days after tender of the security absent specified unusual circumstances.

20 *See* Comment Letter of Fidelity Investments on the FSOC Notice (Mar. 25, 2015) ("Fidelity FSOC Notice Comment Letter"), at 6 ("mutual funds normally process redemption requests by the next business day"); *see also* ICI FSOC Notice Comment Letter, *supra* note 16, at 17 ("For example, a mutual fund has by law up to seven days to pay proceeds to redeeming investors, although as a matter of practice funds typically pay proceeds within one to two days of a redemption request.").

21 17 CFR 240.15c6-1. In a 1995 staff no-action letter, the Division of Investment Management expressed the view that because rule 15c6-1 under the Exchange Act applies to broker-dealers and does not apply directly to funds, the implementation of T+3 pursuant to rule 15c6-1 did not change the standards for determining liquidity, which were based on the requirements of section 22(e) of the Investment Company Act. The Division noted, however, that as a practical matter, many funds have to meet redemption requests within three business days because a broker-dealer is often involved in the redemption process. *See* Letter from Jack W. Murphy, Associate Director and Chief Counsel, Division of Investment Management, SEC, to Paul Schott Stevens, General Counsel, Investment Company Institute (May 26, 1995), *available at* http://www.sec.gov/divisions/investment/noaction/1995/ici052695.pdf, ("May 1995 Staff No-Action

well as any disclosure made to investors regarding payment of redemption proceeds, a mutual fund must adequately manage the liquidity of its portfolio so that redemption requests can be satisfied in a timely manner.[22]

Sufficient liquidity of ETF portfolio positions also is important. ETFs typically make in-kind redemptions of creation units, which can mitigate liquidity concerns for ETFs compared to mutual funds, if the in-kind redemptions are of a representative basket of the ETF's portfolio assets that do not alter the ETF's liquidity profile.[23] However, transferring illiquid instruments to the redeeming authorized participants could result in a liquidity cost to the authorized participant or any of its clients, which would then be reflected in the bid-ask spread and ultimately impact investors. Moreover, declining liquidity in an ETF's basket assets could affect the ability of an authorized participant or any of its clients to readily assemble the basket for purchases of creation units and to sell securities received upon redemption of creation units.[24]

In addition, a significant amount of illiquid securities in an ETF's portfolio can make arbitrage opportunities more difficult to evaluate because it would be difficult for market makers

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Letter"); *see also* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 6 ("As a practical matter, three-day settlement requirements under Exchange Act Rule 15c6-1...effectively take most fund investments to a T+3 settlement timeline.").

22 *See* ICI FSOC Notice Comment Letter, *supra* note 16, at 6-7 ("Daily redeemability is a defining feature of mutual funds. This means that liquidity management is not only a regulatory compliance matter, but also a major element of investment risk management, an intrinsic part of portfolio management, and a constant area of focus for fund managers.").

23 ETFs have some discretion in determining their basket composition. *See, e.g.*, New York Alaska ETF Management LLC, et al., Investment Company Act Release Nos. 31667 (June 12, 2015) (notice) and 31709 (July 8, 2015) (order).

24 ETF Proposing Release, *supra* note 9 at section III.A.1. *But see, e.g.*, Shelly Antoniewicz, Investment Company Institute, *Plenty of Players Provide Liquidity for ETFs* (Dec. 2, 2014), *available at* http://www.ici.org/viewpoints/view_14_ft_etf_liquidity ("Antoniewicz") (stating that most of the trading activity in bond ETF shares is done in the secondary market and not through creations and redemptions with authorized participants).

to price, trade, and hedge their exposure to, the ETF.[25] The effective functioning of this arbitrage mechanism has been pivotal to the operation of ETFs and to the Commission's approval of exemptions that allow their operation.[26] The liquidity of the ETF's portfolio positions is a factor that contributes to the effective functioning of the ETF's arbitrage mechanism and the ETF shares trading at a price that is at or close to the NAV of the ETF.[27]

If authorized participants are unwilling or unable to trade ETF shares in the primary market, and the majority of trading takes place among investors in the secondary market, the ETF's shares may trade at a significant premium or a discount to the value of the ETF's underlying portfolio securities.[28] As a result, the ETF's arbitrage mechanism that keeps the

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25 *See* Comment Letter of the Investment Company Institute on Exchange-Traded Funds, File No. S7-07-08 (May 19, 2008) (discussing the impact of the inclusion of illiquid assets in an ETF's portfolio). *See also* Comment Letter of The American Stock Exchange LLC on the Concept Release: Actively Managed Exchange-Traded Funds, File No. S7-20-01 (Mar. 5, 2002) ("Ultimately it is in the interest of the sponsor and investment adviser to provide for effective arbitrage opportunities. It is unlikely that an ... ETF sponsor would be able to convince the critical market participants such as specialists, market makers, arbitragers and other Authorized Participants to support a product that contained illiquid securities to a degree that would affect the liquidity of the ETF, making it difficult to price, trade and hedge, ultimately leading to its failure in the marketplace.").

26 ETFs exist today only through exemptive orders issued by the Commission providing relief from a number of provisions of the Investment Company Act, including the requirement that they sell and redeem their individual shares at NAV.

27 *See* 2015 ETP Request for Comment, *supra* note 11, at n.102 and accompanying text (requesting comment on the trading of exchange-traded product securities that invest in less liquid assets and the effective functioning of the arbitrage mechanism in these products). *See, e.g.,* Comment Letter of BlackRock, Inc. on the 2015 ETP Request for Comment (Aug. 11, 2015) (discussing the arbitrage mechanism with respect to less liquid assets); Comment Letter of KCG Holdings, Inc. on the 2015 ETP Request for Comment (Aug. 17, 2015) ("While ETF pricing closely tracks NAV for most ETFs, certain types of ETFs exhibit less close alignment between ETF prices and NAV... Price discovery difficulties in the bond market makes it much more difficult and expensive to perform arbitrage in bond ETFs, and this difficultly may be exacerbated during stressed market environments."); Comment Letter of State Street Global Advisors on the 2015 ETP Request for Comment (Aug. 17, 2015) (discussing the arbitrage mechanism with respect to fixed-income based ETFs).

28 *See, e.g.*, Bradley Hope et al., *Stock-Market Tumult Exposes Flaws in Modern Markets*, THE WALL STREET JOURNAL (Aug. 25, 2015), *available at* http://www.wsj.com/articles/stock-market-tumult-exposes-flaws-in-modern-markets-1440547138 (noting that "[d]ozens of ETFs traded at sharp discounts" to NAV during a market sell-off, "leading to outsize losses for investors who entered sell orders at the depth of the panic"). We recognize that not all changes in market liquidity can lead to such extreme results. In many cases of day-to-day price volatility and fluctuations in liquidity, market participants will simply demand greater compensation for purchasing less liquid or more volatile assets. However, declining liquidity can become

secondary price at or close to NAV would not function effectively. In a period of significant decline in market liquidity, this could cause the ETF, in effect, to function more like a closed-end investment company, potentially frustrating the expectations of secondary market investors.[29] In addition, all ETFs permit authorized participants to redeem in cash, rather than in kind, and some ETFs ordinarily redeem authorized participants in cash. ETFs that elect to redeem authorized

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so acute that market makers and investors begin to refrain from conducting transactions. *See, e.g.*, Carrie Driebusch et al., *The Problem with ETFs*, THE WALL STREET JOURNAL (Sept. 14, 2015) (stating that the "trading turmoil of Aug. 24 disrupted the arbitrage activity in which traders buy and sell ETFs and their components to take advantage of price discrepancies.").

29 *See, e.g.*, Matthew Tucker & Stephen Laipply, "Fixed Income ETFs and the Corporate Bond Liquidity Challenge" (2014), *available at* http://www.ishares.com/us/literature/brochure/blackrock-ish-fixed-income-etfs-wp-prd-814.pdf, at 9 ("It should be noted that, although fixed income ETFs have created an incremental source of bond market liquidity for investors, the ETF structure itself remains dependent on the liquidity of the underlying bond market. ETFs serve as efficient risk transfer vehicles because the value at which they trade is reflective of the value of the underlying bonds held within the ETF. If a true and actionable value discrepancy between the ETF and its underlying bond portfolio develops, market participants can trade one versus the other to take advantage of the arbitrage opportunity. This mechanism is premised upon a functioning OTC bond market that can be accessed to buy and sell the underlying securities. Ultimately, if the underlying bond market liquidity becomes impaired then the ETF creation/redemption process would become impaired as well. In such a scenario the ETF would continue to provide price discovery, but would mechanically begin to function more like a closed-end fund (which is unable to grow or shrink in size in order to balance supply and demand). While ETFs provide liquidity enhancement for the bond market, they remain structurally dependent upon the same market.").

Market stresses have demonstrated how declines in market liquidity may cause an ETF's shares to trade at a significant premium or discount to the shares of the ETF's underlying portfolio assets. *See, e.g.,* Eleanor Laise, *Risks Lurk for ETF Investors*, THE WALL STREET JOURNAL (Feb. 1, 2010), *available at* http://www.wsj.com/articles/SB10001424052748703837004575012772071656484 ("A lack of liquidity also may cause the ETF to trade at a large premium or discount to net asset value.... This means an investor buying the fund may overpay for that portfolio, or an investor selling could get less than that basket of securities is worth."); Bradley Kay, *Has the ETF Arbitrage Mechanism Failed?*, MORNINGSTAR (Mar. 11, 2009), *available at* http://news.morningstar.com/articlenet/article.aspx?id=283302 (stating that during periods of market stress, market prices for ETFs may deviate significantly from NAV); ETF Trends, *While Athens Exchange is Closed, the Greece ETF Show Goes On* (July 6, 2015), *available at* http://www.etftrends.com/2015/07/while-athens-exchange-is-closed-the-greece-etf-show-goes-on/ (reporting that the Global X FTSE Greece 20 ETF was trading at a significant discount compared to the net asset value of its underlying portfolio assets because of the closure of the Athens Stock Exchange); ETF Trends, *China A-Shares ETFs Trading at Steep Discount to NAV* (July 9, 2015), *available at* http://www.etftrends.com/2015/07/china-a-shares-etfs-trading-at-steep-discount-to-nav/ (reporting that U.S.-listed China A-shares ETFs were trading at a steep discount to the underlying market because of the fact that a significant number of companies stopped trading on China's mainland stock exchanges).

participants in cash, like mutual funds, would need to ensure that they have adequate portfolio liquidity (in conjunction with any other liquidity sources) to meet shareholder redemptions.[30]

As noted above, ETMFs have features of both mutual funds and ETFs. As ETMFs would redeem their shares on a daily basis from authorized participants, the ETMF would need to hold sufficiently liquid assets to meet such redemptions to the extent that authorized participants redeem in cash. Like ETFs, however, the ETMF's ability to make in-kind redemptions could mitigate liquidity concerns.[31] Further, as ETMF market makers would not engage in the same arbitrage as ETF market makers,[32] the liquidity of an ETMF's portfolio might have a limited relevance beyond the ETMF's ability to meet redemptions.

2. *Liquidity Management by Open-End Funds*

Portfolio managers consider a variety of factors in addition to liquidity when constructing a fund's portfolio, including the fund's investment strategies, economic and market trends, portfolio asset credit quality, and tax considerations. Nevertheless, meeting daily redemption obligations is fundamental for open-end funds, and funds must manage liquidity in order to meet these obligations.[33] Several factors influence how liquidity management by open-end funds affects the equitable treatment of investors in a fund, investor incentives, and potentially the orderly operation of the markets when fulfilling redemption obligations.

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30 When an ETF does permit an authorized participant to redeem in cash, it typically requires the authorized participant to pay a fee covering the costs of the liquidity it receives. *See* BlackRock, Viewpoint, *Fund Structures as Systemic Risk Mitigants* (Sept. 2014), *available at* http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-fund-structures-as-systemic-risk-mitigants-september-2014.pdf ("BlackRock Fund Structures Paper"), at 7.

31 However, an ETMF's transferring illiquid instruments to the redeeming authorized participants would likely affect the premium/discount over NAV at which ETMF shares trade. *See* ETMF Notice, *supra* note 15, at n.17.

32 ETMF market makers would assume no intraday market risk in their ETMF share inventory positions because all trading prices are linked to NAV. *See id.* at paragraphs 13 and 24.

33 *See supra* note 2.

First, it is important to consider how a mutual fund (or ETF redeeming shares by using significant amounts of cash) meets redemptions. When a fund receives redemption requests from shareholders, and the fund does not have cash on hand to meet those redemptions,[34] the fund has discretion to determine whether to sell portfolio assets to generate cash to meet the redemptions and which assets will be sold, or to obtain cash by other available means such as bank lines of credit.[35] A fund may choose to sell its most liquid assets first. This method of selling is limited to some degree by the investment strategies of the fund, and a fund pursuing this method of meeting redemptions to any significant degree may in the near term need to rebalance its portfolio so that the fund continues to follow its investment strategies.[36] A fund that chooses to sell its most liquid assets to meet fund redemptions may minimize the effect of the

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34 A fund can have cash on hand to meet redemptions from cash held in the fund's portfolio, cash received from investor purchases of fund shares, interest payments and dividends on portfolio securities, or maturing bonds. *See, e.g.,* Fidelity FSOC Notice Comment Letter, *supra* note 20, at n.17 ("[S]ecurities do not need to be sold every time a redemption order is placed. Sale of fund assets is necessary only when gross redemptions significantly exceed net inflows.").

35 *See, e.g., id.*, at 21 ("When facing stressed markets and shareholder redemptions, a portfolio manager must decide whether to: (i) maintain current portfolio composition and sell a cross section of holdings; (ii) meet redemptions with cash and/or index futures if held, with the result being increased concentrations in non-cash positions; or (iii) reposition a portfolio's composition by selling a mixture of holdings and cash and/or index futures, thereby realigning holdings in response to shifting market prices and expectations.").

A fund could also use a line of credit to meet redemptions instead of selling assets, but using a line of credit leverages the fund, and thus many funds only do so infrequently. *See infra* section III.C.5.a (discussing the extent to which drawing on a credit line to meet redemptions could result in negative impacts on the fund, and providing guidance on borrowing arrangements entered into by funds); *see also* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 21 ("Fully substituting cash liquidation for security sales is a very short-term strategy if redemptions are persistent."); Comment Letter of Invesco Ltd. on the FSOC Notice (Mar. 25, 2015) ("Invesco FSOC Notice Comment Letter"), at 10 (stating that Invesco portfolio managers do not automatically sell the most liquid assets when there is a need to raise cash for redemptions or other purposes and that they may seek to rebalance portfolios in falling markets in a manner that cushions the impact of redemptions). *But see infra* note 371 (noting that other funds rely on lines of credit more frequently).

A fund also may reserve the right to redeem its shares in kind instead of in cash. However, there are often logistical issues associated with paying in-kind redemptions, which limit the availability of in-kind redemptions under many circumstances. *See infra* section III.C.5.c.

36 Some mutual funds disclose that they may temporarily depart from their investment strategies in order to take a "temporary defensive position" to avoid losses in response to adverse market, economic, political or other conditions. *See* Investment Company Names, Investment Company Act Release No. 24828 (Jan. 17, 2001) [66 FR 8509 (Feb. 1, 2001)] ("Investment Company Names Rule Release").

redemptions on short-term fund performance for redeeming and remaining shareholders, but may leave remaining shareholders in a potentially less liquid and riskier fund until the fund rebalances.[37] In contrast to meeting redemptions by selling its most liquid assets first, a fund alternatively could choose to meet redemptions by selling, to the best of its ability, a "strip" of the fund's portfolio (*i.e.*, a cross-section or representative selection of the fund's portfolio assets).[38] Funds also could choose to meet redemptions by selling a range of assets in between its most liquid, on one end of the spectrum, and a perfect pro rata strip of assets, on the other end of the spectrum. Additionally, funds could choose to opportunistically pare back or eliminate holdings in a particular asset or sector to meet redemptions. As discussed further in section IV.B.2, analysis conducted by staff in the Division of Economic and Risk Analysis (the "DERA Study"[39]) suggests that the typical U.S. equity fund appears to sell relatively more liquid assets (as opposed to a strip of the fund's portfolio) to meet redemptions, and that as a fund's liquidity decreases, a fund will become even more likely to sell its relatively more liquid assets (rather than a strip of its portfolio) to meet redemptions (thus resulting in decreased liquidity in the fund's portfolio).

Second, the effect of redemptions on shareholders is determined by how and when those redemptions affect the price of the fund's shares. Under rule 22c-1, all investors who redeem

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37 *See, e.g.*, Matt Wirz, *Waddell Fund's Sales Leave Investors With Riskier Securities*, THE WALL STREET JOURNAL (June 16, 2015), *available at* http://www.wsj.com/articles/waddell-funds-sales-leave-investors-with-riskier-securities-1434482621 (noting that from July 2014 through June 2015, a high-yield bond fund experienced heavy redemptions that caused its net assets to shrink 33% in this period, and during this same period, the fund's holdings of bonds rated triple-C or below grew to 47% of assets, from 35% before the redemptions).

38 There are practical limitations on a fund's ability to sell a pro rata slice of its portfolio, such as minimum trade sizes, transfer restrictions, illiquid assets, tax complications from certain sales, and avoidance of odd lot positions.

39 Paul Hanouna, Jon Novak, Tim Riley, Christof Stahel, "Liquidity and Flows of U.S. Mutual Funds," Division of Economic and Risk Analysis White Paper, September 2015, *available at* http://wcm.sec.gov/dera/staff-papers/white-papers/liquidity-white-paper-09-2015.pdf.

from an open-end fund on any particular day must receive the NAV next calculated by the fund after receipt of such redemption request.[40] As most funds, with the exception of money market funds, only calculate their NAV once a day, this means that redemption requests received during the day receive the end of day NAV, typically calculated as of 4:00 p.m. Eastern time.[41] When calculating a fund's NAV, however, rule 2a-4 requires funds to reflect changes in holdings of portfolio securities and changes in the number of outstanding shares resulting from distributions, redemptions, and repurchases no later than the first business day following the trade date.[42] We allow this calculation method to provide funds with additional time and flexibility to incorporate last-minute portfolio transactions into their NAV calculations on the business day following the trade date, rather than the trade date.[43] As a practical matter, this calculation method also gives broker-dealers, retirement plan administrators, and other intermediaries additional time to process transactions received by 4:00 p.m. on the trade date, which then may be reflected in the fund's NAV on the business day following the trade date. Given that under many circumstances reflecting these changes on the trade date would not materially affect the fund's price, we have allowed and continue to allow such changes to be reflected no later than the first business day following the trade date.

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40 Rule 22c-1(a). *See also supra* note 2.

41 Commission rules do not require that a fund calculate its NAV at a specific time of day. Rule 22c-1 generally requires that the purchase and redemption of a redeemable security be effected at the current NAV next computed after receipt of a purchase or redemption request. *See* rule 22c-1(a). Current NAV must be computed at least once daily, subject to limited exceptions, Monday through Friday, at the specific time or times set by the board of directors. *See* rule 22c-1(b)(1).

42 Rule 2a-4(a)(2)-(3).

43 *See* Adoption of Rule 2a-4 Defining the Term "Current Net Asset Value" in Reference to Redeemable Securities Issued by a Registered Investment Company, Investment Company Act Release No. 4105 (Dec. 22, 1964) [29 FR 19100 (Dec. 30, 1964)].

Nevertheless, we recognize that trading activity and other changes in portfolio holdings associated with meeting redemptions may occur over multiple business days following the redemption request. Such activities associated with meeting redemptions may include, for example, selling assets and, if the fund's most liquid assets are sold to meet redemptions, rebalancing the portfolio to avoid departing from the fund's investment strategies. If these activities occur (and their associated costs are incurred) in days following redemption requests, the costs of providing liquidity to redeeming investors could be borne at least partially by the remaining investors in the fund, thus potentially diluting the interests of non-redeeming shareholders.[44] The less liquid the fund's portfolio holdings, the greater these liquidity costs can become.[45]

Thus, with respect to redemptions, there can be significant adverse consequences to remaining investors in a fund when it fails to adequately manage liquidity.[46] For example,

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44 *See, e.g.,* Comment Letter of Mutual Fund Directors Forum on the FSOC Notice (Mar. 25, 2015), at 5 (stating that "there could be severe outlier situations in which sudden and extensive redemptions might impose costs on non-redeeming shareholders, either because of increases in transaction costs associated with selling portfolio securities in stressful circumstances or because portfolio managers are forced to sell securities into falling markets at a price less than what they believe the security's fundamental value to be."). We note that ETFs either conduct redemptions with authorized participants in kind or, if in cash, typically require the authorized participant to pay a fee covering the costs of the liquidity it receives. *See supra* note 30 and accompanying text. Accordingly, ETFs do not necessarily create the same dilution concerns as mutual funds.

45 *See* Comment Letter of Nuveen Investments on the FSOC Notice (Mar. 25, 2015) ("Nuveen FSOC Notice Comment Letter"), at 10 (stating that "to the extent that the prices of portfolio securities do not reflect the most current market conditions, which is more likely to occur with less liquid asset classes in stressed markets, a fund with net redemptions may be paying more to redeeming shareholders than it should (giving such redeemers a 'first mover advantage'), thereby harming remaining shareholders and the long-term performance of the fund" but noting that there is no evidence that shareholders are actually motivated by this advantage); Comment Letter of Occupy the SEC on the FSOC Notice (Mar. 25, 2015) ("Occupy the SEC FSOC Notice Comment Letter"), at 13 (stating that many funds that hold securities traded over-the-counter cannot observe market prices so they base their NAVs on price estimates and that these "estimates are surely lagging, particularly in turbulent times").

46 *See, e.g.,* Jason Greene & Charles Hodges, *The Dilution Impact of Daily Fund Flows on Open-end Mutual Funds*, 65 J. OF FIN. ECON. 131 (2002) ("Greene & Hodges") ("Active trading of open-end funds has a meaningful economic impact on the returns of passive, nontrading shareholders, particularly in U.S.-based international funds. The overall sample of domestic equity funds shows no dilution impact, but we find an

portfolio assets held by a fund can become increasingly illiquid as its more liquid portfolio assets are sold to meet redemptions and thus could have a compounding effect of causing the fund's entire portfolio to become increasingly illiquid for purposes of meeting future shareholder redemptions, which could adversely affect the fund's risk profile.[47] Furthermore, if a fund finds that it can only sell portfolio assets (or portions of a position in a particular asset) that are less liquid at prices that incorporate a significant discount from fair value, the discounted sale price can materially affect the fund's NAV.[48]

These factors in fund redemptions—either individually or in combination—can create incentives in times of liquidity stress in the markets for early redemptions (or a "first-mover advantage").[49] If investor redemptions are motivated by this first-mover advantage,[50] they can

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annualized negative impact of 0.48% in international funds (and nearly 1% for a subsample of funds whose daily flows are particularly large).").

47 *See, e.g.*, In re Heartland Advisors, Inc., et al., Investment Company Act Release No. 28136 (Jan. 25, 2008) ("Heartland Release") (settled enforcement action against advisory firm alleging that certain high-yield bond funds experienced liquidity problems (caused in part by adviser's unwillingness to sell bond holdings at prices below which the funds had valued them) and, as a result, the funds borrowed heavily against a line of credit to meet fund redemption requests, and investors redeemed fund shares at prices that benefited redeeming shareholders at the expense of remaining and new investors).

48 *Id.*

49 *See, e.g.*, Qi Chen, Itay Goldstein & Wei Jiang, *Payoff Complementarities and Financial Fragility: Evidence from Mutual Fund Outflows*, 97 J. FIN. ECON. 239 (2010), at 240 ("Because mutual funds conduct most of the resulting trades after the day of redemption, most of the costs are not reflected in the NAV paid out to redeeming investors, but rather are borne by the remaining investors. This leads to strategic complementarities—the expectation that other investors will withdraw their money reduces the expected return for staying in the fund and increases the incentive for each individual investor to withdraw as well—and amplifies the damage to the fund."); Comment Letter of State Street Corporation on the FSOC Notice (Mar. 25, 2015), at 3 ("Anticipation of other investors' activity could be a powerful motivator for selling units by a fund holder, particularly if the structure of the fund was such that continuing investors were concerned in some way of being disadvantaged by earlier generations of exiting investors."). *But see* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 9-10 (stating that there are several limitations in the Chen, Goldstein, & Jiang academic paper, including that its analysis excluded retirement shares, analyzed only equity and not bond funds, and did not examine recent data (it examined data from 1995 to 2005); Nuveen FSOC Notice Comment Letter, *supra* note 45, at 10 (stating that there is no evidence that shareholders are actually motivated by a first-mover advantage). We also note that any first-mover advantage may be further mitigated in ETFs to the extent that they conduct in-kind redemptions of authorized participants or charge liquidity fees for cash redemptions. *See supra* note 30 and accompanying text.

lead to increasing levels of redemptions, and as the level of outflows from a fund increases, the incentive to redeem also increases.[51] Regardless of whether investor redemptions are motivated by a first-mover advantage or other factors, there can be significant adverse consequences to remaining investors in a fund when it fails to adequately manage liquidity.[52] This underlines the importance of fund liquidity management for advancing investor protection by reducing the risk that a fund would be unable to meet redemption obligations without materially affecting the fund's NAV.[53]

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50 *See, e.g.,* Comment Letter of BlackRock on the FSOC Notice (Mar. 25, 2015) ("BlackRock FSOC Notice Comment Letter"), at 17 (stating that although incentives to redeem may exist, this does not necessarily imply that investors will in fact redeem *en masse* in times of market stress, but also noting that a well-structured fund "should seek to avoid features that could create a 'first-mover advantage' in which one investor has an incentive to leave" before others); Comment Letter of Association of Institutional Investors on the FSOC Notice (Mar. 25, 2015) ("AII FSOC Notice Comment Letter"), at 10-11 ("The empirical evidence of historical redemption activity, even during times of market stress, supports the view that either (i) there are not 'incentives to redeem' that are sufficient to overcome the asset owner's asset allocation decision or (ii) that there are disincentives, such as not triggering a taxable event, that outweigh the hypothesized 'incentives to redeem.'"); Comment Letter of The Capital Group Companies on the FSOC Notice (Mar. 25, 2015), at 8 ("We also do not believe that the mutualization of fund trading costs creates any first mover advantage."); ICI FSOC Notice Comment Letter, *supra* note 16, at 7 ("Investor behavior provides evidence that any mutualized trading costs must not be sufficiently large to drive investor flows. We consistently observe that investor outflows are modest and investors continue to purchase shares in most funds even during periods of market stress.").

51 *See, e.g.*, Joshua Coval & Erik Stafford, *Asset Fire Sales (and Purchases) in Equity Markets,* 86 J. FIN. ECON. 479 (2007) ("Coval & Stafford") ("Funds experiencing large outflows tend to decrease existing positions, which creates price pressure in the securities held in common by distressed funds. Similarly, the tendency among funds experiencing large inflows to expand existing positions creates positive price pressure in overlapping holdings. Investors who trade against constrained mutual funds earn significant returns for providing liquidity. In addition, future flow-driven transactions are predictable, creating an incentive to front-run the anticipated forced trades by funds experiencing extreme capital flows."); Teodor Dyakov & Marno Verbeek, *Front-Running of Mutual Fund Fire-Sales*, 37 J. OF BANK. AND FIN. 4931 (2013) ("Dyakov & Verbeek") ("We show that a real-time trading strategy which front-runs the anticipated forced sales by mutual funds experiencing extreme capital outflows generates an alpha of 0.5% per month during the 1990–2010 period . . . Our results suggest that publicly available information of fund flows and holdings exposes mutual funds in distress to predatory trading."). *See infra* notes 805-809 and accompanying text for a discussion of predatory trading concerns.

52 *See, e.g.*, Greene & Hodges, *supra* note 46.

53 *See, e.g.*, Fidelity FSOC Notice Comment Letter, *supra* note 20, at 18 ("Managing liquidity levels to fulfill [a fund adviser's] fiduciary obligations benefits [redeeming and remaining] shareholders as well as the broader financial markets.").

There also is a potential for adverse effects on the markets when open-end funds fail to adequately manage liquidity. For example, if liquid asset levels are insufficient to meet redemptions, funds may sell less-liquid portfolio assets at discounted or even fire sale prices. These sales can produce significant negative price pressure on those assets and correlated assets. Accordingly, redemptions and funds' liquidity risk management can affect not just the remaining investors in the fund, but any other investors holding these assets. Such liquidity stress on the assets held in the fund may transmit stress to other funds or portions of the market as well.[54]

In December 2014, the Financial Stability Oversight Council ("FSOC") issued a notice seeking public comment on the potential risks to the U.S. financial system that may be posed by asset management products and activities in the areas of liquidity and redemptions among others.[55] Although our rulemaking proposal is independent of FSOC, several commenters responding to the FSOC notice discussed issues concerning liquidity and redemptions, and we have considered and cited to the relevant comments throughout the release.[56] As the primary regulator of the U.S. securities markets, we are proposing rules today that focus on mitigating the adverse effects that liquidity risk in funds can have on investors and the fair, efficient and orderly

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54 *See, e.g.*, Francis A. Longstaff, *The Subprime Credit Crisis and Contagion in Financial Markets*, 97 J. FIN. ECON. No. 3 436 (2010) (finding that financial contagion during the financial crisis from the subprime asset-backed securities market was propagated to other markets primarily through liquidity and risk-premium channels, rather than through a correlated-information channel); U.S. Presidential Task Force on Market Mechanisms & U.S. Dept. of the Treasury, *Report of the Presidential Task Force on Market Mechanisms* (Jan. 1988), *available at* https://archive.org/details/reportofpresiden01unit ("1987 Market Crash Report"), at III-16 – III-26, IV-1 – IV-8 (discussing mutual fund selling behavior during the October 1987 stock market crash, and in particular the selling of three mutual fund companies, whose heavy selling of assets to meet significant redemptions "accounted for approximately one quarter of all trading on the NYSE for the first 30 minutes that the Exchange was open" on October 19, 1987 and that such selling had "a significant impact on the downward direction of the market").

55 FSOC Notice, *supra* note 16.

56 Comments submitted in response to the FSOC Notice are available at http://www.regulations.gov/#!docketDetail;D=FSOC-2014-0001.

operation of the markets. To the extent there are any potential financial stability risks from poor fund liquidity management,[57] our proposal may mitigate those risks as well.

C. Recent Developments in the Open-End Fund Industry

Recent industry developments have underlined our focus on the importance of liquidity risk management practices in open-end funds. These developments include significant growth in assets of, and shareholder inflows into, open-end funds with fixed income strategies and alternative strategies since 2008 and the evolution of settlement periods and redemption practices utilized by open-end funds. While mutual funds holding U.S. equities continue to make up the largest category of funds in terms of fund assets, their share of the total industry assets has declined from 65.2% in 2000 to 44.5% in 2014.[58] Assets of foreign bond and foreign equity funds have grown during the same period from 11% to 17.4%,[59] and there has been significant growth in fixed income and alternative strategy funds, as discussed below.

1. Fixed Income Funds and Alternative Funds

We have observed significant growth in cash flows into, and assets of, fixed income mutual funds and fixed income ETFs. Assets in these funds grew from $1.5 trillion at the end of 2008 to $3.5 trillion at the end of 2014, with net inflows exceeding $1.3 trillion during that period.[60] As growth in fixed income fund assets was occurring, we increased our focus on fixed income market structure, holding a roundtable focused on the fixed income markets in 2013 and

57 *See, e.g.,* Itay Goldstein, Hao Jiang & David T. Ng, *Investor Flows and Fragility in Corporate Bond Funds*, unpublished working paper (June 25, 2015), *available at* http://finance.wharton.upenn.edu/~itayg/Files/bondfunds.pdf (finding that "corporate bond funds tend to have more concave flow-performance relationships when they have more illiquid assets and when the overall market illiquidity is high" and that these results "point to the possibility of fragility").

58 DERA Study, *supra* note 39, at Table 2.

59 *Id.*

60 These figures were obtained from staff analysis of Morningstar Direct data, and are based on fund categories defined by Morningstar.

publishing a report on the municipal securities markets in 2012.[61] In addition, both Commissioners and Commission staff have spoken about the need to focus on potential risks relating to the fixed income markets and their underlying liquidity.[62] Commission staff also has focused on the nature of liquidity risk management in fixed income funds, including by selecting fixed income funds as an examination priority in 2014 and 2015.[63]

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61 *See* Transcript, Roundtable on Fixed Income Markets (Apr. 16, 2013), *available at* https://www.sec.gov/spotlight/fixed-income-markets/2013-04-16-fixed-income-markets-transcript.txt (discussing, among other topics, liquidity characteristics and risks in the municipal bond and corporate bond markets); Report on the Municipal Securities Market (July 31, 2012), *available at* https://www.sec.gov/news/studies/2012/munireport073112.pdf (discussing, among other topics, the low liquidity, opacity and fragmentation of the municipal securities market).

62 *See, e.g.*, Chair Mary Jo White, Speech, *Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors*, (June 20, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542122012; Commissioner Luis A. Aguilar, Speech, *Advocating for Investors Saving for Retirement*, (Feb. 5, 2015), *available at* http://www.sec.gov/news/speech/advocating-for-investors-saving-for-retirement.html; Commissioner Daniel M. Gallagher, Speech, *A Watched Pot Never Boils: the Need for SEC Supervision of Fixed Income Liquidity, Market Structure, and Pension Accounting*, (Mar. 10, 2015), *available at* http://www.sec.gov/news/speech/031015-spch-cdmg.html and *Remarks Regarding the Fixed Income Markets at the Conference on Financial Markets Quality,* (Sept. 19, 2012), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1365171491192; Commissioner Michael S. Piwowar, Speech, *Remarks at the 2014 Municipal Finance Conference presented by The Bond Buyer and Brandeis International Business School*, (Aug. 1, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542588006; Commissioner Kara M. Stein, Speech, *Mutual Funds – The Next 75 Years*, (June 15, 2015), *available at* http://www.sec.gov/news/speech/mutual-funds-the-next-75-years-stein.html; Norm Champ, former Director of the Division of Investment Management, Speech, *Remarks to the ICI 2014 Securities Law Developments Conference,* (Dec. 10, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543675348; IM Guidance Update No. 2014-01, Risk Management in Changing Fixed Income Market Conditions (Jan. 2014), *available at* http://www.sec.gov/divisions/investment/guidance/im-guidance-2014-1.pdf ("2014 Fixed Income Guidance Update").

63 *See, e.g.,* 2014 Fixed Income Guidance Update, *supra* note 62; Office of Compliance Inspections and Examinations, National Exam Program 2015 Examination Priorities, *available at* http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf ("National Exam Program 2015 Examination Priorities") ("With interest rates expected to rise at some point in the future, we will review whether mutual funds with significant exposure to interest rate increases have implemented compliance policies and procedures and investment and trading controls sufficient to ensure that their funds' disclosures are not misleading and that their investments and liquidity profiles are consistent with those disclosures."); Office of Compliance Inspections and Examinations, National Exam Program 2014 Examination Priorities, *available at* http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf ("The staff will monitor the risks associated with a changing interest rate environment and the impact this may have on bond funds and related disclosures of risks to investors.").

We also have observed recent growth in alternative mutual funds. Since 2005, the assets of open-end funds with alternative strategies have grown significantly, from approximately $365 million at the end of 2005 to approximately $334 billion at the end of 2014.[64] Although the assets of open-end funds pursuing alternative strategies accounted for a relatively small percentage (approximately 3%) of the mutual fund market as of December 2014, the growth of assets in these funds has been substantial, with asset growth of approximately 58% each year from the end of 2011 to the end of 2014.[65] While growth in alternative mutual funds and ETFs has slowed over the past year, a rising interest rate environment could cause inflows to these funds to increase once again, as investors look to reduce their interest rate risk and/or increase income by investing in alternative strategies.[66]

Unlike alternative mutual funds and ETFs, private funds (such as hedge funds and private equity funds) pursuing similar alternative strategies can invest in portfolio assets that are relatively illiquid without generating the same degree of redemption risk for the fund because investor redemption rights are often limited.[67] In addition, investor expectations of private funds'

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64 DERA Study, *supra* note 39, at pp. 7-8. While there is no clear definition of "alternative" in the mutual fund space, an alternative mutual fund is generally understood to be a fund whose primary investment strategy falls into one or more of the three following buckets: (i) non-traditional asset classes (for example, currencies or managed futures funds), (ii) non-traditional strategies (such as long/short equity, event driven), and/or (iii) less liquid assets (such as private debt). Their investment strategies often seek to produce positive risk-adjusted returns that are not closely correlated to traditional investments or benchmarks, in contrast to traditional mutual funds that historically have pursued long-only strategies in traditional asset classes.

65 *Id.*

66 *See, e.g.*, Brian Haskin, *Flows to Liquid Alts Drop in December, End 2014 Up 10%*, DailyAlts.com, (Feb. 16, 2015), *available at* http://dailyalts.com/flows-liquid-alts-drop-december-end-2014-10 ("Going into 2014, investors held the view that interest rates would rise and, thus, they looked to reduce interest rate risk and/or increase income with the more flexible non-traditional bond funds. This all came to a halt as interest rates actually declined and flows to the category nearly dried up in the second half. This also impacted market neutral strategies which are often used as a substitute for fixed income portfolios.").

67 A private fund is an issuer that would be an investment company, as defined in section 3 of the Investment Company Act, but for the exclusion from the definition of "investment company" in section 3(c)(1) or 3(c)(7) of the Act. Section 202(a)(29) of the Investment Advisers Act of 1940 (the "Investment Advisers

redemption rights differ from the redemption expectations of typical retail investors in open-end funds. For example, investors in private equity funds typically commit their capital for the life of the fund.[68] Hedge funds often contain "lock-up" provisions (in which an investor only can redeem after a specified period of time has elapsed since its initial investment), typically impose limitations on the frequency of redemptions (*e.g.*, allowing redemptions only once a quarter or once a year), and require advance notice periods for redemptions.[69] They also are often able to impose gates, suspensions of redemptions, and side pockets to manage liquidity stress. As a result these funds can, and often do, restrict investor redemption rights as the liquidity of the funds' portfolio assets declines. Data reported on Form PF show that at December 31, 2014, only 16.5% of qualifying hedge funds allowed investors to withdraw *any* of their investment in seven days or less and for almost 60% of reporting qualifying hedge funds, the liquidity of the fund's portfolio was greater than the withdrawal rights provided to investors for all time frames reported on the form.[70] As of that date, 88% of qualifying hedge funds may suspend investor withdrawals and 62% may impose gates on investor withdrawals.[71]

In contrast, alternative strategy mutual funds and ETFs have no such ability to tailor investor redemption rights based on the liquidity profile of the funds' portfolios. Yet some of these funds seek to pursue similar investment strategies as hedge funds and other private funds, while still being bound by the redemption obligations applicable to open-end funds.

Act").

68 *See* Comment Letter of Private Equity Growth Capital Council on the FSOC Notice (Mar. 25, 2015).

69 *See* Comment Letter of Managed Funds Association on the FSOC Notice (Mar. 25, 2015).

70 Based on data reported in response to questions 32 and 50 of Form PF. Reports filed on Form PF are submitted by advisers registered with the Commission with at least $150 million in private fund assets under management. For a definition of which funds are treated as "qualifying hedge funds" for purposes of Form PF that must complete these questions, *see* General Instructions to Form PF, *available at* http://www.sec.gov/about/forms/formpf.pdf.

71 Based on data reported in response to question 49 of Form PF.

Accordingly, our staff has been focused on the liquidity of alternative strategy mutual funds and ETFs, the nature of liquidity and redemption risks faced by investors in these funds given their legal right to be paid the proceeds of any redemption request within seven days.[72] The findings in the DERA Study have lent further support to our focus on liquidity risk management practices in this industry segment, as the study found that alternative strategy mutual funds had cash flows that were significantly more volatile than other strategies, indicating that these funds may face higher levels of redemption risk. Volatility in flows places additional importance on liquidity risk management to prevent some of the consequences from a failure to adequately manage liquidity discussed in section II.B.2 above. The proposed rule and rule amendments build off of many of the observations we and our staff have made through efforts examining the growth in funds and ETFs with fixed income strategies and alternative strategies that are discussed below.

2. *Evolution of Settlement Periods and Redemption Practices*

Practices relating to securities trade settlement periods and the timing of the payment of redemption proceeds to investors also have evolved considerably over the decades since the Commission last addressed liquidity needs in open-end funds.[73] Prior to the adoption of rule 15c6-1 under the Exchange Act in 1993, which established three business days (T+3) as the standard settlement timeframe for broker-dealer trades, there was no federal rule that mandated a

[72] Norm Champ, former Director of the Division of Investment Management, Speech, *Remarks to the Practicing Law Institute, Private Equity Forum*, (June 30, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542253660 (noting that alternative mutual funds should consider setting criteria for assessing the liquidity of a security and consider including those criteria in written policies and procedures for registered fund compliance programs under rule 38a-1 under the Act); National Exam Program 2015 Examination Priorities, *supra* note 63 ("We will continue to assess funds offering alternative investments and using alternative investment strategies, with a particular focus on: (i) leverage, liquidity, and valuation policies and practices; (ii) factors relevant to the adequacy of the funds' internal controls, including staffing, funding, and empowerment of boards, compliance personnel, and back-offices; and (iii) the manner in which such funds are marketed to investors.").

[73] *See, e.g.*, Invesco FSOC Notice Comment Letter, *supra* note 35, at 14 (noting that it "was not long ago that equity securities settled on a T+7 basis rather than today's T+3 standard and initiatives are underway to shorten that time to T+2").

specific settlement cycle for securities transactions.[74] Before the adoption of rule 15c6-1, trades settled on a T+5 basis based on industry practice, and the decline in the securities trading settlement period from T+5 to T+3 prompted funds that were sold through broker-dealers to satisfy redemption requests within three business days.[75] In recent years, market participants have explored the possibility of further reducing this T+3 settlement period.[76] We also have observed that some open-end funds disclose in their prospectuses that they generally will satisfy redemption requests in even shorter periods of time than T+3, including on a next-business-day basis.[77]

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74 *See* Securities Transactions Settlement, Exchange Act Release No. 33023 (Oct. 6, 1993) [58 FR 52891 (Oct. 13, 1993)] ("Securities Transactions Settlement Release") (adopting rule 15c6-1 under the Exchange Act).

75 *See* May 1995 Staff No-Action Letter, *supra* note 21 (noting that funds that are sold through brokers or dealers and that hold portfolio securities that do not settle within three business days "should assess the mix of their portfolio holdings to determine whether, under normal circumstances, they will be able to facilitate compliance with the T+3 standard by brokers and dealers," taking into account the "percentage of the portfolio that would settle in three days or less, the level of cash reserves, and the availability of lines of credit or interfund lending facilities.").

76 *See* PricewaterhouseCoopers LLP (in conjunction with the Depositary Trust Clearing Corporation ("DTCC") Industry Steering Committee), *Shortening the Settlement Cycle: The Move to T+2* (2015), *available at* http://www.ust2.com/pdfs/ssc.pdf; DTCC, *DTCC Recommends Shortening the U.S. Trade Settlement Cycle* (Apr. 2014), *available at* http://www.dtcc.com/~/media/Files/Downloads/WhitePapers/T2-Shortened-Cycle-WP.pdf; *see also* Recommendation of the Investor Advisory Committee: Shortening the Trade Settlement Cycle in U.S. Financial Markets (Feb. 12, 2015), *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/settlement-cycle-recommendation-final.pdf. *See also* Letter from Mary Jo White, Chair, SEC, to Kenneth E. Bentsen, Jr., President & CEO, Securities Industry and Financial Markets Association, and Paul Schott Stevens, President & CEO, Investment Company Institute (Sept. 16, 2015), *available at* http://www.sec.gov/divisions/marketreg/chair-white-letter-to-sifma-ici-t2.pdf; Commissioner Luis A. Aguilar, Public Statement, *The Benefits of Shortening the Securities Settlement Cycle,* (July 16, 2015), *available at* http://www.sec.gov/news/statement/benefits-of-shortening-the-securities-settlement-cycle.html; Commissioner Michael S. Piwowar and Commissioner Kara M. Stein, Public Statement, *Statement Regarding Proposals to Shorten the Trade Settlement Cycle*, (June 29, 2015), *available at* http://www.sec.gov/news/statement/statement-on-proposals-to-shorten-the-trade-settlement-cycle.html.

77 Disclosures by open-end funds are subject to the antifraud provisions of the federal securities laws. Therefore there may be liability under these provisions if a fund fails to meet redemptions within seven days or any shorter time disclosed in the fund's prospectus or advertising materials. *See* section 17(a) of the Securities Act, section 10(b) of the Exchange Act and rule 10b-5 under the Exchange Act, and section 34(b) of the Exchange Act; *see also* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 6 ("mutual funds normally process redemption requests by the next business day"); Nuveen FSOC Notice Comment Letter, *supra* note 45, at 9 (noting settlement periods for trades of fund portfolio securities as a relevant factor in assessing liquidity risk, particularly with securities that "do not trade with enforceable settlement

While standard settlement periods for securities trades in the markets have tended to fall significantly over the last several decades—and investor expectations that redemption proceeds will be paid promptly after redemption requests have risen—settlement periods for other securities held in large amounts by certain funds have not fallen correspondingly. For example, some bank loan funds (an asset class that has grown in recent years)[78] invest substantial amounts of their assets in bank loans and loan participations, which typically have long settlement times compared to other investments.[79] Based on our review of fund filings, many funds that invest in these assets do not consider most of their portfolio holdings to be illiquid and generally represent in their disclosures that they comply with the Commission's current guidelines, which state that an open-end fund should invest no more than 15% of its net assets in "illiquid" assets.[80] However, the settlement periods associated with some bank loans and loan participations may extend beyond the period of time the fund would be required to meet shareholder redemptions,

rights and tend to settle over longer settlement periods than the T+1 or T+3 periods over which mutual fund share redemptions themselves settle").

78 Based on staff analysis of Morningstar Direct Data, net assets of bank loan mutual funds and ETFs grew from $14.6 billion in December 2008 to $123.5 billion in December 2014.

79 *See, e.g.*, BlackRock, Viewpoint, *Who Owns the Assets? A Closer Look at Bank Loans, High Yield Bonds and Emerging Markets Debt* (Sept. 2014) ("BlackRock, Viewpoint, Who Owns the Assets?"), *available at* https://www.blackrock.com/corporate/en-fi/literature/whitepaper/viewpoint-closer-look-selected-asset-classes-sept2014.pdf ("[T]he settlement periods for bank loans are longer than the settlement periods for fixed income securities such as high yield bonds, which typically settle in three days. This delayed settlement period may cause a potential liquidity mismatch for mutual funds offering daily liquidity, requiring fund managers to ensure that a fund has sufficient liquidity over settlement windows to meet potential redemptions."); Comment Letter of OppenheimerFunds on the FSOC Notice (Mar. 25, 2015) ("OppenheimerFunds FSOC Notice Comment Letter") at 3-4 (stating that "loans still take longer to settle than other securities. Median settlement times for buy-side loan sales are 12 days" and noting that an "important tool in managing settlement times is the establishment of a credit line dedicated to bank loan funds.").

80 *See infra* note 92 and accompanying text. Under current Commission guidelines, a portfolio security or other asset is considered illiquid if it cannot be sold or disposed of (rather than settled) in the ordinary course of business within seven days at approximately the value at which the fund has valued the investment.

creating a potential mismatch between the timing of the receipt of cash upon sale of these assets and the payment of cash for shareholder redemptions.[81]

Overall, the evolution of the market towards shorter settlement periods – and corresponding investor expectations – combined with open-end funds holding certain securities with longer settlement periods have raised concerns for us about whether fund portfolios are sufficiently liquid to support a fund's ability to meet its redemption obligations.

D. Current Regulatory Framework

1. Statutory and Regulatory Requirements

Section 22(e) of the Act provides that no open-end fund shall suspend the right of redemption or postpone the date of payment of redemption proceeds for more than seven days after tender of the security absent specified unusual circumstances.[82] This statutory requirement was enacted "in response to abusive practices of early open-end companies that claimed that

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81 Mutual funds and ETFs investing in foreign securities can also have such settlement mismatches. *See, e.g.*, Investment Company Institute, *Understanding Exchange-Traded Funds: How ETFs Work*, (Sept. 2014), at n.34, *available at* https://www.ici.org/pdf/per20-05.pdf (noting that internationally focused ETFs generally require authorized participants to post collateral "because the timing of clearing and settlement in another country may not coincide with the T+3 settlement cycle in the United States"). There has been significant growth in emerging market funds since the year 2000. *See infra* note 664 and accompanying text.

82 Section 22(e) permits open-end funds to suspend redemptions and postpone payment for redemptions already tendered for any period during which the New York Stock Exchange ("NYSE") is closed (other than customary weekend and holiday closings) and in three additional situations if the Commission has made certain determinations. First, a fund may suspend redemptions for any period during which trading on the NYSE is restricted, as determined by the Commission. Second, a fund may suspend redemptions for any period during which an emergency exists, as determined by the Commission, as a result of which it is not reasonably practicable for the fund to: (i) liquidate its portfolio securities, or (ii) fairly determine the value of its net assets. Third, a fund may suspend redemptions for such other periods as the Commission may by order permit for the protection of fund shareholders. *See also* Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management, SEC, to Craig S. Tyle, General Counsel, Investment Company Institute (Dec. 8, 1999) *available at* http://www.sec.gov/divisions/investment/guidance/tyle120899.htm, at n.2 and accompanying text. The Commission has rarely issued orders permitting the suspension of redemptions for periods of restricted trading or emergency circumstances but has done so on a few occasions. *See, e.g.*, In the Matter of The Reserve Fund, on behalf of two of its series, the Primary Fund and the U.S. Government Fund, Investment Company Act Release No. 28386 (Sept. 22, 2008) [73 FR 55572 (Sept. 25, 2008)]; *see also, e.g.*, In the Matter of Municipal Lease Securities Fund, Inc., Investment Company Act Release No. 17245 (Nov. 29, 1989). Money market funds are able to suspend redemptions in certain limited circumstances. *See* rule 22e-3 under the Act; *see also infra* note 155 and accompanying text.

their securities were redeemable, but then instituted barriers to redemption" to prevent net redemptions or to prevent shareholders from switching to other funds.[83] As previously discussed, in addition to the seven-day redemption requirement in section 22(e), rule 15c6-1 under the Exchange Act also impacts the timing of open-end fund redemptions because the rule requires broker-dealers to settle securities transactions, including transactions in open-end fund shares, within three business days after the trade date. Furthermore, rule 22c-1 under the Act, the "forward pricing" rule, requires funds, their principal underwriters, and dealers to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to purchase or redeem fund shares, even though fund assets may be sold in subsequent days in order to meet redemption obligations.[84] Thus, there are a number of statutory and regulatory provisions that must be considered in assessing a fund's ability to meet redemptions and mitigate potential dilution of shareholders' interests.

With the exception of money market funds subject to rule 2a-7 under the Act, the Commission has not promulgated rules requiring open-end funds to invest in a minimum level of liquid assets.[85] The Commission historically has taken the position that open-end funds should

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83 Periodic Repurchases by Closed-End Management Investment Companies; Redemptions by Open-End Management Investment Companies and Registered Separate Accounts at Periodic Intervals or with Extended Payment, Investment Company Act Release No. 18869 (July 28, 1992) [57 FR 34701 (Aug. 6, 1992)] at nn.16-18 and accompanying text ("Interval Fund Proposing Release") (citing Investment Trusts and Investment Companies: Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. 291-92 (1940) (statement of David Schenker, Chief Counsel, SEC Investment Trust Study)).

84 *See supra* notes 41-43 and accompanying text for a discussion of why this calculation method is permitted under rule 22c-1 and rule 2a-4.

85 Under rule 2a-7, money market funds must maintain sufficient liquidity to meet reasonably foreseeable redemptions, generally must invest at least 10% of their portfolios in assets that can provide daily liquidity and at least 30% of their portfolios in assets that can provide weekly liquidity, and may not acquire any illiquid security if, immediately after the acquisition, the money market fund would have invested more than 5% of its total assets in illiquid securities. Rule 2a-7. Additionally, the Commission recently adopted amendments to rule 2a-7 that, among other things: (i) give boards of directors of money market funds discretion to impose a liquidity fee or temporarily suspend the right of redemption if a fund's weekly

maintain a high degree of portfolio liquidity to ensure that their portfolio securities and other assets can be sold and the proceeds used to satisfy redemptions in a timely manner in order to comply with section 22(e).[86] The Commission also has stated that open-end funds have a "general responsibility to maintain a level of portfolio liquidity that is appropriate under the circumstances," and to engage in ongoing portfolio liquidity monitoring to determine whether an adequate level of portfolio liquidity is being maintained in light of the fund's redemption obligations.[87] As noted in this guidance, a fund experiencing net outflows due to shifts in market sentiment may wish to consider reducing its illiquid asset holdings to maintain adequate liquidity.[88] Similarly, a fund may need to determine whether it is appropriate to take certain actions when it has determined that a previously liquid holding has become illiquid due to changed circumstances.[89]

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liquidity level falls below the required regulatory threshold; and (ii) require all non-government money market funds to impose a liquidity fee if the fund's weekly liquidity level falls below a designated threshold of 10%, unless the fund's board determines that imposing such a fee is not in the best interests of the fund. Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (July 23, 2014) [79 FR 47736 (Aug. 14, 2014)] ("2014 Money Market Fund Reform Adopting Release").

86 Statement Regarding "Restricted Securities," Investment Company Act Release No. 5847 (Oct. 21, 1969) [35 FR 19989 (Dec. 31, 1970)] ("Restricted Securities Release") ("Because open-end companies hold themselves out at all times as being prepared to meet redemptions within seven days, it is essential that such companies maintain a portfolio of investments that enable them to fulfill that obligation. This requires a high degree of liquidity in the assets of open-end companies because the extent of redemption demands or other exigencies are not always predictable."); Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Investment Company Act Release No. 17452 (Apr. 23, 1990) [55 FR 17933 (Apr. 30, 1990)] ("Rule 144A Release") (adopting rule 144A under the Securities Act).

87 Guidelines Release, *supra* note 4, at section I ("[A] mutual fund must compute its net asset value each business day and give purchase and redemption orders the price next computed after receipt of an order. Moreover, most mutual funds allow shareholders easily to exchange their fund shares for shares of another mutual fund managed by the same investment adviser, in transactions which generally can include only nominal costs. Shareholders thus easily may move their money among equity, income, and money market funds as they choose, increasing the need for liquidity of mutual fund assets."); *see also* Restricted Securities Release, *supra* note 86 (discussing valuation difficulties that may be associated with restricted securities).

88 Guidelines Release, *supra* note 4.

89 Rule 144A Release, *supra* note 86, at n.61.

Open-end funds also are required by rule 38a-1 under the Act to adopt and implement written policies and procedures reasonably designed to prevent violations of the federal securities laws. A fund's compliance policies and procedures should be appropriately tailored to reflect each fund's particular compliance risks.[90] An open-end fund holding a significant portion of its assets in securities with long settlement periods or with infrequent trading, for instance, may be subject to relatively greater liquidity risks than other open-end funds, and should appropriately tailor its policies and procedures to comply with its redemption obligations.[91]

2. 15% Guideline

In addition to the Commission's historical statements regarding the importance of adequate liquidity in open-end fund portfolios pursuant to section 22(e) of the Act, long-standing Commission guidelines generally limit an open-end fund's aggregate holdings of "illiquid assets" to 15% of the fund's net assets (the "15% guideline").[92] Under the 15% guideline, a

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90 In the rule 38a-1 adopting release, the Commission stated that funds should adopt policies and procedures regarding the pricing of portfolio securities and fund shares. *See* Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] ("Rule 38a-1 Adopting Release") ("These pricing requirements are critical to ensuring fund shares are purchased and redeemed at fair prices and that shareholder interests are not diluted."). The Commission also identifies "portfolio management processes" as an issue that should be covered in the compliance policies and procedures of a fund or its adviser and indicates that each fund should tailor its policies and procedures to address the fund's particular compliance risks. *See id.*, at n.82 (noting that the chief compliance officer's annual report should discuss the fund's particular compliance risks and any changes that were made to the policies and procedures to address newly identified risks).

91 *See supra* note 81 and accompanying text.

92 Guidelines Release, *supra* note 4, at section III. ("If an open-end company holds a material percentage of its assets in securities or other assets for which there is no established market, there may be a question concerning the ability of the fund to make payment within seven days of the date its shares are tendered for redemption. The usual limit on aggregate holdings by an open-end investment company of illiquid assets is 15% of its net assets. An illiquid asset is any asset which may not be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment."). The Guidelines Release modified prior Commission guidance that set a 10% limit on illiquid assets for open-end funds. *See* Restricted Securities Release, *supra* note 86.

While the wording of the Guidelines Release limits *holdings* of illiquid assets above 15% of a fund's net assets, the Guidelines Release cites a prior Commission statement regarding the "prudent limit on mutual fund holdings of illiquid securities" that limits a fund from *acquiring* any illiquid asset if, immediately after such acquisition, the fund's holdings of illiquid assets would exceed a certain percentage of the fund's net portfolio security or other asset is considered illiquid if it cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the fund has valued the investment.[93] The 15% guideline has generally caused funds to limit their exposures to particular types of securities that cannot be sold within seven days and that the Commission and staff have indicated may be illiquid, depending on the facts and circumstances, such as private equity securities, securities purchased in an initial public offering, and certain other privately placed or other restricted securities[94] as well as certain instruments or transactions not maturing in seven days or less, including term repurchase agreements.[95] The Commission has not established a set of required factors that must be considered when assessing the liquidity of these or other types of securities, but rather has provided "examples of factors that would be reasonable for a board of directors to take into account with respect to a rule 144A security (but which would not necessarily be determinative)."[96] These factors include: the frequency of trades and quotations for the security; the number of dealers willing to purchase or sell the security and

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assets. *See* Guidelines Release, *supra* note 4, at n.8 (citing Restricted Securities Release, *supra* note 86). The latter interpretation (that is, the interpretation that the 15% standard is a limit on the acquisition of illiquid assets, not a limit on the holdings of illiquid assets) is consistent with approaches that Congress and the Commission have historically taken in other parts of the Investment Company Act and the rules thereunder. *See infra* note 348.

93 Guidelines Release, *supra* note 4; *see also* ETF Proposing Release, *supra* note 9; Valuation of Debt Instruments and Computation of Current Price Per Share by Certain Open-End Investment Companies (Money Market Funds), Investment Company Act Release No. 13380 (July 11, 1983) [48 FR 32555 (July 18, 1983)]; Rule 144A Release, *supra* note 86.

94 *See* Restricted Securities Release, *supra* note 86. Securities offered pursuant to rule 144A under the Securities Act may be considered liquid depending on certain factors. *See* Rule 144A Release, *supra* note 86. The Commission stated that "determination of the liquidity of Rule 144A securities in the portfolio of an investment company issuing redeemable securities is a question of fact for the board of directors to determine, based upon the trading markets for the specific security" and noted that the board should consider the unregistered nature of a rule 144A security as one of the factors it evaluates in determining its liquidity. *Id.* The Division of Investment Management has also stated that an open-end fund's board of directors may determine that an issue of commercial paper in reliance on section 4(a)(2) of the Securities Act is liquid, even if it may not be resold under rule 144A in certain circumstances. *Merrill Lynch Money Markets Inc.*, SEC Staff No-Action Letter (Jan. 14, 1994).

95 *See* Interval Fund Proposing Release, *supra* note 83.

96 *See* Rule 144A Release, *supra* note 86.

the number of other potential purchasers; dealer undertakings to make a market in the security; and the nature of the security and the nature of the marketplace in which it trades, including the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer.[97]

3. *Overview of Current Practices*

Over the last two years, Commission staff has had the occasion to observe through a variety of different events the current liquidity risk management practices at a cross-section of different fund complexes with varied investment strategies. The staff has observed that liquidity risk management techniques may vary across funds, including funds within the same fund complex, in light of unique fund characteristics, including, for example, the nature of a fund's investment objectives or strategies, the composition of the fund's investor base, and historical fund flows. These observations collectively have shown the staff that, even with various unique characteristics, many open-end funds and fund complexes have implemented procedures for assessing, classifying, and managing the liquidity of their portfolio assets.[98]

Specifically, some of the funds observed by the staff assess their ability to sell particular assets within various time periods (typically focusing on one-, three-, and/or seven-day periods).[99] In conducting this analysis, these funds may take into account relevant market, trading, and other factors, and monitor whether their initial liquidity determination should be changed based on changed market conditions. This process helps open-end funds determine

97 *Id.*

98 There are varying degrees of formality in the adoption and implementation of these procedures.

99 *See* 2014 Fixed Income Guidance Update, *supra* note 62 (noting that fund advisers "generally assess overall fund liquidity and funds' ability to meet potential redemptions over a number of periods" and discussing certain steps that fund advisers may consider taking given potential fixed income market volatility); *see also infra* note 151 and accompanying text.

their ability to meet redemption requests in various market conditions within the disclosed period for payment of redemption proceeds.

Funds observed by the staff that have implemented procedures for assessing and classifying the liquidity of their portfolio assets also often have developed controls to manage fund portfolio liquidity risk and the risk of changing levels of shareholder redemptions, such as holding certain amounts of the fund's portfolio in highly liquid assets, setting minimum cash reserves, and establishing committed back-up lines of credit or interfund lending facilities.[100] A few of the funds observed by staff conduct stress testing relating to the availability of liquid assets to cover possible levels of redemptions.[101] Some of these funds' advisers also have periodic discussions with their boards of directors about how the fund approaches liquidity risk management and what emerging risks they are observing relating to liquidity risk. We have observed that some of the funds with the more thorough liquidity risk management practices have appeared to be able to better meet periods of higher than typical redemptions without

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100 Press coverage has detailed steps some funds and their advisers have taken to manage liquidity in light of changing market conditions as well. *See, e.g.*, Jessica Toonkel, *Fund Boards, Management Go on High Alert Around Bond Liquidity*, REUTERS (Nov. 24, 2014), *available at* http://www.reuters.com/article/2014/11/24/us-funds-bondholders-alert-idUSKCN0J80AD20141124 (reporting that investment advisers "have been testing their funds against various market scenarios, building cushions of cash, shorter-duration bonds and other liquid securities, and regularly discussing risks with their boards"); Katy Burne, *Bond Funds Loan Up on Cash*, THE WALL STREET JOURNAL (Nov. 30, 2014), *available at* http://www.wsj.com/articles/bond-funds-load-up-on-cash-1417394534 (discussing cash buffers and use of certain derivatives to manage liquidity concerns); Cordell Eddings, *Bond Liquidity Risk in $3.5 Trillion Funds Defused by Cash*, BLOOMBERG (Aug. 18, 2014), *available at* http://www.bloomberg.com/news/articles/2014-08-17/bond-liquidity-risk-in-3-5-trillion-funds-defused-by-cash-pile (discussing cash holdings in U.S. fixed income funds that are at historically significant levels).

101 *See, e.g.,* Nuveen FSOC Notice Comment Letter, *supra* note 45, at 12 ("We stress test a fund's ability to meet redemptions over a one-month period in a badly stressed market by hypothetically assuming a large increase in net redemptions, cash outflows for derivatives cash collateral and cash outlay requirements imposed by various leverage structures, and comparing the level of cash needed to meet that hypothetical scenario against the amount of cash the fund could reasonably expect to raise from various sources (including selling assets in a hypothetically stressed market or drawing on a credit facility) in that same time frame."); ICI FSOC Notice Comment Letter, *supra* note 16, at 24 (stating that some asset managers conduct forms of stress testing to determine the impact of certain changes on portfolio liquidity).

significantly altering the risk profile of the fund or materially affecting the fund's performance, and thus with less dilutive impacts.

Conversely, the Commission is concerned that some funds employ liquidity risk management practices that are substantially less rigorous. Some funds observed by the staff do not take different market conditions into account when evaluating portfolio asset liquidity, and do not conduct any ongoing liquidity monitoring. Some funds do not incorporate any independent oversight of fund liquidity risk management outside of the portfolio management process.[102] Staff has observed that some of these funds, when faced with higher than normal redemptions, experienced particularly poor performance compared with their benchmark and some even experienced an adverse change in the fund's risk profile, each of which can increase the risk of investor dilution.

Finally, the Commission learned through staff outreach that many funds treat their risk management process for assessing the liquidity profile of portfolio assets, and the incorporation of market and trading information, as entirely separate from their assessment of assets under the 15% guideline. The former process is typically conducted on an ongoing basis through the fund's risk management function, through the fund's portfolio management function, or through the fund's trading function (or a combination of the foregoing), while assessment of assets under the 15% guideline is more typically conducted upon purchase of an asset through the fund's compliance or "back-office" functions, with little indication that information generated from the risk management or trading functions informs the compliance determinations. This functional

[102] *See, e.g.*, BlackRock FSOC Notice Comment Letter, at 6 (stating that among several overarching principles that provide the foundation for a prudent market liquidity risk management framework for collective investment vehicles is having "a risk management function that is independent from portfolio management, with direct reporting lines to senior leadership and a regular role in communication with the asset manager's board of directors").

divide may be a by-product of the limitations of the 15% guideline as a stand-alone method for comprehensive liquidity risk management, a situation that our proposed framework is meant to address.[103]

Overall, our staff outreach has increased our understanding of some of the valuable liquidity risk management practices employed by some firms as a matter of prudent risk management. This outreach also has shown us the great diversity in liquidity risk management practices that raises concerns regarding various funds' ability to meet their redemption obligations and minimize the effects of dilution under certain conditions. Collectively, these observations have informed our understanding of the need for an enhanced minimum baseline requirement for fund management of liquidity risk.

E. Rulemaking Proposal Overview

Against this background, today we are proposing a multi-layered set of reforms designed to promote effective liquidity risk management throughout the open-end fund industry and thereby reduce the risk that funds will not be able to meet redemption obligations and mitigate potential dilution of the interests of fund shareholders in accordance with section 22(e) of, and rule 22c-1 under, the Investment Company Act. The proposed amendments also seek to enhance disclosure regarding fund liquidity and redemption practices. In addition, these proposed reforms are intended to address the liquidity-related developments in the open-end fund industry discussed above and are a part of a broader set of initiatives to address the impact of open-end fund investment activities on investors and the financial markets, and the risks associated with

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[103] *See infra* section III.C.4 for a discussion of the limitations of the 15% guideline.

the increasingly complex portfolio composition and operations of the asset management industry.[104]

First, we are proposing new rule 22e-4, which would require each registered open-end fund, including open-end ETFs but not including money market funds, to establish a liquidity risk management program. The proposed rule would require a fund's liquidity risk management program to incorporate certain specified elements. One primary element of this program is a new requirement for funds to classify and monitor the liquidity of portfolio assets, reflecting that liquidity may be viewed as falling on a spectrum rather than a binary conclusion that an asset is either "liquid" or "illiquid." Another principal feature is a new requirement that funds establish a minimum amount of their assets that would be held in cash and assets that the fund believes are convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to the sale.[105] This proposed requirement is aimed at decreasing the likelihood that funds would be unable to meet their redemption obligations and promote effective liquidity risk management industry-wide. We also anticipate that the proposed program requirement would result in investor protection benefits, as improved liquidity risk management

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104 Such other initiatives include modernizing investment company reporting and disclosure, addressing the risks of derivatives use, and requiring large investment companies and investment advisers to engage in annual stress tests as required by section 165(i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). *See* Chair Mary Jo White, Speech, *Remarks to the New York Times DealBook Opportunities for Tomorrow Conference* (Dec. 11, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543677722; Investment Company Reporting Modernization, Investment Company Act Release No. 31610 (May 20, 2015) [80 FR 33590 (June 12, 2015)] ("Investment Company Reporting Modernization Release").

105 Proposed rule 22e-4(a)(8) defines "Three-Day Liquid Asset" to mean "any cash held by a fund and any position of a fund in an asset (or portion of the fund's position in an asset) that the fund believes is convertible into cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale. In determining whether a position or portion of a position in an asset is a three-day liquid asset, a fund must take into account the factors set forth in paragraph (b)(2)(ii) of this section, to the extent applicable." Proposed rule 22e-4(a)(9) defines "Three-Day Liquid Asset Minimum" to mean "the percentage of the fund's net assets to be invested in three-day liquid assets," in accordance with rule 22e-4(b)(2)(iv)(A) and (C).

could decrease the chance that a fund could meet its redemption obligations only with material effects on the fund's NAV or changes to the fund's risk profile.

Even with improved liquidity risk management, circumstances could arise in which shareholder purchase and redemption activity could dilute the value of existing shareholders' interests in the fund. For this reason, we are also proposing amendments to rule 22c-1 under the Act to permit a fund (except a money market fund or ETF) to use "swing pricing," the process of adjusting a fund's NAV to effectively pass on to purchasing or redeeming shareholders more of the costs stemming from their trading activity. Swing pricing could protect existing shareholders from dilution associated with such purchase and redemption activity and could be another tool to manage liquidity risks. Pooled investment vehicles in certain foreign jurisdictions currently use various forms of swing pricing to mitigate shareholder dilution associated with other shareholders' capital activity, and we believe swing pricing could be an effective tool to assist U.S. registered funds in mitigating potential shareholder dilution.

Finally, we are proposing disclosure- and reporting-related amendments to provide greater transparency with respect to funds' liquidity risks and risk management. Specifically, we are proposing amendments to Form N-1A to require disclosure regarding swing pricing, if applicable, and to improve disclosure regarding how funds meet redemptions of fund shares. We also are proposing amendments to proposed Form N-PORT and proposed Form N-CEN to provide detailed information, both to the Commission and the public, regarding a fund's liquidity-related holdings data and liquidity risk management practices. We note that while these disclosure- and reporting-related amendments are primarily applicable to mutual funds that are not money market funds, as well as ETFs, certain of the proposed amendments are applicable to money market funds as well.

We anticipate that these proposed requirements will facilitate the Commission's risk monitoring efforts by providing greater transparency regarding the liquidity characteristics of fund portfolio holdings, as well as to monitor and assess compliance with rule 22e-4 if adopted. While proposed Form N-PORT and proposed Form N-CEN are primarily designed to assist the Commission, we believe that the proposed requirements also would increase investor understanding of particular funds' liquidity-related risks and redemption policies, which in turn would assist investors in making investment choices that better match their risk tolerances.[106] We note that many investors, particularly institutional investors, as well as academic researchers, financial analysts, and economic research firms, could use the information regarding a fund's liquidity-related holdings data and liquidity risk management practices reported on Form N-PORT to evaluate fund portfolios.[107] Finally, we are proposing to require that ETFs report on proposed Form N-CEN information regarding any requirement to post collateral by authorized participants that are purchasing or redeeming shares. Such collateral requirements could affect authorized participants' capacity and willingness to serve as authorized participants for ETFs, and, in turn, the effective functioning of the ETF's arbitrage mechanism and the ETF shares trading at a market price that approximates the NAV of the ETF.

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106 *See, e.g.*, Comment Letter of Markit on the FSOC Notice (Mar. 25, 2015), at 2 ("we believe that liquidity and redemption risk contained in asset management products can be mitigated by providing risk managers or investors of pooled investment vehicles better information about the liquidity risk associated with pool investments so that they can price it more accurately. This could be done through, among other things, disclosures of the 'prudent valuation' (accounting for pricing uncertainty) of the fund's investments and the implementation of appropriate liquidity risk management policies and procedures").

107 *See infra* section IV.C.3.

III. DISCUSSION

A. Program Requirements and Scope of Proposed Rule 22e-4

Today we are proposing new rule 22e-4 under the Investment Company Act, which would require that each registered open-end management investment company, including open-end ETFs but not including money market funds,[108] establish a written liquidity risk management program. We expect that the proposed rule 22e-4 program requirements would reduce the risk that funds will be unable to timely meet their redemption obligations under section 22(e) of the Investment Company Act and other statutory and regulatory provisions,[109] mitigate potential investor dilution, and provide for more effective liquidity risk management among funds. We believe that this, in turn, would result in significant investor protection benefits and enhance the fair and orderly operation of the markets.[110]

1. Proposed Program Elements

Proposed rule 22e-4 would require each fund to adopt and implement a written liquidity risk management program that is designed to assess and manage the fund's liquidity risk.[111] Under the proposed rule, liquidity risk would be defined as the risk that a fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are

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108 Under proposed rule 22e-4(a)(5), "fund" means "an open-end management investment company that is registered or required to register under section 8 of the Act (15 U.S.C. 80a-8) and includes a separate series of such an investment company, but does not include a registered open-end management investment company that is regulated as a money market fund under § 270.2a-7."

109 In addition to the seven-day redemption requirement in section 22(e), rule 15c6-1 under the Exchange Act also impacts the timing of open-end fund redemptions because the rule requires broker-dealers to settle securities transactions, including transactions in open-end fund shares, within three business days after the trade date. *See supra* note 21 and accompanying text. Furthermore, funds' redemption obligations are also governed by any disclosure to shareholders that a fund has made about the time within which it will meet redemption requests, as disclosures by open-end funds are subject to the antifraud provisions of the federal securities laws. *See supra* note 77 and accompanying text.

110 *See infra* section IV.C.1.

111 Proposed rule 22e-4(b)(1).

reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value.[112] Proposed rule 22e-4 specifies that a fund's liquidity risk management program shall include the following required program elements: (i) classification, and ongoing review of the classification, of the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset); (ii) assessment and periodic review of the fund's liquidity risk; and (iii) management of the fund's liquidity risk, including the investment of a set minimum portion of net assets in assets that the fund believes are convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale.[113] Proposed rule 22e-4 incorporates specific requirements for each of these program elements, and these requirements are discussed in detail below. A fund may, as it determines appropriate, expand its liquidity risk management procedures and related disclosure concerning liquidity risk beyond the required program elements, and should consider doing so whenever it would be necessary to ensure effective liquidity management. A fund would be required to set and invest a prescribed minimum portion of net assets in assets that are cash or that the fund believes are convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to the sale, and also would be required to classify the liquidity of the fund's portfolio positions. In other respects, the proposed program requirements are more

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112 Proposed rule 22e-4(a)(7). This definition is similar to the definition of "liquidity risk" that the Commission has used in other contexts, modified as appropriate to apply to the specific liquidity needs of investment companies. *See* Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013) [78 FR 51823 (Aug. 21, 2013)], at n.291 ("Generally, funding liquidity risk is the risk that a firm will not be able to meet cash demands as they become due and asset liquidity risk is the risk that an asset will not be able to be sold quickly at its market value.").

This proposed definition contemplates that a fund consider both expected requests to redeem, as well as requests to redeem that may not be expected, but are reasonably foreseeable. *See infra* section III.C.

113 Proposed rule 22e-4(b)(1), (2).

principles-based and would permit each fund to tailor its liquidity risk management program to the fund's particular risks and circumstances.

The requirements of proposed rule 22e-4, including the liquidity risk assessment requirements, are applicable to all open-end funds, which term is defined to include each separate series of a registered open-end investment company.[114] Therefore, each series of a fund would be responsible for developing a liquidity risk management program tailored to its own liquidity risk in order to comply with the proposed rule. We anticipate that liquidity risk could differ—sometimes significantly—among the series of an investment company, based on variations in each of the proposed liquidity risk assessment factors required to be considered. Under these circumstances, it would be appropriate for each series' liquidity risk management program to incorporate risk assessment and risk management elements that are distinct from other series' programs. However, to the extent that the series of an investment company are substantially similar in terms of cash flow patterns, investment strategy, portfolio liquidity, and the other factors a fund would be required to consider in assessing its liquidity risk,[115] it may be appropriate for each series to adopt the same or a similar liquidity risk management program.

Proposed rule 22e-4 includes board oversight provisions related to the liquidity risk management program requirement. Specifically, a fund's board would be required to approve the fund's liquidity risk management program, any material changes to the program, and the fund's designation of the fund's investment adviser or officers as responsible for administering the fund's liquidity risk management program (which cannot be solely portfolio managers of the

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114 *See* proposed rule 22e-4(a)(5).

115 *See infra* section III.C.1.

fund).[116] A fund also would be required to disclose certain information about its liquidity risk and risk management in its registration statement,[117] as well as on proposed Forms N-CEN and N-PORT.[118]

2. *Scope of Proposed Rule 22e-4 and Related Disclosure and Reporting Requirements*

Proposed rule 22e-4, as well as the related disclosure and reporting requirements, would apply to all registered open-end funds (including open-end ETFs) other than money market funds. The liquidity risk management program required under proposed rule 22e-4 would reduce the risk that funds would be unable to meet shareholder redemptions in light of their statutory and regulatory requirements for meeting redemption requests, as well as any disclosure made to investors regarding payment of redemption proceeds, without materially affecting the fund's NAV.[119]

Although we recognize that various fund characteristics, such as a fund's investment strategy, ownership concentration, redemption policies, and other similar factors, could make a fund relatively more prone to liquidity risk,[120] we believe that all registered open-end funds (other than money market funds), not only those whose investment strategies create greater liquidity risk, should fall within the scope of proposed rule 22e-4. While we are not proposing different

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116 Proposed rule 22e-4(b)(3).

117 Proposed Items 11(c)(7)-(8) of Form N-1A.

118 Proposed Items B.7, C.7, and C.13 of proposed Form N-PORT; proposed Item 44 of proposed Form N-CEN.

119 *See supra* notes 18-22 and accompanying text (discussing funds' redemption obligations under section 22(e) of the Investment Company Act (requiring funds to make payment to shareholders for securities tendered for redemption within seven days of their tender), as well as circumstances in which funds must satisfy redemption requests within a period shorter than seven days (because they are sold through broker dealers, which are subject to rule 15c6-1 under the Exchange Act (establishing a three-business day (T+3) settlement period for security trades effected by a broker or a dealer), and/or because they have disclosed to investors that they will meet redemption requests within a period shorter than seven days).

120 *See infra* section III.C.1.

liquidity risk management program requirements for different types of funds, the proposed rule is designed to result in robust liquidity risk management programs whose scope, and related costs and burdens, are adequately tailored to manage the liquidity risk faced by a particular fund. The proposed rule requires each fund to assess its liquidity risk periodically, after consideration of certain enumerated factors, and to adopt policies and procedures for managing its liquidity risk based on this assessment.[121] For example, a fund whose ownership is relatively concentrated, and that has an investment strategy requiring it to hold a significant portion of unlisted securities that do not trade frequently, would likely establish a different liquidity risk management program than a fund whose portfolio assets consist mostly of exchange-traded securities with a very high average daily trading volume.[122]

We are not proposing to exclude any particular subset of open-end management investment companies other than money market funds from the scope of proposed rule 22e-4, because even funds with investment strategies that historically have entailed relatively little liquidity risk could experience liquidity stresses in certain environments. For example, although most equity securities are generally understood to be more liquid than fixed income securities, investments in certain types of equities involve some degree of liquidity risk.[123] Also, unexpected market events could cause the liquidity of assets that typically are more liquid to decrease.[124] Furthermore, different types of funds within the same broad investment strategy may

121 Proposed rule 22e-4(b)(2)(iii)-(iv).

122 *See infra* section III.C.1.

123 For example, certain foreign securities (equities as well as fixed income securities) may entail very long settlement times and trading limitations. *See infra* note 197. Also, certain equity securities, such as microcap equity securities, trade relatively infrequently, which in turn could diminish their liquidity. *See* Securities and Exchange Commission, Office of Investor Education and Advocacy, "Microcap Stock: A Guide for Investors", *available at* http://www.sec.gov/investor/pubs/microcapstock.htm.

124 For example, during the "Flash Crash" of October 15, 2014, one of the most volatile trading days since 2008, yield decreases on 10-year Treasuries resulted in certain fixed income market participants turning off

demonstrate different levels of liquidity (and thus, presumably, different levels of liquidity risk).[125] We are also not proposing to provide different liquidity requirements for relatively small funds because, as discussed in the Economic Analysis section below, smaller funds tend to demonstrate relatively high flow volatility (and thus possibly greater liquidity risk).[126]

Like traditional open-end funds, the Commission believes that open-end ETFs could experience liquidity risk, and thus proposes to include open-end ETFs within the scope of rule 22e-4.[127] As discussed above, the liquidity of an ETF's portfolio securities is a factor that contributes to the effective functioning of the ETF's arbitrage mechanism and the ETF shares trading at a price that is at or close to the NAV of the ETF.[128] In addition, ETFs that permit authorized participants to redeem in cash, rather than in kind, and ETFs that typically redeem in cash, like traditional mutual funds, would need to ensure that they have sufficient portfolio liquidity (in conjunction with any other liquidity sources) to meet shareholder redemptions in cash.[129] And especially in times of declining market liquidity, the liquidity of an ETF may be

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automatic pricing on electronic trading platforms on account of fears that the market was moving too quickly for automatic prices to keep up with the market. This, in turn, slowed the pace of trading in U.S. Treasuries, temporarily decreasing their liquidity. *See, e.g.*, Joint Staff Report: The U.S. Treasury Market on October 15, 2014 (July 13, 2015), *available at* http://www.treasury.gov/press-center/press-releases/Documents/Joint_Staff_Report_Treasury_10-15-2015.pdf ("Flash Crash Staff Report") (report of staff findings from the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the U.S. Securities and Exchange Commission, and the U.S. Commodity Futures Trading Commission discussing in depth, among other things, the strains in liquidity conditions during the events of October 15).

125 *See infra* note 627 and accompanying text.

126 *See infra* note 727 and accompanying text.

127 *See supra* notes 23-30 and accompanying text.

128 *See supra* notes 25-29 and accompanying text. The Commission's 2015 Request for Comment on Exchange-Traded Products requests comment on the effectiveness and efficiency of the arbitrage mechanism for exchange-traded products (including ETFs) whose portfolio securities are relatively less liquid. *See* 2015 ETP Request for Comment, *supra* note 11, at Question #15.

129 *See supra* note 30 and accompanying text. Based on the same consideration, we propose to include ETMFs within the scope of rule 22e-4. *See supra* note 31 and accompanying text.

limited by the liquidity of the market for the ETF's underlying securities.[130] As discussed below, we believe that the liquidity-related concerns relevant to ETFs structured as unit investment trusts ("UITs") are different from those relevant to open-end ETFs, and thus we are proposing not to include ETFs structured as UITs within the scope of proposed rule 22e-4.[131]

The scope of proposed rule 22e-4 does not include closed-end investment companies ("closed-end funds"). Closed-end funds do not issue redeemable securities and are not subject to section 22(e) of the Investment Company Act.[132] Closed-end funds' liquidity needs are consequently different from those of open-end funds. This has been acknowledged previously by the Commission; for example, the 15% guideline is applicable only to open-end funds and not closed-end funds.[133] Closed-end funds that elect to repurchase their shares at periodic intervals under Investment Company Act rule 23c-3 ("closed-end interval funds") are subject to certain liquidity standards in order to ensure that they can complete repurchase offers, and must adopt written procedures reasonably designed to ensure that their portfolio assets are sufficiently liquid to comply with their fundamental policies on repurchases.[134] However, other closed-end funds

130 *See supra* note 24 and accompanying text.

131 *See infra* note 144 and accompanying paragraph. We note that the vast majority of ETFs are organized as open-end funds. *See* ETF Proposing Release, *supra* note 9.

132 *See* sections 22(e), 2(a)(32) (defining "redeemable security") and 5(a)(1)-(2) (defining "open-end company" and "closed-end company") of the Act.

133 *See* Guidelines Release, *supra* note 4; *see also* Repurchase Offers by Closed-End Management Investment Companies, Investment Company Act Release No. 19399 (Apr. 7, 1993) [58 FR 19330 (Apr. 14, 1993)] ("Repurchase Offers Release"), at n.7 and accompanying text.

134 Specifically, rule 23c-3 requires that: (i) a specified percentage of the investment company's portfolio consists of assets that can be sold or disposed of in the ordinary course of business, at approximately the price at which the investment company has valued the investment, within the period within which the investment company pays repurchase proceeds; and (ii) the investment company's board of directors adopts written procedures reasonably designed, taking into account current market conditions and the company's investment objectives, to ensure that the company's portfolio assets are sufficiently liquid so that the company can comply with its fundamental policy on repurchases. *See* rule 23c-3(b)(10)(i), (iii).

Based on staff analysis, there were 26 closed-end interval funds, representing approximately $5.7 billion in assets, in 2014.

are subject to no explicit liquidity requirements under the 1940 Act.[135] Because closed-end funds, with the exception of closed-end interval funds, are not subject to specific statutory or regulatory liquidity requirements, we are not proposing to include closed-end funds within the scope of rule 22e-4. Although closed-end interval funds do have to comply with certain liquidity standards and therefore must manage their liquidity risk, we believe that the written liquidity procedures they are required to adopt under rule 23c-3(b)(10)(iii) are adequate given these funds' more limited liquidity needs. Also, because closed-end interval funds do not permit shareholders to redeem their shares each day, they may be better able to structure their portfolios to anticipate their liquidity needs than open-end funds. For these reasons, we are not including these funds within the proposed scope of rule 22e-4.

UITs, including ETFs structured as UITs, also would not be covered within the scope of proposed rule 22e-4. A UIT issues redeemable securities, like a traditional open-end fund, which represent undivided interests in an essentially fixed portfolio of securities.[136] As units of a UIT series[137] are redeemable, UITs are subject to the requirements of section 22(e).[138]

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135 *See* Interval Fund Proposing Release, *supra* note 83, at text following n.35 ("Closed-end companies are not subject to a liquidity standard.").

136 Securities and Exchange Commission, Office of Investor Education and Advocacy, Unit Investment Trusts (UITs), *available at* http://www.sec.gov/answers/uit.htm ("UIT Answers").

137 UITs typically consist of a number of consecutive series, with each series representing units in a specific, separate portfolio of securities. Unlike traditional open-end investment companies, UITs have no corporate management structure, and their portfolios are not managed.

138 With respect to UITs that are not ETFs, and that do not serve as separate account vehicles that are used to fund variable annuity and variable life insurance products, sponsors have historically maintained a secondary market in UIT units, rather than having the series liquidate portfolio securities to meet redemptions, because a large number of redemptions could necessitate premature termination of the series. *See* Form N-7 for Registration of Unit Investment Trusts under the Securities Act of 1933 and the Investment Company Act of 1940, Investment Company Act Release No. 15612 (Mar. 9, 1987) [52 FR 8268 (Mar. 17, 1987)] ("Form N-7 Re-Proposing Release"), at text following n.1; *see also* UIT Answers, *supra* note 136.

At present, however, the majority of UIT assets are attributable to separate account vehicles that are used to fund variable annuity and variable life insurance products, and the sponsors of these UITs do not typically maintain a secondary market in UIT units. *See infra* note 139 and accompanying text.

We are not proposing to include UITs within the scope of the proposed rule for a number of reasons. First, we understand based on staff analysis that approximately 75% of the assets held in UITs currently serve as separate account vehicles that are used to fund variable annuity and variable life insurance products.[139] These UITs essentially function as pass-through vehicles, investing principally in securities of one or more open-end investment companies, which as discussed above would be subject to the scope of proposed rule 22e-4.[140] Thus, we believe that the liquidity risk of these UITs would be even more limited if proposed rule 22e-4 were adopted, because their underlying holdings are funds that would be required to adopt their own liquidity risk management programs under the proposed rule.

Second, UITs are not actively managed, and their portfolios are not actively traded. A UIT buys a relatively fixed portfolio of securities, and generally holds them with little change for the life of the UIT.[141] A UIT does not have a board of directors, corporate officers, or an investment adviser to render advice during the life of the trust.[142] Accordingly, the provisions of proposed rule 22e-4, which require a fund's board to approve and oversee a liquidity risk management program and the fund's adviser or officers to administer the program, are thus inapposite to the management structure of a UIT.[143]

Finally, we also are not including UIT ETFs within the scope of proposed rule 22e-4 because UIT ETFs generally track established and widely recognized indices.[144] Moreover, they

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139 Based on data as of December 2014.

140 Jeffrey K. Dellinger, THE HANDBOOK OF VARIABLE INCOME ANNUITIES 448-450 (2006).

141 *See* UIT Answers, *supra* note 136.

142 *See id.* Because of this lack of management, some UIT trust documents provide that its administrator must redeem a pro rata share of the trust's holdings when an investor redeems from a UIT, subject to practical constraints such as securities with transfer restrictions.

143 *See infra* section III.D.

144 Based on information from Morningstar as of July 22, 2015, the following ETFs are structured as UITs,

fully replicate their underlying indices including with respect to their basket assets. Therefore, we do not view a liquidity risk management program as necessary or beneficial for UIT ETFs.

We also propose to exclude from the scope of rule 22e-4 all money market funds subject to the requirements of rule 2a-7 under the Investment Company Act. Money market funds are subject to extensive requirements concerning the liquidity of their portfolio assets. As described below, these requirements are more stringent than the liquidity-related requirements applicable to funds that are not money market funds (and that would be applicable to funds that are not money market funds under proposed rule 22e-4), on account of the historical redemption patterns of money market fund investors and the assets held by money market funds.[145] Rule 2a-7 includes a general portfolio liquidity standard, which requires that each money market fund hold securities that are sufficiently liquid to meet reasonably foreseeable shareholder redemptions in light of its obligations under section 22(e) of the Act and any commitments the fund has made to shareholders.[146] Money market funds are also subject to a specific limitation on the acquisition of illiquid securities. Namely, a money market fund cannot acquire illiquid securities if, immediately after the acquisition, the fund would have invested more than 5% of its total assets in illiquid securities.[147] This limit on illiquid asset holdings is more stringent than the corollary 15% guideline for open-end funds that are not money market funds, which as discussed above,

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and each ETF tracks the index in its name unless otherwise noted: SPDR Dow Jones Industrial Average ETF Trust, SPDR S&P 500 ETF Trust, SPDR S&P Midcap 400 ETF Trust, Invesco Powershares QQQ Trust Series 1 (which tracks the NASDAQ 100 Index), and the Invesco BLDRS Index Funds Trust (which has ETFs tracking the BNY Mellon Asia 50 ADR Index, the BNY Mellon Developed Markets 100 ADR Index, the BNY Mellon Emerging Markets 50 ADR Index, and the BNY Mellon Europe Select ADR Index).

145 *See infra* notes 722-725 and accompanying text.

146 Rule 2a-7(d)(4).

147 Rule 2a-7(d)(4)(i).

limits a fund's aggregate holdings of illiquid assets to 15% of the fund's net assets.[148] In addition to the 5% limit on money market funds' illiquid asset holdings, all taxable money market funds must invest at least 10% of their total assets in "daily liquid assets,"[149] and all money market funds must invest at least 30% of their total assets in "weekly liquid assets."[150] There is no current or proposed corollary requirement for open-end funds that are not money market funds to invest certain portions of their assets in daily liquid assets or weekly liquid assets.

Money market funds are also subject to liquidity-related disclosure and reporting requirements.[151] These disclosure and reporting requirements do not currently extend to funds that are not money market funds, although under the proposed amendments to Form N-PORT, funds that are not money market funds would be required to report information about each portfolio asset's liquidity classification under rule 22e-4 and whether it is a 15% standard asset.[152]

Money market funds also have certain tools at their disposal to manage heavy redemptions that are not available to other open-end funds.[153] A money market fund is permitted to impose a liquidity fee on redemptions or temporarily suspend redemptions if its weekly liquid

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148 *See supra* section II.D.2.

149 Rule 2a-7(d)(4)(ii).

150 Rule 2a-7(d)(4)(iii).

151 On the compliance date for the disclosure-related money market fund reforms adopted in 2014 (Apr. 14, 2016), money market funds will be required to disclose each day the percentage of their total assets invested in daily liquid assets and weekly liquid assets on their websites. *See* rule 2a-7(h)(10)(ii) (a money market fund must maintain a schedule, chart, graph, or other depiction on its website showing historical information about its investments in daily liquid assets and weekly liquid assets for the previous six months, and must update this historical information each business day, as of the end of the preceding business day). As of the compliance date, they also will be required to report information about the liquidity of their portfolio securities on Form N-MFP. *See* Form N-MFP Items C.21, C.22, and C.23.

152 *See infra* section III.G.2; proposed Item C.7 of proposed Form N-PORT (requiring a fund to disclose whether a portfolio investment is a 15% Standard Asset); Form N-MFP Item 44 (requiring a money market fund to disclose whether each portfolio security is an illiquid security).

153 *See infra* notes 722-725 and accompanying text for a discussion of why we are not proposing a liquidity fee regime similar to that for money market funds for other types of open-end management investment companies.

assets fall below 30% of its total assets and the fund's board determines that imposing a fee or gate is in the fund's best interests; if a fund's weekly liquid asset falls below 10% of total assets, the fund is required to impose a liquidity fee on redemptions unless the fund's board determines that imposing such a fee would not be in the fund's best interests.[154] Additionally, rule 22e-3 permits a money market fund to suspend redemptions and postpone payment of redemption proceeds in an orderly liquidation of the fund if, subject to other requirements, the fund's board makes certain findings.[155] Because money market funds are required to maintain a liquidity risk management program, we propose that these funds be excluded from the scope of rule 22e-4.

3. *Request for Comment*

While we request detailed comment on each of the specific elements of proposed rule 22e-4 below, here we request comment on the general program requirement of the proposed rule, as well as the extent to which the proposed program requirement would promote effective liquidity risk management.

- As proposed, rule 22e-4 would require that a fund's liquidity risk management program include certain general elements. Do commenters believe that the general elements of the program would enhance a fund's ability to assess and manage its liquidity risk? Are there any elements that should be excluded from the program requirement, or are there

154 *See* rule 2a-7(c)(2); *see also* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A. The compliance date for the amendments to rule 2a-7 related to liquidity fees and gates is October 14, 2016.

155 *See* rule 22e-3(a) (permitting a money market fund to permanently suspend redemptions and liquidate if the fund's level of weekly liquid assets falls below 10% of its total assets or, in the case of a fund that is a government money market fund or a retail money market fund, the fund's board determines that the deviation between the fund's amortized cost price per share and its market-based NAV may result in material dilution or other unfair results to investors or existing shareholders); *see also* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.4 (discussing amendments to rule 22e-3 adopted as part of the 2014 money market fund reforms); Division of Investment Management, 2014 Money Market Fund Reform Frequently Asked Questions (Aug. 4, 2015), *available at* http://www.sec.gov/divisions/investment/guidance/2014-money-market-fund-reform-frequently-asked-questions.shtml.

any additional elements that should be included in the program requirement? Should any of the proposed elements be modified? Do commenters believe that the program would enhance funds' management of liquidity risk better than they already do in practice? Do commenters believe that the program would materially strengthen a fund's ability to meet its redemption obligations and would materially reduce potential dilution? Should the rule focus not just on the liquidity of the fund's assets but also more specifically and prominently on its liabilities, such as derivatives obligations, that may affect the liquidity of the fund?

- Should the Commission be more prescriptive in requiring a fund to adopt certain specific policies and procedures for classifying and monitoring the liquidity of portfolio assets, assessing and periodically reviewing liquidity risk, and/or managing the fund's liquidity risk, beyond the proposed requirements of rule 22e-4? If so, what other procedures should the Commission require? Are there operational challenges associated with any of the other procedures the Commission could require? To what extent do funds currently have policies and procedures resembling the proposed program requirements? Have funds' current policies and procedures proven effective at managing liquidity risk, and how have they evolved in recent years? Are these policies and procedures primarily overseen by a fund's chief compliance officer, chief risk officer (if any), or someone else?

We also request comment on the scope of proposed rule 22e-4.

- Do commenters agree that all open-end funds, including open-end ETFs but excluding money market funds, should be subject to the program requirement of the proposed rule? If not, why not? Do commenters agree that the proposed program requirement gives enough flexibility for a fund to adopt a program whose scope, and related costs and benefits, are adequately tailored for that fund to manage its actual and potential liquidity risk?

- Should certain funds or types of funds be excluded from the proposed program requirement, or subject to a different or less stringent requirement, because their investment strategies, ownership concentrations, redemption policies, or some other factor makes them less prone to liquidity risk? If so, which funds or types of funds, and why? Should smaller funds and smaller fund complexes be excluded from the proposed program requirement, or subject to a different or less stringent requirement? Why or why not? How should we distinguish between funds that should be subject to liquidity risk management program requirements and those that should not? Conversely, are there particular types of funds (or investment strategies) that are subject to heightened liquidity risk and should be subject to more prescriptive or stringent requirements under a liquidity risk management program or otherwise? If so, what types of funds should be considered to have higher liquidity risk and why? Can these types of funds be easily categorized or defined? What enhanced liquidity risk management program requirements should be considered for such funds and why? Are there any types of funds (or investment strategies) with such limited liquidity that we should consider limiting their ability to be structured as open-end funds?
- Do commenters agree that open-end ETFs and ETMFs should be included? If not, why not? Do commenters believe that ETFs and/or ETMFs incur additional liquidity risk if they permit redeeming authorized participants to receive cash, rather than an in-kind basket of securities, in exchange for redeemed shares?

- Should any of the requirements of the proposed rule be modified for ETFs or ETMFs on account of the relief from section 22(e) some of these funds receive under their exemptive orders? Should any of the requirements apply differently when an ETF or an ETMF is organized as a class of an open-end fund or as a feeder fund in a master-feeder structure where other classes or feeder funds operate as traditional mutual funds?

Exemptive orders for ETF relief include provisions that govern the composition of portfolio deposits and redemption baskets. In general, portfolio deposits and redemption baskets must represent pro rata slices of the ETF's portfolio and must be the same for all purchasers and redeemers that transact with the ETF on the same day. In recent years, ETF sponsors have requested increased flexibility in determining the composition of portfolio deposits and redemption baskets.[156]

- We request comments on whether such flexibility would result in favorable or unfavorable changes in how ETFs manage the liquidity of their holdings. For example, would ETFs benefit from reduced cash drag? Would the flexibility enable or encourage ETFs to reduce the overall liquidity of their portfolios or to hold a greater amount of relatively illiquid assets? Does the existing 15% guideline adequately address any concerns regarding liquidity that could result from greater basket flexibility? Would the requirements we are proposing adequately address any concerns regarding liquidity that could result from greater basket flexibility? If not, could other requirements adequately address any concerns?

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156 *See, e.g.*, Comment Letter of Charles Schwab & Co., Inc. on the 2015 ETP Request for Comment (Aug. 17, 2015) ("At a minimum, we believe it is important that ETF managers have the ability to construct non-pro rata baskets, subject to compliance and board oversight to help identify and address instances where the use of such baskets may conflict with the interests of the ETF and its shareholders.").

We request comment on the types of investment products that the Commission proposes not to include, or to specifically exclude, from the scope of proposed rule 22e-4.

- Do commenters agree that closed-end funds, including closed-end interval funds, should not be included within the scope of the proposed rule? Should we make any changes to the liquidity requirements for closed-end interval funds?
- Do commenters agree that UITs should not be included within the proposed rule's scope? Is there any subset of UITs that should be considered for inclusion, if only for some aspects of the rule? Is there a significant risk that UITs (or a certain subset of UITs) may not be able to meet redemption requests? With respect to UITs that are not ETFs, and that do not serve as separate account vehicles that are used to fund variable annuity and variable life insurance products, is it reasonable to expect that UIT sponsors would maintain a secondary market in UIT units to the same extent and in the same manner as they have historically?
- Alternatively, should we require UITs to meet certain minimum liquidity requirements at the time of deposit of the securities, such as requiring a UIT to maintain a prescribed minimum portion of its net assets in assets that it believes are convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to the sale? Why or why not? What specific requirements of proposed rule 22e-4 should be modified for UITs to account for the facts that UITs are not actively managed, UITs' portfolios are not actively traded, and UITs do not have a board of directors, corporate officers, or an investment adviser to render advice during the life of the trust?

- Is it appropriate that we include ETFs organized as open-end funds but not ETFs organized as UITs within the rule? Should we exclude from the scope of the rule ETFs organized as open-end funds that, similar to UIT ETFs, fully track established and widely recognized indices? Why or why not? Do commenters believe that ETFs organized as open-end funds would reorganize as UITs in response to the rule? Why or why not?
- Do commenters agree that we should specifically exclude money market funds from the scope of proposed rule 22e-4? Is there any subset of money market funds that should be considered for inclusion, if only for some aspects of the rule?

B. Classifying the Liquidity of a Fund's Portfolio Positions Under Proposed Rule 22e-4

We have not updated the liquidity guidelines applicable to funds and fund portfolio assets in over two decades, and we believe that developments in the fund industry as well as staff observations of funds' current liquidity risk management practices warrant proposing requirements for classifying the liquidity of funds' portfolio positions.[157] We are aware based on staff experience that many fund managers engage in analysis of the liquidity of portfolio assets, beyond considering whether the fund's portfolio construction is consistent with the 15% guideline, and we believe that all open-end funds and their shareholders would benefit from a comprehensive review of the liquidity of funds' portfolio positions. Staff outreach has shown that funds today employ notably different procedures for assessing and classifying the liquidity of their portfolio assets.[158] Some funds have implemented procedures that analyze multiple

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157 *See supra* section II.D.

158 *See* 2014 Fixed Income Guidance Update, *supra* note 62; *see also* BlackRock FSOC Notice Comment Letter, *supra* note 50, at 6 (stating that among several overarching principles that provide the foundation for a prudent market liquidity risk management framework for collective investment vehicles is "[m]easuring or estimating (a) levels of liquid assets with recognition of tiers of liquidity, (b) liquidation time frames"); Invesco FSOC Notice Comment letter, *supra* note 35, at 11 (stating that their liquidity analysis includes

aspects relating to an asset's liquidity, including relevant market, trading, and asset-specific factors, and monitor whether their initial liquidity determinations should be amended based on changed conditions. While the 15% guideline requires a binary determination of whether an asset is liquid or illiquid, funds with relatively comprehensive liquidity classification procedures tend to view the liquidity of their portfolio assets in terms of a more-liquid to less-liquid spectrum.[159] This "spectrum"-based approach to liquidity can enhance a fund's ability to construct a portfolio whose liquidity profile is calibrated to reflect the fund's specific liquidity needs. The staff has observed, however, that other funds, including some with relatively less liquid strategies, use liquidity classification practices that are substantially less thorough, do not take relevant factors into account when evaluating portfolio assets' liquidity and do not incorporate ongoing liquidity monitoring. To the extent that these practices result in a fund holding assets that are insufficiently liquid to meet redemptions without materially affecting the fund's NAV (assuming that the fund must sell portfolio assets to meet redemptions), we believe these practices could adversely affect fund investors—either by decreasing the price that redeeming shareholders will receive for their shares and the price of the shares held by non-redeeming investors, or if the fund sells its most liquid assets to meet redemptions, by potentially increasing the liquidity risk of the fund shares held by non-redeeming shareholders.

Due to the foregoing concerns, we are proposing new requirements for classifying and monitoring the liquidity of funds' portfolio positions. Under proposed rule 22e-4, a fund would be required to classify the liquidity of each of the fund's positions in a portfolio asset (or portions

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classifying certain portfolio holdings in liquidity buckets across a liquidity spectrum, utilizing certain quantitative metrics and qualitative factors).

159 *See, e.g.,* ICI FSOC Notice Comment Letter, *supra* note 16, at 23 ("While the SEC's 85 percent liquidity test requires binary determinations for each portfolio holding..., for broader liquidity management purposes fund managers think of portfolio holdings as falling along a liquidity continuum.").

of a position in a particular asset) and review the liquidity classification of each of the fund's portfolio positions on an ongoing basis.[160] In classifying and reviewing the liquidity of portfolio positions, proposed rule 22e-4 would require a fund to consider the number of days within which a fund's position in a portfolio asset (or portions of a position in a particular asset) would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale.[161] The proposed rule would require a fund to consider certain specified factors in classifying the liquidity of its portfolio positions.[162]

The proposed liquidity categorization process would be *in addition to* the existing 15% guideline (which would be retained, as discussed below[163]) and would require a fund to assess the liquidity of its portfolio positions individually, as well as the liquidity profile of the fund as a whole. A fund would be able to use this assessment, in turn, to establish procedures for managing its liquidity risk and to determine whether the liquidity of its portfolio reflects its liquidity needs for meeting shareholder redemptions, thus reducing potential dilution of non-redeeming shareholders.[164] As described above, we understand that, in practice, funds apply the 15% guideline to limit the funds' exposures to particular types of securities that generally cannot be sold or sold quickly.[165] Although the 15% guideline involves determining whether an asset can be sold or disposed of within seven days at approximately its stated value, it does not

160 Proposed rule 22e-4(b)(2)(i).

161 *Id.*; *see also infra* section III.B.1.a.

162 *See* proposed rule 22e-4(b)(2)(ii); *see also infra* sections III.B.1.a, III.B.2.

163 *See infra* section III.C.4.

164 *See generally infra* section III.C (discussing the proposed requirements associated with assessing and managing a fund's liquidity risk); *see also infra* section III.C.1 (discussing the factors a fund would be required to consider in assessing its liquidity risk, that is, the risk that a fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value).

165 *See supra* notes 94-97 and accompanying text.

involve a fund considering whether it can actually receive the proceeds of any sale within seven days. The 15% guideline also does not involve a fund taking into account any market or other factors in considering an asset's liquidity,[166] or assessing whether the fund's position size in a particular asset affects the liquidity of that asset. In contrast, the proposed liquidity categorization approach incorporates each of these aspects, which, as discussed further below, we believe are critical to comprehensively assessing the liquidity of a fund's position in a particular portfolio asset.[167] We thus have come to consider the 15% guideline alone to be insufficient to limit a fund's liquidity risk given the fund's obligations to meet shareholder redemptions. We believe the principal benefit of the 15% guideline is to limit the ability of certain highly illiquid strategies, such as private equity, to operate in an open-end fund form.

1. *Proposed Relative Liquidity Classification Categories*

a. Proposed Classification Requirement

Proposed rule 22e-4(b)(2)(i) would require a fund to classify each of the fund's positions in a portfolio asset (or portions of a position in a particular asset) based on the relative liquidity of the position.[168] For purposes of proposed rule 22e-4, a fund would assess the relative liquidity of each portfolio position based on the number of days within which it is determined, using information obtained after reasonable inquiry, that the fund's position in an asset (or a portion of

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166 The Commission has, however, discussed factors that would be reasonable for a board of directors to take into account in assessing the liquidity of a rule 144A security (but which would not necessarily be determinative). *See supra* notes 96-97 and accompanying text.

167 In section III.C.4 below, we discuss the interplay between the 15% guideline as proposed to be codified and the proposed requirement for a fund to invest a set minimum portion of its net assets in three-day liquid assets.

168 As discussed in detail below, proposed rule 22e-4 would require a fund to assess and manage its liquidity risk, and these risk assessment and risk management requirements would be based in part on the proposed liquidity classification requirement set forth in proposed rule 22e-4(b)(2)(i) and described in this section. *See infra* sections III.C.1, III.C.3. We are also proposing to require that a fund disclose information regarding the liquidity classification of each of the fund's portfolio positions, as determined pursuant to proposed rule 22e-4(b)(2)(i). *See infra* section III.G.2.

that asset) would be convertible to cash[169] at a price that does not materially affect the value of that asset immediately prior to sale. That is, the person who classifies the liquidity of each portfolio position[170] must determine—using information obtained after reasonable inquiry—the time period in which the fund would be able to sell the position, at a price that does not materially affect the value of that asset immediately prior to sale, and settle the sale (*i.e.*, receive cash for the sale of the asset). With respect to this determination, the term "immediately prior to sale" is meant to reflect that the fund must determine whether the sales price the fund would receive for the asset is reasonably expected to move the price of the asset in the market, independent of other market forces affecting the asset's value. The term "immediately prior to sale" is not meant to require a fund to anticipate and determine in advance the precise current market price or fair value of an asset at the moment before the fund would sell the asset. As discussed in more detail below, a fund would be required to consider certain specified market-based, trading, and asset specific factors in determining how long a particular portfolio position would take to convert to cash.[171]

In making this assessment, a fund could determine that different portions of a position in a particular asset could be converted to cash within different times. If a fund were to conclude, based on the liquidity classification factors required to be considered, that it would take the fund longer to convert its entire position in an asset to cash than it would to convert only a portion of that position to cash, it could determine, for example, that 50% of the position could be converted to cash within 1 day, but the remainder of the position could take up to 3 days to

169 *See* proposed rule 22e-4(a)(3) (defining "convertible to cash" as "the ability to be sold, with the sale settled").

170 *See infra* section III.D.3 (discussing designation of administrative responsibilities for the liquidity risk management program to the fund's adviser or officers).

171 These factors are discussed in detail below. *See infra* section III.B.2.

convert to cash. Staff outreach has shown that some funds currently consider the liquidity character of their portfolio holdings—particularly relatively large holdings—to be tiered in this manner, with a certain percentage of the holding deemed to be more liquid than the remainder of the holding. Proposed rule 22e-4 would thus specify that a fund would be required to adopt policies and procedures for classifying the liquidity of each of the fund's positions in a portfolio asset, *or portions of the fund's position in a particular asset.*[172] In this release, any reference to a fund classifying the liquidity of its position in a particular portfolio asset should be read to also include circumstances in which the fund would classify the liquidity of portions of a position in a particular asset.

Based on its determination of the number of days within which the fund could convert its position in an asset to cash under this standard, the fund would be required to classify each of its positions in a portfolio asset into one of six liquidity categories:

- Convertible to cash within 1 business day.
- Convertible to cash within 2-3 business days.
- Convertible to cash within 4-7 calendar days.[173]
- Convertible to cash within 8-15 calendar days.
- Convertible to cash within 16-30 calendar days.
- Convertible to cash in more than 30 calendar days.

As discussed below, we anticipate that the proposed liquidity categorization approach would permit a fund to take a more nuanced approach to portfolio construction and liquidity risk management than an approach under which a fund would simply designate portfolio assets as

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172 *See* proposed rule 22e-4(b)(2)(i) (emphasis added).

173 *See infra* text following note 194 (discussing potential overlaps between the 2-3 business day and 4-7 calendar day liquidity classification categories).

liquid or illiquid. The proposed approach also would provide the framework for detailed reporting and disclosure about the liquidity of funds' portfolio assets in a structured data format, as the six liquidity categories described above would be incorporated into the fund's portfolio holdings reporting on proposed Form N-PORT.[174] In particular, the structured data format would increase the ability of Commission staff, investors, and other potential users to aggregate and analyze the data in a much less labor-intensive manner. This data, in turn, would assist Commission staff in monitoring risks and trends with respect to funds' portfolio liquidity (for example, observing whether portfolio liquidity increases or decreases in response to market events), and would also permit investors to better evaluate the liquidity profile of funds' portfolios and better assess the potential for returns and risks of a particular fund.[175] In addition, the proposed categorization requirement also would provide the foundation for the requirement for a fund to invest a prescribed minimum percentage of its net assets in "three-day liquid assets" (that is, any cash held by a fund and any position in an asset, or portion thereof, that the fund believes is convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale).[176]

The proposed approach would require a fund to assess the liquidity of its entire position in a portfolio asset, or each portion of that position, as opposed to the liquidity of the normal trading lot for that asset. It has been argued that because a fund will not likely need to sell its entire position in a particular asset under normal market circumstances, liquidity determinations should be based on the sale of a single trading lot for that asset, except in unusual

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174 *See* proposed Item C.13 of proposed Form N-PORT; *see also infra* section III.G.2.

175 *See infra* section III.G.2.

176 *See* proposed rule 22e-4(a)(8); proposed rule 22e-4(b)(2)(iv)(A)-(C); *see also infra* section III.C.3.

circumstances.[177] We agree that the fact that a fund may not be able to convert its entire position in an asset to cash at a price that does not materially affect the value of that asset immediately prior to sale should not, by itself, be dispositive of a portfolio asset's liquidity. Nevertheless, assessing liquidity only on the basis of the ability to sell and receive cash for a single trading lot of a portfolio asset ignores the fact that a fund needing to sell certain assets in order to meet redemptions would almost certainly need to sell greater than one trading lot of a particular asset. In addition, a fund may need to dispose of an entire position because of deteriorating credit quality or other portfolio management factors. Similarly, an index fund may need to sell an entire position in an asset if that asset falls out of the tracked index. The liquidity of the entire position size thus is relevant to the liquidity of the overall portfolio, a fund's ability to meet its stated investment strategy, and a fund's portfolio management.

The proposed categorization approach also is meant to promote more consistent liquidity classification practices within the fund industry. Proposed rule 22e-4 would require a fund to consider certain specified factors, to the extent applicable, with respect to each position in an asset (or similar asset(s), if data concerning a particular portfolio asset is not available to the fund). The proposed rule would specify that this consideration must include certain specified market, trading, and asset-specific factors (each discussed in more detail below), as applicable.[178] We believe that codifying these factors would contribute to more consistency in the quality and breadth of funds' analyses of their portfolio positions' liquidity, while recognizing that funds' portfolios, and the particular assets included within a portfolio, are diverse and that not every factor will be relevant to each liquidity determination. We recognize, and anticipate, that

177 *See* Investment Company Institute, *Valuation and Liquidity Issues for Mutual Funds* (Feb. 1997) ("ICI Valuation and Liquidity Issues White Paper"), at 42.

178 *See* proposed rule 22e-4(b)(2)(ii); *see also infra* section III.B.2.

different funds could classify the liquidity of identical portfolio positions differently, depending on their analysis of the factors required to be considered under the proposed rule. There could be multiple appropriate reasons for this, including different information available to funds at different times, and fund-specific reasons for classifying the liquidity of a position in a particular way that are not equally applicable to another fund (for example, in the context of an asset used for hedging or risk mitigation purposes[179]).

Proposed rule 22e-4 does not specify that certain asset classes fall within particular liquidity categories, because we believe that individual funds would be more effective in assessing and reviewing their portfolio positions' liquidity based on an evaluation of market and asset-specific factors, than the Commission would be in determining asset classes' liquidity based on a categorical approach. While we recognize that permitting each fund to determine its own portfolio positions' liquidity would likely result in less consistency in funds' portfolio position liquidity classifications than specifying by rule which asset classes fall into certain liquidity categories, we believe that the proposed approach is preferable to an approach that involves Commission-imposed liquidity classifications of certain asset classes. We are concerned that an approach involving Commission-imposed liquidity classifications would likely result in certain assets' liquidity being overestimated and others' liquidity being underestimated, since we believe that a portfolio position's liquidity character depends on a range of interrelated factors (as discussed below).[180] Also, we are concerned that Commission-imposed liquidity classifications would be overly rigid and would be difficult to adjust quickly to reflect changing

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[179] *See infra* section III.B.2.i.

[180] *See infra* section III.B.2.

market conditions.[181] Thus, we believe that this approach would be more likely to provide an inaccurate reflection of an asset's liquidity than the proposed classification approach.

Although we are not proposing an approach that presumes that certain asset classes fall within particular liquidity categories, we note that if a fund is an outlier with respect to its liquidity classifications, Commission staff would be able to identify such outlier classifications based on the fund's position-level liquidity disclosure on Form N-PORT and determine whether further inquiry is appropriate.[182] If Commission staff does determine to examine a fund's liquidity classifications based on the fund's Form N-PORT disclosure, it would be able to examine whether the fund considered the required factors in classifying the liquidity of its portfolio positions. Thus, while the actual liquidity classifications assigned to funds' portfolio positions could vary from fund to fund, the proposed approach provides a regulatory framework that should promote consistency in funds' liquidity classification practices.

The proposed approach to liquidity classification reflects our understanding that many funds evaluate assets' liquidity across a liquidity spectrum, as opposed to making a binary determination of whether an asset is liquid or illiquid. As discussed above, Commission staff outreach to funds has shown us that it is common for funds to treat portfolio assets as relatively liquid or illiquid compared to other portfolio assets, and some funds "score" the liquidity of their portfolio holdings based on a variety of factors, including the period of time it takes to convert the holdings to cash, similar to those that we are proposing. We also understand that some

181 *See, e.g.*, Flash Crash Staff Report, *supra* note 124 (noting that, while "[t]he U.S. Treasury market is the deepest and most liquid government securities market in the world," liquidity conditions in the market for U.S. Treasury securities became "significantly strained" during the October 2015 "Flash Crash").

182 *See infra* section III.G.2.

third-party service providers currently provide data and analyses assessing the relative liquidity of a fund's portfolio assets.[183]

A nuanced liquidity classification approach has practical benefits in terms of managing liquidity to meet anticipated redemptions. Because we understand based on staff outreach that many funds today consider very few, if any, of their portfolio assets to be holdings limited by the 15% guideline, we believe that the proposed spectrum-based approach to liquidity classification acknowledges the liquidity variation in funds' portfolio positions better than the current framework, in which a fund could consider its entire portfolio (or a significant portion of the portfolio) to be simply "liquid." We believe that this approach would permit a fund to better plan how it would meet redemptions occurring in a day, a week, or some other period, by categorizing asset positions in terms of the respective times in which they could be converted to cash and constructing the fund's portfolio in order to manage its expected and reasonably foreseeable redemptions during these periods. The proposed liquidity classification approach also would enhance a fund's ability to adjust its portfolio composition in anticipation of, or in reaction to, adverse events, or to comply with its investment strategy or mandate.

The proposed approach would provide the framework for reporting and disclosure about the liquidity of funds' portfolio assets that would permit our staff to better monitor liquidity trends and funds' liquidity risk profiles, and also would help investors and other market participants assess funds' relative liquidity. As discussed below, we are proposing amendments to proposed Form N-PORT that would require a fund to indicate the liquidity classification of each of a fund's portfolio positions.[184] Funds are not currently required to disclose information

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183 *See infra* note 205 and accompanying paragraph.

184 *See infra* section III.G.2.a.

about the liquidity of their portfolio assets, although Item C.7 of Form N-PORT, as proposed earlier this year, would require that each fund report whether each particular portfolio security is an "illiquid asset" and defines illiquid assets in terms of current Commission guidelines.[185] Requiring a fund to classify the liquidity of each portfolio position also would facilitate fulsome reporting of a fund's liquidity profile on Form N-PORT. As discussed below, we believe that the proposed N-PORT reporting requirements would permit enhanced Commission monitoring and oversight of the fund industry and would result in investor protection benefits, because we believe the proposed requirements would permit investors (particularly institutional investors), as well as academic researchers, financial analysts, and economic research firms, to use the liquidity-related data reported on Form N-PORT to evaluate fund portfolios and related risks.[186]

The time frames associated with the proposed liquidity categories reflect our understanding of some of the relevant periods that some funds currently consider in assessing the liquidity of a fund's portfolio assets.[187] There are many ways in which identifying portfolio positions that are convertible to cash in one business day or two-to-three business days could enhance a fund's ability to calibrate its liquidity profile in order to manage its expected and reasonably foreseeable redemptions during these periods.[188] For example, if a fund discloses that

185 *See supra* note 118 and accompanying text; *see also infra* notes 563-565 and accompanying text.

186 *See infra* sections III.G.2.a; IV.C.3.b.

187 We note that Question 32 on Form PF requests information regarding the percentage of the reporting fund's portfolio capable of being liquidated within certain time frames. *See supra* note 70 for additional information about Form PF. However, the time frames associated with the liquidity categories in proposed rule 22e-4 are different from those incorporated in Form PF Question 32 on account of the different redemption obligations of registered funds versus private funds, as well as, relatedly, the different liquidity profile of registered funds' portfolio assets (generally) versus private funds' portfolio assets.

188 With respect to the one-day and two-to-three-day liquidity categories, we are proposing to incorporate a convertible-to-cash time period that is based on business days instead of calendar days, in order to minimize unnecessary re-classifications of portfolio positions that could affect data analyses of a fund's Form N-PORT data reporting regarding these positions. If these two liquidity categories were based on calendar days instead of business days, a portfolio position reported on a Friday might be considered to be

it will generally pay redemption proceeds within one business day after receiving a shareholder's redemption request (although it may delay payment for seven calendar days, as permitted by section 22(e) of the Investment Company Act), it would be required to identify portfolio assets that, if needed, could be converted to cash within one day. Many funds that do not pay redemption proceeds within a day of receiving a redemption request nevertheless may pay redemption proceeds within a time period shorter than the seven days required by section 22(e). For example, because rule 15c6-1 under the Exchange Act, which became effective in 1995, established three business days as the standard settlement period for securities trades effected by a broker-dealer, this rule effectively requires most funds to pay redemption proceeds within three business days after receiving a redemption request, because a broker or dealer will be involved in the redemption process.[189] Market participants also are exploring further reducing this settlement period from T+3 to T+2, and possibly eventually to T+1.[190] Likewise, even funds that do not disclose that they will pay redemption proceeds within periods shorter than seven days may find

convertible to cash within three calendar days (because markets would not be open over the weekend), but the same portfolio position reported on a different weekday would be considered to be convertible to cash within one or two calendar days. This could cause a fund to have to re-classify portfolio positions based on the reporting date, and this re-classification could skew analyses that the Commission staff or other parties conduct using Form N-PORT data. Because the required classification is the most granular in shortest-term liquidity categories, we believe such reporting consistency is particularly important. However, after the one-day and two-to-three-day liquidity categories, we are proposing to switch to a calendar day framework both to tie to the seven calendar day requirement for meeting redemptions under section 22(e) of the Act and because the longer the timeframe is to convert the asset to cash, the more we recognize the timeframe is likely to be a less precise estimate and thus the additional precision from the business day categorization is less likely to be material to the classification.

189 *See* Securities Transactions Settlement Release, *supra* note 74. In 2004, the Commission issued a concept release seeking input on, among other things, the benefits and costs associated with implementing a settlement cycle for most broker-dealer transactions that is shorter than three days. Concept Release: Securities Transactions Settlement, Investment Company Act Release No. 26384 (Mar. 11, 2004) [69 FR 12922 (Mar. 18, 2004)] ("Securities Transactions Settlement Concept Release").

Several comments from asset managers received in response to the FSOC Notice noted that, as a practical matter, the three-business-day settlement requirements of rule 15c6-1 effectively take most fund investments to a T+3 settlement timeline. *See, e.g.*, SIFMA IAA FSOC Notice Comment Letter, *supra* note 16, at n.34; Fidelity FSOC Notice Comment Letter, *supra* note 20, at n.20.

190 *See supra* note 76 and accompanying text.

it useful to identify portfolio positions that may be converted to cash quickly (*i.e.*, within three business days or shorter) in order to meet unexpected or unusually high redemption requests, or to rebalance or otherwise adjust a portfolio's composition quickly.

Along with identifying positions that may be converted to cash within either one business day or two-to-three business days, we believe that identifying each "less liquid asset"—that is, any position in an asset (or portion of a position in a particular asset) that is not a three-day liquid asset[191]—would enhance a fund's ability to determine the portion of the fund's portfolio that the fund may not be able to rely on selling to meet redemption requests within the three-day period required by rule 15c6-1 under the Exchange Act, or within some shorter period.[192] Among less liquid assets, some may be convertible to cash in just over three business days, others may not be convertible to cash for a year or more, and still others may fall in between these two extremes. To reflect this, we are proposing four categories of less liquid assets: positions convertible to cash within four-to-seven calendar days, eight-to-fifteen calendar days, sixteen-to-thirty calendar days, and over-thirty calendar days.[193]

Determining whether a portfolio position is convertible to cash within four-to-seven calendar days would enhance a fund's ability to identify those positions that are not immediately or very quickly convertible to cash (*i.e.*, those positions convertible to cash within one, two, or three business days), but that nevertheless could be converted to cash in a time frame that would permit funds to pay redeeming shareholders within the seven-day period established by section 22(e). For example, for a fund that typically sells its most liquid assets to meet redemptions, the

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191 *See* proposed rule 22e-4(a)(6).

192 *See infra* notes 333-334 and accompanying text (discussing common reasons why a fund could be required to meet redemption requests within three business days, or within some shorter period).

193 *See* proposed rule 22e-4(b)(2)(i)(C)-(F).

four-to-seven day liquidity category could assist the fund in constructing a second layer of portfolio liquidity to meet redemptions using liquidity within the fund even after it has sold or disposed of its most liquid assets.[194] We anticipate that funds could determine that a variety of securities within different asset classes could be converted to cash within four-to-seven calendar days, depending on facts and circumstances.

We understand that circumstances could arise in which the settlement period for a particular portfolio position could be viewed either as two-to-three business days or four-to-seven calendar days. For example, if a sale were to occur on a Thursday and be settled on a Monday, the settlement period could be viewed either as two business days or four calendar days. Because this could cause ambiguity for reporting purposes,[195] in situations in which the settlement period could be viewed either as two-to-three business days or four-to-seven calendar days, a fund should classify the portfolio position based on the shorter settlement period (*i.e.*, two-to-three business days, not four-to-seven calendar days).[196]

We believe that the eight-to-fifteen calendar day and sixteen-to-thirty calendar day categories of less liquid assets would distinguish a position that is convertible to cash in close to seven calendar days (*i.e.*, close to the required redemption period established by section 22(e)) from one that takes significantly longer (*i.e.*, close to a month) to convert to cash. For example, if a fund were to enter into a period of extended redemptions that it anticipates would last for multiple days, it could begin trying to liquidate eight-to-fifteen day assets in order to plan to

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194 *See supra* text accompanying and following note 37 (discussing the fact that a fund that sells its most liquid assets to meet redemptions minimizes the effect of the redemptions on short-term fund performance for redeeming and remaining investors, but may leave remaining investors in a potentially less liquid and riskier fund until the fund rebalances).

195 *See infra* section III.G.2 (discussing proposed Form N-PORT reporting requirements).

196 *See* proposed note to proposed rule 22e-4(b)(2)(i); *see also supra* note 188.

meet redemptions that would occur more than a week in the future. The over-thirty calendar day category is meant to identify those portfolio positions that are the least liquid, including those that may have very extended settlement periods.

Assets with settlement periods longer than three business days would be considered less liquid assets. Assets also should be classified under the rule based on typical expected settlement periods for transactions in that asset in the particular jurisdiction, and not based on the prospect of gaining expedited settlement of the purchase or sale upon request. Transactions in certain types of securities have historically entailed lengthy settlement periods. For example, transactions in certain foreign securities,[197] agency mortgage-backed securities (other than secondary market trades),[198] and U.S. bank loan participations[199] typically require settlement periods of more than three business days. An asset having a shorter settlement period could also be considered to be a less liquid asset, however, if a fund were to determine, based on the factors required to be assessed under the proposed rule, that it could not sell its position in the asset and

197 *See, e.g.*, Comment Letter of the Global Foreign Exchange Division to the European Commission and the European Securities and Markets Authority re: Consistent Regulatory Treatment for Incidental Foreign Exchange (FX) Transactions Related to Foreign Securities Settlement – "FX Security Conversions" (Mar. 25, 2014), *available at* http://www.gfma.org/Initiatives/Foreign-Exchange-(FX)/GFMA-Submits-Comments-to-the-EC-and-the-ESMA-on-Consistent-Regulatory-Treatment-for-Incidental-Foreign-Exchange-Transactions/ ("Typically, the settlement cycle for most non-EUR denominated securities is trade date plus three days ('T+3'). Accordingly, the bank custodian or broker-dealer would enter into a FX transaction on a T+3 basis as well. In some securities markets, for example in South Africa, the settlement cycle can take up to seven days (T+7).").

198 *See, e.g.*, James Vickery & Joshua Wright, *TBA Trading and Liquidity in the Agency MBS Market*, 19 FRBNY ECON. POLICY REVIEW 1 (May 2013), *available at* http://www.newyorkfed.org/research/epr/2013/1212vick.pdf (noting that over ninety percent of agency mortgage-backed securities trading occurs in the to-be-announced ("TBA") forward market, and that the trade date of a TBA trade will usually precede settlement by between two and sixty days).

199 *See, e.g.*, BlackRock, Viewpoint, Who Owns the Assets, *supra* note 79; Michael Mackenzie & Tracy Alloway, *Lengthy US loan settlements prompt liquidity fears*, FIN. TIMES (May 1, 2014) *available at* http://www.ft.com/intl/cms/s/0/32181cb6-d096-11e3-9a81-00144feabdc0.html; OppenheimerFunds FSOC Notice Comment Letter, *supra* note 79, at 3-4 (stating that "loans still take longer to settle than other securities. Median settlement times for buy-side loan sales are 12 days" and noting that an "important tool in managing settlement times is the establishment of a credit line dedicated to bank loan funds.").

settle the sale (at a price that does not materially affect the value of that asset immediately prior to sale) within three business days.

b. Request for Comment

We request comment on the proposed requirements for classifying the relative liquidity of a fund's portfolio positions.

- What procedures or practices do funds currently use to assess and classify the liquidity of portfolio assets? Have these procedures proven effective in the past? If not, under what circumstances were they ineffective, and why? Have funds modified their procedures for assessing and classifying liquidity in recent years to account for changes in market structure and the advent of new types of market participants? If so, how? Who at the fund and/or the adviser is tasked with assessing the liquidity of the funds' portfolio assets? Are any third-party service providers used in assessing portfolio assets' liquidity, and if so, how are such service providers used and what are the costs associated with their services? Would the proposed requirements require funds to make systems modifications and what costs would be associated with any potential system modifications? What would the associated costs and other burdens be for funds to assess and classify the liquidity of portfolio assets?
- Do commenters agree that it would be useful for a fund to consider portfolio positions' liquidity in terms of a spectrum instead of a binary determination that an asset is liquid or illiquid, and do funds currently consider the relative liquidity of portfolio assets by classifying assets (either explicitly or informally) into multiple liquidity categories? If so, what categories are used, and why? Alternatively, should we define the term "illiquid assets?" Why or why not? If so, how should we define it?

- Do funds currently consider the period in which a fund's position in an asset can be converted into cash (that is, sold, with the sale settled) in assessing and classifying the liquidity of portfolio assets? Do commenters agree that it would be useful for a fund to assess the liquidity of its entire position in a portfolio asset, or portions of a position in a particular asset, as opposed to the liquidity of a single trading lot of a portfolio asset held by the fund? Do funds currently consider the ability to sell varying portions of a fund's position in a portfolio asset (fractions of the position, as well as the entire position) in assessing that asset's liquidity?
- What assumptions, estimations, and judgments would funds need to make in order to determine liquidity classifications, and how would these assumptions, estimations, and judgments affect the comparability of reporting across funds? Are there concerns, such as proprietary or liability concerns, associated with reporting liquidity classifications based on such assumptions, estimations, and judgments?
- The proposed rule would require a fund to determine, using information obtained after reasonable inquiry, the number of days within which a fund's position in a portfolio asset (or portion of a position in a particular asset) would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale. Do commenters believe that the terms "information obtained using reasonably inquiry," "at a price that does not materially affect the value of that asset," and "immediately prior to sale" are sufficiently clear? If not, how could they be made clearer?
- Do the proposed liquidity categories reflect the manner in which funds currently assess and categorize the liquidity of their portfolio holdings as part of their portfolio and risk management? Should we increase or decrease the number of liquidity categories to

which a fund might assign a portfolio position? For example, should we combine the last three liquidity categories (convertible to cash within 8-15, 16-30, or in more than 30 calendar days) into one liquidity classification category (*e.g.*, "convertible to cash in more than 7 calendar days")? Why or why not? Should we add one or more liquidity categories outside of the more than 30 calendar day time period (*e.g.*, "convertible to cash in more than 90 calendar days")? Why or why not? Should we revise the time periods associated with any of the proposed liquidity categories? Alternatively, should we permit a fund to classify the liquidity of its portfolio securities based not on conversion-to-cash time periods specified by the Commission, but instead based on conversion-to-cash time periods that the fund determines to be appropriate (taking into account the fund's redemption obligations)? Would such an approach diminish comparability in funds' reporting of their liquidity assessment on proposed Form N-PORT, discussed below?

- Regarding the proposed liquidity categories that would be associated with less liquid assets, is there any reason why an asset with a settlement period longer than three business days should not be deemed to be a less liquid asset? What types of funds would be largely composed of assets that would be considered less liquid assets under proposed rule 22e-4?
- To what extent do commenters anticipate that assets in the eight-to-fifteen calendar days, sixteen-to-thirty calendar days, and over-thirty calendar days classification categories under the proposed rule overlap with assets that funds currently consider to be limited by the 15% guideline?

- Are the proposed liquidity categories appropriate for ETFs and ETMFs? Should ETFs and ETMFs that transact primarily in kind be permitted to have different liquidity categories? If so, what categories and why?
- Should smaller funds or funds pursuing particular types of investment strategies be permitted to have different liquidity categories? If so, how should we define those subsets of funds?
- Should we use business days or calendar days for all the liquidity classification categories, rather than using business days in the shorter categories, but calendar days for the longer categories? If we used calendar days for all the categories, how could we avoid changes in asset classification based on whether the asset was held near a weekend? In addition, if we used calendar days, how could we obtain information on which assets could be converted to cash within the three business day requirement in rule 15c6-1? If we used business days for all categories, how could we obtain information on which assets could be converted to cash within the seven calendar day (as opposed to business day) requirement for payment of redemption proceeds under section 22(e) of the Act?

2. *Factors to Consider in Classifying the Liquidity of a Portfolio Position*

Staff outreach to the fund industry has highlighted certain common factors that some funds use in evaluating portfolio assets' liquidity. Specifically, the most comprehensive liquidity analyses take into account relevant market-based, trading, and asset-specific factors in assessing a fund's ability to convert a position in a portfolio asset (or portions of a position in a particular asset) to cash at approximately its stated value during current market conditions. The Commission has previously provided examples of factors that would be reasonable for a board of directors to consider in assessing the liquidity of a rule 144A security,[200] and outreach has shown that certain funds reference these factors when considering the liquidity of all portfolio assets (not just rule 144A securities). Other funds, however, classify the liquidity of their portfolio assets using substantially less thorough practices (*e.g.*, assuming, without individualized analysis, that certain asset classes are always liquid or always illiquid). As discussed above, we believe that a nuanced classification approach may have practical benefits in improving how funds manage liquidity to meet anticipated redemptions.[201]

Proposed rule 22e-4(b)(2)(ii) would require a fund to take the following factors into account, to the extent applicable, when classifying the liquidity of each portfolio position in a particular asset:

- Existence of an active market for the asset, including whether the asset is listed on an exchange, as well as the number, diversity, and quality of market participants;
- Frequency of trades or quotes for the asset and average daily trading volume of the asset (regardless of whether the asset is a security traded on an exchange);
- Volatility of trading prices for the asset;
- Bid-ask spreads for the asset;
- Whether the asset has a relatively standardized and simple structure;
- For fixed income securities, maturity and date of issue;
- Restrictions on trading of the asset and limitations on transfer of the asset;
- The size of the fund's position in the asset relative to the asset's average daily trading volume and, as applicable, the number of units of the asset outstanding; and
- Relationship of the asset to another portfolio asset.

200 *See supra* note 96 and accompanying text.

201 *See supra* paragraphs accompanying note 178 and following note 183.

These factors are based on those certain investment advisers consider when systematically evaluating the liquidity of portfolio assets.[202] We are proposing to require that all funds take into account these factors, as applicable, to encourage effective liquidity assessment across the fund industry. This list is not meant to be exhaustive. We recognize that the specific factors appropriate for consideration could vary depending on the issuer and the particular asset, and therefore an evaluation of a particular portfolio position's liquidity could focus more heavily on certain factors and less on others. In evaluating the liquidity of its portfolio positions, a fund could also take into account other pertinent factors in addition to those set forth in proposed rule 22e-4(b)(2)(ii). However, a fund would be required to consider, as applicable, the proposed rule 22e-4(b)(2)(ii) factors as a minimum set of considerations to be used in classifying the liquidity of each portfolio position.

If a fund lacks pertinent information about a portfolio asset, the fund would be required to consider the proposed rule 22e-4(b)(2)(ii) factors as applied to similar assets (for purposes of this release, "comparable assets").[203] For example, if a fund has never before invested in a particular asset—particularly, an asset that does not trade frequently and for which market data is not generally available or is of low quality—the fund could estimate the time it would take to convert the asset to cash if better market data were available for comparable assets (for example, as applicable, assets that are similar in terms of duration, credit quality, bid-ask spread, and/or maturity). Under these circumstances, a fund would be required to evaluate all applicable

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202 *See, e.g.,* ICI FSOC Notice Comment Letter, *supra* note 16, at 23 ("Specific information that may contribute further to the manager's view of an asset's liquidity may include: (i) assessments of bid-ask spreads, volumes, depth of secondary market for the asset, information from pricing vendors, and other data; (ii) deliberations among portfolio managers and traders regarding valuation and liquidity; (iii) analysis of the capital structure and credit quality of the asset/holding; (iv) the "newness" of a bond issue (newer issues tend to be more liquid); and (v) liquidity data provided by third parties. Some fund managers assign "liquidity scores" to particular holdings based on these types of factors.").

203 *See* proposed rule 22e-4(b)(2)(ii).

22e-4(b)(2)(ii) factors with respect to the comparable assets. If data concerning a portfolio asset (as opposed to the comparable assets) were to become available to a fund, we would expect that a fund would assess, as part of its ongoing review of the liquidity classifications assigned to each portfolio position, whether the liquidity classification given to the portfolio asset is appropriate in light of newly available data.[204]

We understand that some third-party service providers currently provide data and analyses assessing the relative liquidity of a fund's portfolio assets,[205] and we believe that a fund could also appropriately use this type of data to inform or supplement its consideration of the proposed liquidity classification factors. However, before doing so, a fund should consider having the person(s) at the fund or investment adviser tasked with administering the fund's liquidity risk management program review the quality of the data received from third parties, as well as the particular methodologies used and metrics analyzed by third parties, to determine whether this data would effectively inform or supplement the fund's consideration of the proposed liquidity classification factors. This review could include an assessment of whether modifications to an "off-the-shelf" product are necessary to accurately reflect the liquidity characteristics of the fund's portfolio holdings.

In the following sections, we discuss each of the proposed liquidity classification factors and provide guidance on specific issues associated with each of these factors that a fund may wish to consider in evaluating the liquidity of its portfolio positions.

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204 *See infra* section III.B.3.a.

205 These third-party vendors may, for example, create liquidity scores for a fund's portfolio assets based on factors such as duration, rating, bid-ask spreads, and instrument maturity, and provide models that reflect how an asset's liquidity may be affected by different market conditions.

a. Existence of Active Market, Including Whether the Asset Is Listed on an Exchange, and the Number, Diversity, and Quality of Market Participants

Under proposed rule 22e-4(b)(2)(ii)(A), a fund would be required to consider, to the extent applicable, the existence of an active market for the asset, including whether the asset is listed on an exchange, as well as the number, diversity, and quality of market participants.

The manner in which a fund may sell a particular portfolio asset, including whether an asset is listed on an exchange, can affect that asset's liquidity. While in general, being listed on a developed and recognized exchange increases an asset's liquidity,[206] the fact that an asset is exchange-traded does not necessarily mean that a fund would be able to convert that asset to cash within a relatively short period. For example, a small-cap equity stock might be listed on an exchange but trade quite infrequently, which would tend to decrease its relative liquidity. Conversely, certain securities that are traditionally traded in over-the-counter ("OTC") markets, such as corporate bonds, could be considered more liquid if, for instance, they are frequently traded and there are generally a substantial number of bids to purchase the security. As an extreme example, short-term securities issued (or guaranteed as to principal and interest) by the U.S. government do not trade on exchanges, but are typically considered to be quite liquid.[207]

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206 *See, e.g.,* Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools* (Jan. 2013), at part 1, section II.A.1, *available at* http://www.bis.org/publ/bcbs238.pdf; *see also* Nuveen FSOC Notice Comment Letter, *supra* note 45, at 9 ("While securities that trade on exchanges… or in deep principal/over-the-counter ("OTC") markets (e.g., U.S. Treasuries) are generally liquid even in stressed markets, other securities that trade on an OTC basis… have faced increasing liquidity challenges in normal markets and can be subject to insufficient quality bids in times of stress as market makers pull back their capital. This can make it not only more difficult to sell these securities, but also to accurately value those assets that are retained.").

207 *See* rule 15c3-1(c)(2)(vi)(A)(*1*) under the Exchange Act (describing securities haircuts for securities issued or guaranteed as to principal or interest by the United States or any agency thereof); *see also* Liquidity Coverage Ratio: Liquidity Risk Measurement Standards (Sept. 9, 2014) [79 FR 61440 (Oct. 10, 2014)] ("Liquidity Coverage Ratio Release") (in liquidity coverage ratio rule adopted by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation, "Level 1 Liquid Assets" are described as securities issued or unconditionally guaranteed as to timely payment of principal and interest by the U.S. Department of the Treasury, and liquid and readily-marketable securities issued or unconditionally guaranteed as to the timely payment of

The means of trading a portfolio asset can affect its liquidity regardless of whether the asset is a security traded on an exchange. For example, whether an asset is traded in a bilateral transaction with a single dealer, or through an electronic auction mechanism whereby a trader can simultaneously contact multiple counterparties, can have different effects on that asset's liquidity.[208] The choice of trading mechanism may have different liquidity effects depending on the asset being traded and other market conditions, and therefore it is difficult to make general statements regarding the correlation between a particular trading mechanism and the liquidity of the asset being traded. However, a fund should consider past experience in using different trading mechanisms to sell a particular asset (or similar assets), when assessing the liquidity of a portfolio position in that asset.

In addition, there are multiple considerations that a fund could assess in evaluating the diversity and quality of market participants for a particular asset. A fund may wish to consider the number of market makers on both the buying and selling sides of transactions. A fund also may consider the quality of market participants who purchase and sell units of a particular portfolio asset, and may wish to assess, in particular: the market participant's capitalization; the reliability of the market participant's trading platform(s); and the market participant's experience and reputation transacting in various types of assets. We believe that the diversity and quality of market participants are meaningful in assessing a portfolio position's liquidity because the most liquid assets tend to have active sale or repurchase markets at all times with diverse market

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principal and interest by any other U.S. government agency (provided that its obligations are fully and explicitly guaranteed by the full faith and credit of the U.S. government)). *But see* Flash Crash Staff Report, *supra* note 124 (noting that, while "[t]he U.S. Treasury market is the deepest and most liquid government securities market in the world," liquidity conditions in the market for U.S. Treasury securities became "significantly strained" during the October 2015 "Flash Crash").

208 *See, e.g.*, Terrence Hendershott & Ananth Madhavan, *Click or Call? Auction versus Search in the Over-the-Counter Market* (Mar. 19, 2012), *available at* http://people.stern.nyu.edu/jhasbrou/SternMicroMtg/SternMicroMtg2012/Accepted/ClickOrCall13.pdf.

participants.[209] The presence of multiple market makers may be a sign that a market is liquid.[210] Diversity of market participants, on both the buying and selling sides of transactions, is also an important factor for a fund to consider because it tends to reduce market concentration and may facilitate a market remaining liquid during periods of stress.[211]

b. Frequency of Trades or Quotes and Average Daily Trading Volume

Proposed rule 22e-4(b)(2)(ii)(B) would require a fund to consider the frequency of trades and quotes for a particular asset in evaluating the liquidity of a portfolio position in that asset, as well as the asset's average daily trading volume, regardless of whether the asset is a security traded on an exchange.

In general, the greater the frequency of trades for an asset (and, relatedly, the greater the frequency of bid and ask quotes for that asset), the more liquid that asset is. However, this is not a perfect or complete measure, and trade size also should be considered in assessing the relationship between trade frequency and liquidity. For example, 100 trades at $100 might or might not signify greater liquidity than 50 trades at $200, although they are likely to suggest

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209 *See, e.g.*, Abdourahmane Sarr & Tonny Lybek, *Measuring Liquidity in Financial Markets*, IMF Working Paper (Dec. 2002), *available at* http://www.imf.org/external/pubs/ft/wp/2002/wp02232.pdf ("Liquid markets tend to exhibit five characteristics: (i) tightness (ii) immediacy, (iii) depth, (iv) breadth, and (v) resiliency.").

210 *See, e.g.*, Sunil Wahal, *Entry, Exit, Market Makers, and the Bid-Ask Spread*, 10 REV. OF FIN. STUD. 871 (1997), *available at* http://www.acsu.buffalo.edu/~keechung/MGF743/Readings/H1.pdf ("Large-scale entry (exit) is associated with substantial declines (increases) in quoted end-of-day inside spreads, even after controlling for the effects of changes in volume and volatility. The spread changes are larger in magnitude for issues with few market makers; however, even for issues with a large number of market makers, substantial changes in quoted spreads take place.").

211 *See, e.g.*, Amir Rubin, *Ownership Level, Ownership Concentration, and Liquidity*, 10 J. FIN. MARKETS 219 (Aug. 2007), *available at* http://www.sfu.ca/~arubin/JFM_2006074.pdf ("We examine the link between the liquidity of a firm's stock and its ownership structure, specifically, how much of the firm's stock is owned by insiders and institutions, and how concentrated is their ownership. We find that the liquidity-ownership relation is mostly driven by institutional ownership rather than insider ownership. Importantly, liquidity is positively related to total institutional holdings but negatively related to institutional block holdings.").

better liquidity than one trade at $10,000.[212] In evaluating the frequency of trades (and bid and ask quotes) for an asset, a fund should generally consider, among other relevant factors, the number of dealers quoting prices for that asset, the number of other potential purchasers and sellers, and dealer undertakings to make a market in the asset.

High average trading volume also tends to be correlated with greater liquidity. In general, the greater the average daily trading volume for a particular portfolio asset, the deeper the market, and the more likely it is that a fund would be able to convert its position to cash at a price that does not materially affect the value of that asset immediately prior to sale.[213] A fund may wish to particularly consider the number of days a particular asset has shown zero trading volume during the prior month, year, or other relevant period, as this could indicate particularly limited liquidity. High trading volume is not always indicative of available liquidity for a particular asset, however. For example, high trading volumes might be associated with high selling pressure on the asset and trades at that time may have a high price impact.[214]

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212 *See* Erik Banks, *Liquidity Risk: Managing Funding and Asset Risk* (2nd ed. 2013), at 169.

213 *See id.* at 168; *see also* MarketWatch, *Fitch: Bond Trade Frequency Strongly Linked to Issue Size* (Jan. 29, 2015), *available at* http://www.marketwatch.com/story/fitch-bond-trade-frequency-strongly-linked-to-issue-size-2015-01-29 (discussing Fitch Ratings study findings showing that smaller investment-grade corporate bond issues, under $500 million, trade materially less frequently than larger issue bonds); Fidelity FSOC Notice Comment Letter, *supra* note 20, at 21 ("Liquidity management is linked to portfolio managers' attention to market risks indicated by . . . shrinking transaction volumes which exacerbate the impact cost for additional trading").

We note that double-counting of trades is a potential issue to consider when assessing average trading volume. Double-counting occurs because of differences between dealer and auction markets. In a dealer market, trades are "double-counted" because the dealer buys from person A and then sells to person B. In an auction market, person A and B trade directly. *See, e.g.*, Anne M. Anderson & Edward A. Dyl, *Trading Volume: NASDAQ and the NYSE*, 63 FIN. ANALYSTS J. 79 (May/June 2007), *available at* http://www.cfapubs.org/doi/abs/10.2469/faj.v63.n3.4693.

214 *See, e.g.*, Jennifer Huang & Jiang Wang, *Liquidity and Market Crashes*, 22 REV. OF FIN. STUD. 2607 (2009), *available at* http://rfs.oxfordjournals.org/content/22/7/2607.full (discussing how there can be high selling pressure (and high volume) along with low liquidity and how this can create market crashes); Mark Carlson, *A Brief History of the 1987 Stock Market Crash with a Discussion of the Federal Reserve Response*, Federal Reserve Board Working Paper 2007-13 (Nov. 2006), *available at* http://www.federalreserve.gov/pubs/feds/2007/200713/200713pap.pdf (discussing how the 1987 stock market crash had both high volume and low liquidity).

Assets that are components of widely followed market indices tend to have relatively high trading volume, and therefore relatively high liquidity compared to other assets. If a security is included in such an index, market participants are likely to invest in the security in order to replicate the index. This, in turn, will increase demand and trading volume for the security, therefore increasing the security's liquidity compared to securities not in such an index.[215] Additionally, index components are selected, with a goal of promoting replicability of the index, based on multiple factors including liquidity screens, which in turn may be based on an asset's trading volume.[216] A security's inclusion in a widely followed market index therefore suggests relatively high trading volume, and thus a greater level of liquidity relative to similar securities that were not chosen to be part of such an index (*e.g.*, a high-yield corporate bond included in a widely followed market index would likely be more liquid than an otherwise similar high-yield corporate bond that is not a component of such an index).

c. Volatility of Trading Prices

Under proposed rule 22e-4(b)(2)(ii)(C), a fund would be required to consider the volatility of trading prices for a particular portfolio asset when evaluating the liquidity of a position in that asset. In general, there is an inverse relationship between liquidity and volatility,[217] as lack of liquidity in a particular asset tends to amplify price volatility for that

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215 *See, e.g.*, Shantaram P. Hegde & John B. McDermott, *The Liquidity Effects of Revisions to the S&P 500 Index: An Empirical Analysis*, 6 J. FIN. MARKETS 413 (2003) ("Using a recent sample of S&P 500 additions, we find a sustained increase in the liquidity of the added stocks.").

216 *See, e.g.*, Stock Index Liquidity Screen patent application (Owner: Frank Russell Company) (Mar. 19, 2009), *available at* http://appft.uspto.gov/netacgi/nph-Parser?Sect1=PTO2&Sect2=HITOFF&p=1&u=%2Fnetahtml%2FPTO%2Fsearch-bool.html&r=1&f=G&l=50&co1=AND&d=PG01&s1=%22stock+index+liquidity+screen%22&OS="stock+index+liquidity+screen"&RS="stock+index+liquidity+screen" (describing various methods that index providers use to identify securities with inadequate liquidity and exclude them from indices).

217 *See, e.g.*, Tarun Chordia, Asani Sarkar & Avanidhar Subrahmanyam, *An Empirical Analysis of Stock and Bond Market Liquidity*, Federal Reserve Bank of New York Staff Reports, no. 164 (Mar. 2003), *available at* http://www.newyorkfed.org/research/staff_reports/sr164.pdf (finding that unexpected liquidity and

asset.[218] Additionally, Commission staff understands that certain funds and fund groups have historically experienced liquidity disruptions during periods of extreme market volatility, such as the June 2013 "taper tantrum."[219] For these reasons, we believe that trading price volatility is potentially a valuable metric to consider in determining an asset's liquidity.

d. Bid-Ask Spreads

Bid-ask spreads—the difference between bid and offer prices for a particular asset—have historically been viewed as a useful measure for assessing the liquidity of assets that trade in the OTC markets.[220] A fund would thus be required, under proposed rule 22e-4(b)(2)(ii)(D), to consider a portfolio asset's bid-ask spreads in evaluating the liquidity of a position in that asset. The bid-ask spread of a particular fixed income asset is related to the riskiness of that asset, as well as the length of time that a broker-dealer believes it will have to hold the asset before selling it.[221] In general, high bid-ask spreads for a particular asset correlate with a lack of liquidity in

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volatility shocks are positively and significantly correlated across stock and bond markets).

218 *See, e.g.*, Prachi Deuskar, *Extrapolative Expectation: Implications for Volatility and Liquidity* (Aug. 2007), *available at* https://business.illinois.edu/pdeuskar/Deuskar_Extrapolative_Liquidity_Volatility.pdf ("Illiquidity amplifies supply shocks, increasing realized volatility of prices, which feeds into subsequent volatility forecasts."); *see also* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 21 ("Liquidity management is linked to portfolio managers' attention to market risks indicated by...increasing market- and security-specific volatility.").

219 In May 2013, Ben Bernanke, then Chairman of the Federal Reserve Board, announced that the Federal Reserve may start scaling back its asset purchase program—in which the Federal Reserve purchased approximately $85 billion worth of bonds and mortgage-backed securities each month—sooner than investors expected. This caused interests rates on fixed income products to spike, and bond prices to fall dramatically. This market dislocation came to be known as the "taper tantrum." *See* Condon & Kearns, *Fed Worried About Triggering Another 'Taper Tantrum,'* BloombergBusiness (Oct. 8, 2014), *available at* http://www.bloomberg.com/news/articles/2014-10-08/fed-worried-about-triggering-another-taper-tantrum-.

220 *See, e.g.*, Michael J. Fleming, *Measuring Treasury Market Liquidity*, Federal Reserve Bank of New York Policy Review (Sept. 2003), *available at* http://www.newyorkfed.org/research/epr/03v09n3/0309flem.pdf (providing a literature review of studies analyzing bid-ask spreads in relation to Treasury market liquidity); *see also* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 21 ("Liquidity management is linked to portfolio managers' attention to market risks indicated by...heightened market impact costs (as indicated by widening bid/ask spreads)").

221 *See* MarketAxess, *The MarketAxess Bid-Ask Spread Index (BASI)™: A More Informed Picture of Market Liquidity in the U.S. Corporate Bond Market* (2013), *available at* http://www.marketaxess.com/pdfs/research/marketaxess-bid-ask-spread-index-BASI.pdf (discussing

that asset. For example, when liquidity was significantly constricted during the 2007-2009 financial crisis, bid-ask spreads on U.S. investment grade bonds were notably elevated.[222] However, bid-ask spreads alone do not necessarily provide a comprehensive understanding of an asset's liquidity. For instance, bid-ask spreads are often constrained by the increments in which prices are quoted.[223]

e. Standardization and Simplicity of Structure

Proposed rule 22e-4(b)(2)(ii)(E) would require a fund to consider whether a portfolio asset has a relatively standardized and simple structure in evaluating the liquidity of a position in that asset. Assets that trade OTC with terms set at issuance such as sizes, maturities, coupons, and payment dates tend to be relatively more liquid compared to similarly situated assets without standardized terms. The issue of standardization is particularly significant with respect to the corporate bond market, since corporate issuers commonly have large numbers of bonds outstanding, and trading can be fragmented among that universe of bonds. For example, while

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methodology for developing an index that tracks bid-ask spreads of U.S. corporate bonds).

222 *See, e.g.*, BlackRock Investment Institute, *Got Liquidity?* (Sept. 2012), *available at* http://www.blackrock.com/investing/literature/whitepaper/got-liquidity-us-version.pdf, at p.7; *see also* Oppenheimer, *Diminished Liquidity in the Corporate Bond Market: Implications for Fixed Income Investors* (Mar. 16, 2015), *available at* https://www.opco.com/redirect/bond-liquidity-report-3-15.aspx, at p.1.

223 *See, e.g.*, Michael A. Goldstein & Kenneth A. Kavajecz, *Eighths, Sixteenths, and Market Depth: Changes in Tick Size and Liquidity Provision on the NYSE*, 56 J. FIN. ECON. 125 (2000), *available at* http://www.acsu.buffalo.edu/~keechung/MGF743/Readings/G5.pdf ("Using limit order data provided by the NYSE, we investigate the impact of reducing the minimum tick size on the liquidity of the market. While both spreads and depths (quoted and on the limit order book) declined after the NYSE's change from eighths to sixteenths, depth declined throughout the entire limit order book as well. The combined effect of smaller spreads and reduced cumulative limit order book depth has made liquidity demanders trading small orders better off; however, traders who submitted larger orders in lower volume stocks did not benefit, especially if those stocks were low priced."); Hendrik Bessembinder, *Tick Size, Spreads, and Liquidity: An Analysis of Nasdaq Securities Trading Near Ten Dollars*, 9 J. OF FIN. INTERMEDIATION 213 (July 2000), *available at* http://www.acsu.buffalo.edu/~keechung/MGF743/Readings/G4.pdf ("There is no evidence of a reduction in liquidity with the smaller tick size. The largest spread reductions occur for stocks whose market makers avoid odd-eighth quotes. This finding provides support for models implying that changes in the tick size can affect equilibrium spreads on a dealer market and indicates that the relation between tick size and market quality is more complex than the imposition of a constraint on minimum spread widths.").

each of the top ten largest issuers in the United States had one common equity security outstanding as of April 2014, these issuers collectively had more than 9,000 bonds outstanding.[224] Conversely, some types of OTC-traded securities exhibit a relatively high level of standardization, such as government and agency bonds, futures contracts, and certain swap contracts. Central clearing of certain OTC-traded securities, which generally requires the terms of these securities to be highly standardized, has been associated with an increase in these assets' liquidity, as measured by factors such as the bid-ask spreads for these assets and the number of dealers providing quotes for these assets.[225] While standardization of a particular security contract alone is not indicative of that security's liquidity, standardization can increase liquidity by simplifying the ability to quote and trade securities, enhancing operational efficiency to execute and settle trades, and improving secondary market transparency.

f. Maturity and Date of Issue

With respect to fixed income assets, proposed rule 22e-4(b)(2)(ii)(F) would require a fund to consider the maturity of a particular asset, as well as when the asset was issued, in

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224 *See* BlackRock, Viewpoint, *Corporate Bond Market Structure: The Time for Reform Is Now* (Sept. 2014), at p.7, *available at* http://www.blackrock.com/corporate/en-ae/literature/whitepaper/viewpoint-corporate-bond-market-structure-september-2014.pdf.

225 *See, e.g.*, Yee Cheng Loon & Zhaodong (Ken) Zhong, *The impact of central clearing on counterparty risk, liquidity, and trading: Evidence from the credit default swap market*, 112 J. OF FIN. ECON. 91 (Apr. 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2176561 (analyzing the impact of central clearing on credit default swaps and finding that cleared reference entities experience an improvement in both liquidity and trading activity relative to noncleared entities); Joshua Slive, Jonathan Witmer & Elizabeth Woodman, *Liquidity and Central Clearing: Evidence from the CDS Market*, Bank of Canada Working Paper 2012-38 (Dec. 2012), *available at* http://www.bankofcanada.ca/wp-content/uploads/2012/12/wp2012-38.pdf (analyzing "the relationship between liquidity and central clearing using information on credit default swap clearing at ICE Trust and ICE Clear Europe," and finding that "the introduction of central clearing is associated with a slight increase in the liquidity of a contract" (but noting that the effects of central clearing on liquidity must be viewed in light of the fact that the central counterparty chooses the most liquid contracts for central clearing, consistent with liquidity characteristics being important in determining the safety and efficiency of clearing)). *But see* Manmohan Singh, *Collateral, Netting and Systemic Risk in the OTC Derivatives Market*, IMF Working Paper 10/99 (Apr. 1, 2010), *available at* https://www.imf.org/external/pubs/cat/longres.cfm?sk=23741.0 (arguing that large increases in collateral posted for the centrally cleared trades negatively affect market liquidity given that most large banks will be reluctant to offload their positions to central counterparties).

assessing the liquidity of the fund's position in that asset. In general, a fixed income asset trades most frequently in the time directly following issuance, and its trading volume decreases in the asset's remaining time to maturity.[226] Thus "on-the-run" securities (that is, bonds or notes of a particular maturity that were most recently issued) tend to trade significantly more frequently than their "off-the-run" counterparts (that is, bonds or notes issued before the most recently issued bond or note of a particular maturity).[227] Because high trading volume generally suggests relatively higher liquidity,[228] a fixed income asset's date of issuance and maturity (which in turn are generally correlated with the trading volume of a fixed income asset) together are important liquidity indicators. We understand, based on staff outreach and industry knowledge, that remaining time to maturity is a key factor that fixed income funds commonly consider in assessing the liquidity of their portfolio positions.

g. Restrictions on Trading and Limitations on Transfer

Proposed rule 22e-4(b)(2)(ii)(G) would require a fund to consider any restrictions on trading a particular asset, and limitations on transfers of that asset, in evaluating the liquidity of a

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226 *See, e.g.*, Sugato Chakravarty & Asani Sarkar, *Liquidity in U.S. Fixed Income Markets: A Comparison of the Bid-Ask Spread in Corporate, Government and Municipal Bond Markets*, Federal Reserve Board of New York Staff Report No. 73 (Mar. 1999), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=163139.

227 The on-the-run phenomenon refers to the fact that, in fixed income markets, securities with nearly identical cash flows trade at different yields and with different liquidity. In particular, most recently issued (*i.e.*, on-the-run) government bonds of a certain maturity are generally more liquid than previously issued (*i.e.*, off-the-run or old) bonds maturing on similar dates. *See, e.g.*, Paolo Pasquariello & Clara Vega, *The on-the-run liquidity phenomenon*, 92 J. OF FIN. ECON. 1 (Apr. 2009), *available at* http://webuser.bus.umich.edu/ppasquar/onofftherun.pdf (analyzing the liquidity differentials of on-the-run and off-the-run U.S. Treasury bonds and finding, among other things, that on-the-run and off-the-run liquidity differentials are economically and statistically significant—showing that on-the-run bonds tend to be more liquid than their off-the-run counterparts—even after controlling for certain intrinsic characteristics of the bonds); Michael Barclay, Terrence Hendershott & Kenneth Kotz, *Automation versus Intermediation: Evidence from Treasuries Going Off the Run*, 61 J. FIN. 2395 (Oct. 2006), *available at* http://faculty.haas.berkeley.edu/hender/on-off.pdf (discussing how "when Treasury securities go 'off the run' their trading volume drops by more than 90%").

228 *See supra* section III.B.2.b.

portfolio position in that asset. We previously stated that the liquidity of rule 144A securities is "a question of fact for the board of directors [of the fund] to determine based upon the trading markets for the specific security."[229] We also stated that a fund's board may find it reasonable to consider certain factors when evaluating the liquidity of a rule 144A security, including: (i) the frequency of trades and quotes for the security; (ii) the number of dealers willing to purchase or sell the security and the number of other potential purchasers; (iii) dealer undertakings to make a market in the security; and (iv) the nature of the security and the nature of the marketplace trades (*e.g.*, the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer).[230] These guidance factors are consistent with certain of the proposed rule 22e-4(b)(2)(ii) factors,[231] and a fund is required to consider the proposed rule 22e-4(b)(2)(ii) factors in evaluating the liquidity of a 144A security.

Regardless of whether a portfolio asset is a restricted security, it may nevertheless be subject to other limitations on transfer. For example, for securities that are traded in certain foreign markets, government approval may be required for the repatriation of investment income, capital, or the proceeds of sales of securities by foreign investors.[232] Portfolio assets furthermore

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229 *See* Rule 144A Release, *supra* note 86. As discussed below, the Commission has stated that an investment company's board of directors may delegate day-to-day responsibility for such determinations to the investment company's investment adviser, provided that the board retains sufficient oversight. *See infra* section III.D.3; *see also* Rule 144A Release at n.61.

230 *See* Rule 144A Release, *supra* note 86, at text following n.62.

231 "The frequency of trades and quotes for the security" is consistent with proposed rule 22e-4(b)(2)(ii)(B). "The number of dealers willing to purchase or sell the security and the number of other potential purchasers" and "dealer undertakings to make a market in the security," are reflected in proposed rule 22e-4(b)(2)(ii)(A). "The nature of the security and the nature of the marketplace trades" is a very general factor, and we believe that many of the proposed rule 22e-4(b)(2)(ii) factors (in particular, those reflected in proposed rule 22e-4(b)(2)(ii)(A), (B), (C), (D), (E), (F), (G), and (H)) indicate the nature of the security and the nature of marketplace trades.

232 *See, e.g.*, HSBC, *Emerging Markets FX: Regulatory understanding a priority*, HSBC's Emerging Markets Currency Guide 2012 (Dec. 2011), *available at* http://www.hsbcnet.com/gbm/attachments/rise-of-the-rmb/currency-guide-2012.pdf?WT.ac=CIBM_gbm_pro_rmbrise_pbx01_On; *see also* Liquidity Coverage Ratio Release, *supra* note 207, at section II.B.3.iv (discouraging banking entities from holding a

may be subject to certain contractual limitations on transfer.[233] Securities subject to transfer limitations in general are less liquid than securities without such limitations.

h. Size of Position in an Asset Relative to the Asset's Average Daily Trading Volume and, as Applicable, Number of Units of the Asset Outstanding

Under proposed rule 22e-4, a fund's liquidity analysis regarding a particular portfolio asset would be required to take into consideration the ability to sell and receive cash for the entire position (or, as applicable, portions of a position in a particular asset), not only its ability to convert a single trading lot of that asset to cash.[234] Because the size of a fund's portfolio position in a particular asset is a key element in determining a fund's ability to convert the entire position (or portions of a position in a particular asset) to cash, the proposed rule would require a fund assessing the liquidity of a portfolio asset to consider the size of the fund's position in that asset.[235] Staff outreach has shown that many funds currently consider this factor in evaluating the liquidity of their portfolio positions. A fund would be required to consider the size of its position in a particular portfolio asset relative to the asset's average daily trading volume and, as

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disproportionate amount of their eligible highly qualified liquid assets in locations outside the United States where unforeseen impediments may prevent timely repatriation of such assets during a liquidity crisis).

233 *See, e.g.*, Stephen H. Bier, Julien Bourgeois & Joseph McClain, *Mutual Funds and Loan Investments*, The Investment Lawyer (Mar. 2015), at 2, *available at* http://www.dechert.com/files/Uploads/Documents/FSG/Mutual%20Funds%20and%20Loan%20Investments%20-%20The%20Investment%20Lawyer.pdf ("[M]any loans and assignment trades remain bespoke transactions that require consents from borrowers or key syndicate members, and loan documents are still negotiated written documents that require human review. As a result...the mechanics of loan trades and certain trade settlement times cause funds to carefully monitor liquidity considerations surrounding loan investments.... [In making such determinations, funds] typically consider factors common to general liquidity determinations, as well as factors specific to the loan markets, which can include: (i) the legal limitations on the transferability or sale of a loan including the requirement to obtain consents from borrowers or syndicate agents and members prior to assignment; (ii) the existence of a trading market for the loans and the estimated depth of the market; (iii) the frequency of trades or quotes for the loan; (iv) the estimated length of the settlement period; and (v) the borrower's health.").

234 *See* proposed rule 22e-4(b)(2)(i); *supra* paragraph accompanying note 177.

235 *See* proposed rule 22e-4(b)(2)(ii)(H).

applicable, the number of units of the asset outstanding.[236] Small-capitalization securities are generally less liquid than large-capitalization securities[237] and, as discussed above, securities with lower trading volume are generally less liquid than securities whose trading volume is higher.[238] The size of a fund's position in a particular portfolio asset could augment the effects of these two liquidity factors. For example, if a fund holds a significant position in a small-capitalization security, this could indicate that its position is relatively illiquid.[239] Likewise, holding a large position in a thinly traded security diminishes the possibility that a fund would be able to convert a significant portion of that position to cash in order to meet redemptions. In considering the number of units of an asset that are currently outstanding, a fund may wish to take into account the extent to which units of an asset may be technically outstanding, but cannot be purchased by a member of the public (*e.g.*, shares of a company that the company has repurchased from the public, but not cancelled because the company plans to later reissue the shares, for example to cover employee stock grants). Because units of an asset that cannot be purchased by a member of the public are not able to be actively traded, this consideration could be relevant to a fund's assessment of how the size of a portfolio position relative to the number of outstanding units may affect that position's liquidity.

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236 Proposed rule 22e-4(b)(2)(ii)(H).

237 *See, e.g.*, DERA Study, *supra* note 39, at p. 27; *cf. also* Amy K. Edwards, Lawrence E. Harris & Michael S. Piwowar, *Corporate Bond Market Transaction Costs and Transparency*, 62 J. FIN. 1421, 1444 (June 2007) ("Large issues have significantly lower transaction costs than do small issues.").

238 *See supra* section III.B.2.b.

239 *See, e.g.*, Marshall E. Blume & Donald B. Keim, *Institutional Investors and Stock Market Liquidity: Trends and Relationships* (Aug. 21, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2147757 (examining the relation between illiquidity and two measures of institutional stock ownership – the percentage of a stock owned by institutions and the number of institutions that own the stock – and finding that the number of institutions that own and trade a stock is more important than the percentage of institutional ownership in explaining the cross-sectional variability of illiquidity ("an increase in the number of institutional holders of a stock decreases the average number of shares of the stock held by individual institutions and, thereby, reduces the potential size of a trade and its accompanying liquidity-induced impact")).

When a fund is evaluating the size of its position in a particular asset as a factor in assessing that position's liquidity, it would be required to consider the extent to which the timing of disposing of the position could create any market value impact.[240] Selling a large position in a particular asset into the market over a short time period could entail a negative price impact on the asset, which in turn could cause losses to the fund and its shareholders. Therefore, this consideration is relevant to determining the period in which a fund would be able to convert a particular portfolio position (or portion thereof) to cash, without affecting the value of that asset by virtue of the transaction.

i. Relationship of Asset to Another Portfolio Asset

Under proposed rule 22e-4(b)(2)(ii)(I), a fund would be required to consider, in assessing the liquidity of a position in a particular portfolio asset, whether the fund invests in the asset because it is connected with an investment in another portfolio asset. This may arise in connection with a derivatives transaction, or if the fund uses an asset for hedging or risk mitigation purposes.

When funds enter into certain transactions that implicate section 18 of the Investment Company Act, they generally will maintain in a segregated account certain liquid assets in order to "cover" the fund's obligation under the transactions. We applied this framework to certain financing transactions in Investment Company Act Release No. 10666 ("Release 10666"), issued in 1979,[241] and also understand that funds today apply this framework to certain derivatives, based on the guidance we provided in Release 10666 and on no-action letters issued by our

240 Proposed rule 22e-4(b)(2)(ii)(H).

241 Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979) [44 FR 25128 (Apr. 27, 1979)] ("Release 10666").

staff.[242] We explained in Release 10666 that "[a] segregated account freezes certain assets of the investment company and renders such assets unavailable for sale or other disposition."[243] We also stated in Release 10666 that only liquid assets should be placed in a segregated account. Thus, although we expect that assets used by a fund to cover derivatives and other transactions would be liquid when considered in isolation, when evaluating their liquidity for purposes of the proposed rule, the fund would have to consider that they are being used to cover other transactions and, consistent with our position in Release 10666, are "frozen" and "unavailable for sale or other disposition." Because these assets are only available for sale to meet redemptions once the related derivatives position is disposed of or unwound, a fund should classify the liquidity of these segregated assets using the liquidity of the derivative instruments they are covering. Release 10666 notes that segregated assets may be "replaced by other appropriate non-segregated assets of equal value," and when they are so replaced, formerly segregated assets would no longer be considered unavailable for sale or other disposition.[244] When a formerly segregated asset is no longer segregated, a fund generally should assess, as part of its ongoing review of the liquidity classifications assigned to each portfolio position, whether the liquidity classification given to the portfolio asset when it was segregated continues to be appropriate.[245]

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242 *See generally* Use of Derivatives by Investment Companies Under the Investment Company Act of 1940, Investment Company Act Release No. 29776 (Aug. 31, 2011) [76 FR 55237 (Sept. 7, 2011)] ("Investment Company Derivatives Use Concept Release") (providing background information on the application of section 18 to derivatives and certain other transactions).

243 *See also* Dear Chief Financial Officer Letter from Lawrence A. Friend, Chief Accountant, Division of Investment Management (Nov. 7, 1997) (staff letter taking the position that a fund could segregate assets by designating such assets on its books, rather than establishing a segregated account at its custodian).

244 *See* Release 10666, *supra* note 241.

245 *See infra* section III.B.3.a.

A fund may purchase an asset in connection with its holding of another asset for other reasons, such as hedging. For example, a fund might purchase a debt security denominated in a foreign currency and attempt to hedge the currency risks associated with the debt security by entering into a currency future. When evaluating the liquidity of the currency future, the fund should consider the way the currency future is being used in the fund's portfolio. In situations where a fund purchases a more liquid asset in connection with a less liquid asset, and it plans to transact in the more liquid asset only in connection with the less liquid asset, then the liquidity of the two assets is linked by the fund and, in this case, the fund should consider the liquidity classification of the foreign debt security when determining the liquidity of the currency future.

j. Request for Comment

We request comment on the proposed factors that a fund would be required to consider, as applicable, in classifying the liquidity of each portfolio position in a particular asset.

- What factors do funds currently use to assess and classify the liquidity of portfolio assets, and do the proposed factors reflect factors that funds already consider when evaluating portfolio assets' liquidity? Do commenters agree that requiring a fund to consider certain factors would encourage effective liquidity assessment across the fund industry? Would considering certain factors improve funds' ability to meet their redemption obligations and to reduce potential dilution of non-redeeming shareholders? Would classification generally enhance funds' liquidity risk management, including funds' ability to meet their redemption obligations and to reduce potential dilution of non-redeeming shareholders?
- Should any of the proposed factors not be required to be considered by a fund in making liquidity determinations? Should any of the proposed factors be modified? Are there any additional factors, besides the proposed factors, that a fund should be required to consider

in evaluating the liquidity of a portfolio position in a particular asset? Should the proposed rule text be modified to explicitly exempt certain types of funds from considering certain factors? Or are there additional factors, besides the proposed factors, that should be required to be considered by certain types of funds? Should funds be required to consider correlations between asset classes more generally, outside the derivatives and hedging contexts? Should certain factors be given more weight than others? Should proposed rule 22e-4 explicitly require a fund to classify the liquidity of a position (or portions of a position in a particular asset) used to cover a derivative position using the same liquidity classification category as it assigned to the derivative? Should the Commission provide additional guidance regarding the circumstances in which a fund should consider the liquidity of a particular portfolio asset in relation to the liquidity of another asset? What types of operational challenges would arise in connection with considering the liquidity of a particular portfolio asset in relation to the liquidity of another asset?

- Instead of codifying the factors as part of proposed rule 22e-4, should the Commission solely provide guidance as to what would be appropriate for a fund to consider in assessing its portfolio assets' liquidity? Why or why not? Would the failure to codify the factors diminish how consistently they are applied across the industry?
- Would a more principles-based approach, in lieu of codified factors or guidance, be more appropriate? For example, would it be less costly to implement and allow more flexible use of factors that might be more pertinent in analyzing the liquidity of a particular asset? Or would a more principles-based approach not materially advance portfolio asset liquidity assessments beyond those conducted today under the 15% guidelines, and thus

be subject to similar limitations as discussed above as a stand-alone method for liquidity assessment?

- To the extent that a fund lacks pertinent information about a particular portfolio asset, should the fund be required to consider the proposed rule 22e-4(b)(2)(ii) factors with respect to appropriate comparable assets? What characteristics of the portfolio asset and the comparable asset would a fund generally compare in determining the weight to ascribe to the comparable asset's liquidity in evaluating the portfolio asset's liquidity?
- Should ETFs and ETMFs be governed by the same, a subset of, or different factors? If so, which factors and why?

We seek comment on the Commission's guidance regarding each of the proposed factors.

- Besides the guidance, are there any other specific issues associated with any of the proposed factors that a fund may wish to consider in evaluating the liquidity of a portfolio position in a particular asset?
- Do commenters generally agree with the guidance that we have proposed regarding the ways that each of the proposed factors could indicate relative liquidity or illiquidity of a portfolio asset? Should we add a note to rule 22e-4 indicating that the release includes additional guidance regarding the proposed factors?

3. *Ongoing Review of the Liquidity of a Fund's Portfolio Positions*

a. Proposed Ongoing Review Requirement

Proposed rule 22e-4(b)(2)(i) would require a fund to review the liquidity classification of each of the fund's portfolio positions on an ongoing basis. As appropriate, a fund could determine to revise its liquidity classification of a portfolio position based on this ongoing review requirement. The Commission has previously stated that it "expects funds to monitor portfolio liquidity on an ongoing basis to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained."[246] Some have interpreted this statement to mean that the Commission does not intend for a fund to reassess the liquidity status of *individual* securities on an ongoing basis, but instead to monitor whether a fund *portfolio's* overall liquidity profile is appropriate in light of its redemption obligations under section 22(e).[247] We agree that a fund should monitor the liquidity of its portfolio holistically, in light of shareholder flows, to determine the fund's capacity to meet its redemption obligations.[248] However, decreased liquidity of individual portfolio components can directly affect the ability of a fund to meet its redemption obligations, or to meet obligations in a manner that does not dilute the interests of non-redeeming shareholders.[249] We thus believe that requiring a fund to review position-level liquidity classifications made under proposed rule 22e-4 on an ongoing basis would reduce the risk that the fund will be unable to meet its redemption obligations and reduce potential dilution of shareholders' interests.

As discussed above, Commission staff understands, based on outreach to the fund industry and information provided by industry participants, that different funds employ varying approaches to monitoring the liquidity of individual assets and positions. We understand that some funds may not normally review the liquidity of individual portfolio assets on a continuing basis after they are acquired. On the other hand, our staff learned through outreach efforts across the fund industry that certain funds periodically reassess the liquidity of each portfolio security

246 Guidelines Release, *supra* note 4, at section II.

247 *See* ICI Valuation and Liquidity Issues White Paper, *supra* note 177, at 45.

248 *See* Guidelines Release, *supra* note 4, at section II. (stating, with respect to the Commission's expectation that a fund would monitor its portfolio liquidity, "For example, an equity fund that begins to experience a net outflow of assets because investors increasingly shift their moneys from equity to income funds should consider reducing its holdings of illiquid securities in an orderly fashion in order to maintain liquidity.").

249 *See, e.g.*, Heartland Release, *supra* note 47.

based on market-wide developments, as well as events affecting particular securities or asset classes.[250]

Pursuant to the proposed ongoing review requirement, each fund would be required to consider the rule 22e-4(b)(2)(ii) factors, as applicable, in reviewing its portfolio positions' liquidity on an ongoing basis.[251] However, beyond this, rule 22e-4 does not include prescribed review procedures, nor does it incorporate specific developments that a fund must monitor. A fund may wish to determine the frequency of its ongoing review of portfolio positions' liquidity classifications based in part on the liquidity of its portfolio holdings, as well as the timing of its portfolio acquisitions and turnover, in order to evaluate whether its portfolio acquisitions are in compliance with the three-day liquid asset minimum requirement.[252] For example, a fund whose portfolio assets' liquidity could depend significantly on current market conditions should generally review the liquidity classifications of its portfolio assets relatively often (up to daily, or even hourly, depending on facts and circumstances). On the other end of the spectrum, it may be appropriate for a fund whose portfolio holdings' liquidity tends to be more stable (for example, a large-cap equity fund) to consider reviewing the liquidity classifications of its portfolio assets less frequently.[253]

In adopting ongoing review policies and procedures, a fund generally should include policies and procedures for identifying market-wide developments, as well as security- and asset-class-specific developments, that could demonstrate a need to change the liquidity

250 *See also, e.g.*, ICI FSOC Notice Comment Letter, *supra* note 16, at 23-25 ("A mutual fund manager's liquidity management practices typically will include active monitoring of the liquidity profile of individual portfolio holdings.").

251 *See* proposed rule 22e-4(b)(2)(i)-(ii).

252 *See infra* section III.C.3 (discussion of three-day liquid asset minimum requirement).

253 We note that at a minimum, a fund would review its liquidity classification at least monthly in order to accurately report this information on proposed Form N-PORT.

classification of a portfolio position. For instance, relevant market-wide developments could include changes in interest rates or other macroeconomic events, market-wide volatility, market-wide flow changes, dealer inventory or capacity changes, and extraordinary events such as natural disasters or political upheaval.[254] Security- and asset-class specific developments that a fund may wish to consider include corporate events (such as bankruptcy, default, or delisting, as well as reputational events) and regulatory changes affecting certain asset classes. Any of these developments could cause changes, for example, in the frequency of trades or quotes for a particular asset, as well as changes to that asset's trading volume, price volatility, and bid-ask spreads.

b. Request for Comment

We request comment on the proposed ongoing review requirement.

- How do funds currently monitor the liquidity of portfolio assets, and how frequently do they do so? To what extent do funds anticipate that the ongoing review procedures that would be required under proposed rule 22e-4 would replicate the procedures funds currently use to monitor whether portfolio assets are limited by the 15% guideline? Are current processes largely automated? Do funds believe that systems could be used to automate the monitoring that would be required under proposed rule 22e-4? What trade-offs or risks does automated monitoring pose vis-à-vis manual monitoring, and how do firms currently manage those risks? Are there circumstances in which automated monitoring is inappropriate, and, if so, why?
- Is the ongoing review requirement, as proposed, sufficiently clear? Are there certain approaches to ongoing review that we should require and/or on which we should provide

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254 *See, e.g.*, 2014 Fixed Income Guidance Update, *supra* note 62.

guidance? Should we specify a minimum time period for funds to review their liquidity classifications under proposed rule 22e-4? Should we require that a fund monitor for certain specified developments or events, and/or expand our guidance on the market-wide and security- and asset-class-specific developments that a fund could consider?

C. Assessing and Managing a Fund's Liquidity Risk

We believe that assessing and managing liquidity risk in a comprehensive manner is critical to a fund's ability to honor redemption requests within the seven-day period required under section 22(e) of the Investment Company Act, as well as within any shorter time period disclosed in the fund's prospectus or advertising materials or required for purposes of rule 15c6-1. Proposed rule 22e-4(a)(7) would define liquidity risk as the risk that the fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value. This proposed definition contemplates that a fund consider both expected requests to redeem (*e.g.*, shareholder flows relating to seasonality or shareholder tax considerations), as well as requests to redeem that may not be expected, but are reasonably foreseeable under stressed conditions (*e.g.*, shareholder outflows related to stressed market conditions or increased volatility, or outflows that are reasonable to expect in light of a reputational event affecting the fund or the departure of a fund's portfolio manager).[255]

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255 *See, e.g.*, *infra* section IV.C.1.e (discussing why we do not believe that a general stress testing requirement would be an adequate substitute for the proposed three-day liquid asset requirement).

A fund's liquidity risk depends on a variety of factors, including, among others, its cash flows, investment strategy, portfolio liquidity, use of borrowings and derivatives, cash (and cash equivalents) on hand, and borrowing arrangements.[256] Staff outreach has shown that funds consider these types of factors in assessing their liquidity risk, and some funds conduct stress tests (incorporating these factors) to analyze various redemption scenarios to determine whether the fund has sufficient liquid assets to cover different levels of redemptions.[257] Likewise, we understand that a fund may employ many different policies and procedures for managing its liquidity risk, including adjusting portfolio composition to withstand potential liquidity stresses, maintaining bank lines of credit or other borrowing arrangements, requesting notification from large shareholders about possible upcoming redemptions, and other similar risk management techniques. In addition, some fund complexes have established a dedicated risk management function, with independent risk oversight. Other funds, however, employ substantially less comprehensive liquidity risk assessment and management practices and procedures. These

256 *See infra* section III.C.1; *see also* Nuveen FSOC Notice Comment Letter, *supra* note 45, at 10-11 (stating that mutual funds that could have liquidity challenges in difficult markets include those that invest not only in less liquid asset classes, but also those with larger investor concentrations, with fund flows particularly sensitive to changes in the returns of the markets in which they invest, that hold a large amount of a single issuance or a high percentage of its average daily trading volume, with meaningful use of effective leverage, and that invest in assets that do not have contractual settlement periods and tend to settle over longer periods than ordinary securities).

257 *See supra* text following note 100; *see also supra* note 104 (discussing Commission initiative to require large investment companies and investment advisers to engage in annual stress tests as required by section 165(i) of the Dodd-Frank Act); BlackRock FSOC Notice Comment Letter, *supra* note 50, at 6 (stating that among several overarching principles that provide the foundation for a prudent market liquidity risk management framework for collective investment vehicles is estimating "potential fund redemptions based on (a) historical behavior under normal as well as under adverse market conditions, and (b) monitoring investor profiles and related redemption behaviors to help identify potential liquidity needs, recognizing the differences between institutional and retail investors, large and small investors, categories of assets (e.g., retirement versus non-retirement assets), and the platforms on which funds are sold (e.g., self-directed versus through an intermediary"); AII FSOC Notice Comment Letter, *supra* note 50, at 15 ("investment advisers to mutual funds continually review a broad series of metrics to evaluate the current adequacy of the fund's liquidity position. These include historic data regarding redemption request levels, stressing the historic redemption levels, assessing levels of liquidity of categories of assets held by the fund based on industry standards, assessing current and expected market conditions of the types of asset held by the fund and then assessing liquidity in those various market conditions.").

funds, for example, may have little coordination between the compliance personnel who monitor the fund's adherence to the 15% guideline, and the portfolio and risk management personnel who assess the liquidity profile of portfolio assets. Staff outreach has shown that it is fairly common for a fund not to have adopted a specific liquidity risk management program, but instead to rely primarily on the portfolio management process to consider liquidity risk when making portfolio management decisions. While a fund's portfolio management function has access to a great deal of information relevant to the liquidity of the fund's portfolio assets, and thus pertinent to the fund's liquidity risk, portfolio managers may have competing interests that could potentially impede effective liquidity risk management. For example, depending on the circumstances, a fund's portfolio manager could be reluctant to invest a portion of the fund's assets in highly liquid assets, which may be appropriate for liquidity risk management purposes, but that the manager believes could cause a fund's performance to lag compared to similar funds or the fund's benchmark.[258] In sum, our staff has found that the comprehensiveness as well as the independence of funds' liquidity risk management vary significantly.

Because we are concerned with funds' ability to meet their redemption obligations and to mitigate shareholder dilution associated with redemptions, we are proposing new requirements for assessing and managing funds' liquidity risk. Proposed rule 22e-4(b)(2)(iii) would require a fund to assess and periodically review its liquidity risk, taking into account certain factors. Proposed rule 22e-4(b)(2)(iv) would require a fund to manage its liquidity risk based on this assessment, including: (i) requiring the fund to determine (and periodically review) a minimum

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258 *But see* Mikhail Simutin, *Cash Holdings and Mutual Fund Performance*, 18 REV. OF FIN. 1425 (2013) ("Simutin") ("Cash holdings of equity mutual funds impose a drag on fund performance but also allow managers to make quick investments in attractive stocks and satisfy outflows without costly fire sales. This article shows that actively managed equity funds with high abnormal cash—that is, with cash holdings in excess of the level predicted by fund attributes—outperform their low abnormal cash peers by over 2% per year.").

percentage of the fund's net assets that must be invested in three-day liquid assets (the fund's "three-day liquid asset minimum");[259] (ii) prohibiting a fund from acquiring any less liquid asset if the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets;[260] and (iii) prohibiting a fund from acquiring any 15% standard asset if the fund would have invested more than 15% of its net assets in 15% standard assets.[261]

We are proposing these new requirements with the goal of providing funds with the flexibility to adopt policies and procedures that would be most appropriate to assess and manage their liquidity risk, while at the same time reducing the risk that funds will be unable to meet redemption obligations, minimizing dilution, and elevating the overall quality of liquidity risk assessment and management across the fund industry. Given that a fund's liquidity risk arises from the interaction of multiple discrete and overlapping factors, we believe that the most effective liquidity risk management programs would be multi-faceted and customized to reflect the sources of the fund's liquidity risk. The requirements that we are proposing are therefore intended to be largely principles-based and would permit a fund to tailor its risk assessment and management procedures to respond to the fund's particular risks and circumstances. On the other hand, we also believe that requiring each fund to consider, as a baseline, a standard set of factors for assessing liquidity risk, requiring each fund to keep a minimum portion of net assets in cash and assets that the fund believes are convertible to cash within three business days without materially affecting the value of the asset (which minimum each fund would determine based on standard factors), and limiting a fund's holdings of 15% standard assets would create an

[259] Proposed rule 22e-4(b)(2)(iv)(A)-(B).

[260] Proposed rule 22e-4(b)(2)(iv)(C).

[261] Proposed rule 22e-4(b)(2)(iv)(D). In addition, proposed rule 22e-4(b)(2)(iv)(E) would require a fund to establish policies and procedures regarding redemptions in kind, to the extent that the fund engages in or reserves the right to engage in redemptions in kind.

overall framework that we believe would assist the development of effective and thorough liquidity risk assessment and management across the fund industry, thereby strengthening the ability of funds to meet redemption obligations and mitigating dilution of the interests of fund shareholders.

1. Assessing a Fund's Liquidity Risk

Proposed rule 22e-4 envisions a two-pronged liquidity risk assessment and risk management process, whereby a fund would be required to assess its liquidity risk, based on certain specified factors, and then develop a liquidity risk management program tailored to the fund's liquidity risk.[262] Here we discuss the liquidity risk assessment portion of this process. The requirements we are proposing for the fund's management of the risks identified by this assessment are discussed in a later section of the release.[263] Proposed rule 22e-4(b)(2)(iii) would require each fund to assess the fund's liquidity risk, considering certain specified factors that are discussed in more detail below. We compiled these factors based, in part, on staff outreach to funds and third-party service providers who assess liquidity risk on behalf of funds. To the extent that funds currently conduct liquidity stress tests, we understand that these stress tests commonly incorporate many of the proposed factors (or functionally similar factors).[264] The proposed liquidity risk factors also incorporate considerations that we believe have historically contributed to liquidity risk in open-end funds.[265]

262 To the extent that liquidity risk differs among each series of an investment company, each series would be required to adopt a liquidity risk management program whose liquidity risk assessment and management elements are distinct from other series' programs. *See supra* paragraph accompanying notes 114-115.

263 *See infra* sections III.C.3 – III.C.5.

264 *See supra* notes 101, 257 and accompanying text.

265 *See* Guidelines Release, *supra* note 4 (noting that funds should consider cash flows into specific investment strategies in determining whether the fund is maintaining an adequate level of liquidity).

The proposed rule would require each fund to take the following factors into account, as applicable, in assessing the fund's liquidity risk:

- Short-term and long-term cash flow projections, taking into account the following considerations:
  - Size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods;
  - The fund's redemption policies;
  - The fund's shareholder ownership concentration;
  - The fund's distribution channels; and
  - The degree of certainty associated with the fund's short-term and long-term cash flow projections
- The fund's investment strategy and liquidity of portfolio assets;
- Use of borrowings and derivatives for investment purposes; and
- Holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources.

This list is not meant to be exhaustive. In assessing its liquidity risk, a fund may take into account considerations in addition to the factors set forth in proposed rule 22e-4(b)(2)(iii). For example, if a fund elects to conduct stress testing[266] to determine whether it has sufficient liquid assets to cover different levels of redemptions, a fund should consider incorporating the results of this stress testing into its liquidity risk assessment. However, a fund would be required to consider, as applicable, the proposed rule 22e-4(b)(2)(iii) factors as a minimum set of considerations to be used in assessing its liquidity risk. For this reason, a fund that elects to conduct stress tests may wish to review the factors and parameters it uses to construct scenario analyses concerning the adequacy of the fund's portfolio liquidity, and update these factors and

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266 *See supra* notes 101, 257 and accompanying text.

parameters to reflect the proposed liquidity risk assessment factors. We believe that stress tests that incorporate the proposed factors, though not required, could be particularly useful to a fund in assessing its liquidity risk.

We recognize that some of the proposed factors may not be applicable in assessing the liquidity risk of certain funds or types of funds. For example, we recognize that certain considerations that the proposed rule would require a fund to consider in assessing its cash flow projections (*e.g.*, shareholder ownership concentration, and the fund's distribution channels) would generally be more applicable to mutual funds than to ETFs. To the extent that a proposed factor is not applicable to a particular fund, the fund would not be required to consider that factor in assessing its liquidity risk.

Below we provide guidance on specific issues associated with each of the proposed liquidity risk assessment factors. We also request comment below with respect to each of the proposed factors, as well as guidance regarding each factor.

a. Cash Flow Projections

A fund's cash flow (the amount of cash flowing either into or out of the fund) is important in determining whether the fund will have sufficient cash to satisfy redemption requests.[267] Cash flow projections thus directly affect a fund's liquidity risk.[268] As discussed below, we believe that several factors influence the extent to which a fund's cash flow profile

267 *See, e.g.*, Invesco FSOC Notice Comment Letter, *supra* note 35, at 11("Cash inflows from sources such as gross subscriptions (including reinvested dividends on fund shares), dividend and interest payments on portfolio securities and maturities of debt securities held in portfolios do help manage fund level liquidity and are taken into account by portfolio managers as part of their liquidity management."); ICI FSOC Notice Comment Letter, *supra* note 16, at 18 ("Managing liquidity as part of overall portfolio management is a dynamic process requiring fund managers to make daily adjustments to accommodate cash inflows and outflows. . . Portfolio managers and traders typically receive data on cash flows at least daily and thus have a strong sense of whether additional actions (including the sale of portfolio holdings) would be needed to meet redemption requests or otherwise adjust a fund's liquidity profile.").

268 Proposed rule 22e-4(a)(7).

could indicate or contribute to the fund's liquidity risk. Proposed rule 22e-4(b)(2)(iii)(A) thus would require a fund to consider these factors when evaluating its liquidity risk. In general, we believe that the better a fund's portfolio and risk managers are able to predict the fund's net flows, the better they will be able to measure and manage the fund's liquidity risk.[269] Predictability about whether periods of market stress or declines in fund performance generally lead to increased redemptions of fund shares is particularly significant, as careful liquidity risk management during these periods could prevent the need to sell less-liquid portfolio assets under unfavorable circumstances, which in turn could create significant negative price pressure on the assets and, to the extent the fund continues to hold a portion of those assets, decrease the value of the assets still held by the fund at least temporarily.[270]

A fund would be required to consider the size, frequency, and volatility of historical purchases and redemptions of fund shares, during both normal and stressed periods, when considering its cash flow projections.[271] A fund whose inflows generally correspond to its outflows in terms of timing, size, frequency, and response to market events will likely be able to use cash received from purchases to pay redeeming shareholders, which decreases the fund's

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269 *See, e.g.*, Gordon J. Alexander, Gjergi Cici & Scott Gibson, *Does Motivation Matter When Assessing Trade Performance? An Analysis of Mutual Funds*, 20 REV. OF FIN. STUD. 125 (Jan. 2007) (noting that unexpected investor flows may force managers to rebalance their portfolios to control liquidity, and that these liquidity-related trades should underperform trades motivated by valuation beliefs).

270 *See, e.g., supra* note 54 and accompanying paragraph; Coval & Stafford, *supra* note 51 (noting that fire sales can be anticipated based on past flows and returns); Peter Fortune, *Mutual Funds, Part I: Reshaping the American Financial System*, NEW ENGLAND ECON. REV. (July/Aug. 1997), at 66-67, ("Fortune"), *available at* http://www.bostonfed.org/economic/neer/neer1997/neer497d.htm (positing that funds with insufficient liquidity to meet redemption requests following a significant decline in stock prices will need to sell securities in a declining market, making the funds more sensitive to price fluctuations); 1987 Market Crash Report, *supra* note 54, at III-16 – III-26, IV-1 – IV-8 (discussing mutual fund selling behavior during the October 1987 stock market crash, and in particular the selling of three mutual fund companies, whose heavy selling of assets to meet significant redemptions "accounted for approximately one quarter of all trading on the NYSE for the first 30 minutes that the Exchange was open" on October 19, 1987 and that such selling had "a significant impact on the downward direction of the market").

271 Proposed rule 22e-4(b)(2)(iii)(A)*(1)*.

liquidity risk. Funds whose net flows are relatively less volatile in terms of size and frequency will likely entail less liquidity risk than similar funds with more volatile net flows, because funds with less flow volatility can better plan how to meet fund redemptions and thus will be less likely to need to sell portfolio assets in a manner that creates a market impact in order to pay redeeming shareholders.[272] A fund should generally review historical purchases and redemptions of fund shares across a variety of market conditions in order to determine how the fund's flows may differ during stressed and normal periods (keeping in mind that historical experience may not necessarily be indicative of future outcomes, depending on changes in market conditions and the fund's particular circumstances). In particular, if outflows are greater, more frequent, or more volatile during stressed periods, this could exacerbate the fund's liquidity risk.[273] A fund may find it instructive to understand when its highest, lowest, most frequent, and most volatile purchases and redemptions occurred within various time horizons, such as the past one, five, ten, and twenty years (as applicable, considering the fund's operating history). In addition to considering its own historical flow data, a fund, particularly a fund without a substantial operating history, may wish to consider purchase and redemption activity in funds with similar investment strategies. Consideration of similar funds' purchases and redemptions could show whether the fund's historical flows are typical or aberrant compared to those seen in similar funds and assist new funds in predicting flow patterns.

A fund may wish to evaluate whether the size, frequency, and volatility of its shareholder flows follow any discernable pattern. For example, patterns in shareholder flows have been

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[272] *See, e.g.*, Thomas M. Idzorek, James X. Xiong & Roger G. Ibbotson, *The Liquidity Style of Mutual Funds*, 68 FIN. ANALYSTS J. 38 (2012), at n.4, *available at* http://corporate.morningstar.com/us/documents/MethodologyDocuments/ResearchPapers/LiquidityStyleOfMutualFunds.pdf (noting that funds with less volatile fund flows can afford to hold more illiquid stocks because they can accommodate redemptions with the liquid portion of their portfolios).

[273] *See, e.g.*, *supra* note 270.

observed relating to seasonality,[274] shareholder tax considerations,[275] fund advertising,[276] and changes in fund performance ratings provided by third-party rating agencies.[277] A fund's investment strategy also could contribute to its shareholder flows: for instance, we understand that certain investors tend to trade in and out of ETFs with index-based strategies frequently because they invest in these ETFs for hedging and/or short-term trading purposes.[278]

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[274] *See, e.g.*, Mark J Kamstra, et al., *Seasonal Asset Allocation: Evidence from Mutual Fund Flows* (Dec. 2013), *available at* http://www.bus.umich.edu/ConferenceFiles/2014-Mitsui-Finance-Symposium/files/Kramer_Seasonal_Asset_Allocation.pdf ("[W]e find that aggregate investor flow data reveals a preference for U.S. money market and government bond mutual funds in the autumn, and equity funds in the spring, controlling for the influence of seasonality in past performance, advertising, liquidity needs, and capital gains overhang on fund flow. This movement of large amounts of money between fund categories is correlated with a proxy for variation in risk aversion across the seasons, consistent with households' revealed preferences for safer investments in the fall, and riskier investments in the spring."); Hyung-Suk Choi, *Seasonality in Mutual Fund Flows*, 31 J. OF APPLIED BUS. RESEARCH 715 (Mar./Apr. 2015), *available at* http://www.cluteinstitute.com/ojs/index.php/JABR/article/viewFile/9162/9156 ("January is the month when equity funds experience the largest net cash flows and December is the month with the smallest cash flows.").

[275] *See, e.g.*, Woodrow T. Johnson & James M. Poterba, *Taxes and Mutual Fund Inflows around Distribution Dates*, NBER Working Paper 13884 (Mar. 2006, rev'd Mar. 2008), *available at* http://economics.mit.edu/files/2512 ("Johnson & Poterba") (finding a "modest" decline in inflows into mutual funds by taxable investors prior to a capital gains distribution date); Brad M. Barger & Terrance Odean, *Are Individual Investors Tax Savvy? Evidence from Retail and Discount Brokerage Accounts*, 88 J. OF PUB. ECON. 419 (Jan. 2004), *available at* http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/areindividualinvestorstaxsavvy_2003.pdf (observing tax losses being related at greater rates than gains only in the month of December).

[276] *See, e.g.*, Murat Aydogdu & Jay W. Wellman, *The Effects of Advertising on Mutual Fund Flows: Results from a New Database*, FINANCIAL MANAGEMENT (Fall 2011), *available at* http://onlinelibrary.wiley.com/doi/10.1111/j.1755-053X.2011.01161.x/epdf (finding significant differences in the effectiveness of mutual fund advertising to attract inflows (*e.g.*, smaller funds received significant inflows due to advertising, while "flagship" funds did not attract inflows as a result of their advertisements)).

[277] *See, e.g.*, Diane Del Guercio & Paula A. Tkac, *Star Power: The Effect of Morningstar Ratings on Mutual Fund Flow*, 43 J. OF FIN. AND QUANTITATIVE ANALYSIS 907 (Dec. 2008), *available at* http://www.jstor.org/stable/27647379?seq=1#page_scan_tab_contents (finding that certain changes in performance ratings (rather than changes in the underlying fund performance) have a substantial influence on retail investors inflows into and outflows from mutual funds).

[278] *See, e.g.*, 2015 ICI Fact Book, *supra* note 3, at 13 ("Investment managers, including mutual funds and pension funds, use ETFs to manage liquidity—helping them manage their investor flows and remain fully invested in the market. Asset managers also use ETFs as part of their investment strategies, including as a hedge against their exposure to equity markets."); *see also* Izhak Ben-David, Francesco A. Franzoni & Rabih Moussawi, *Do ETFs Increase Volatility?*, NBER Working Paper No. 20071, at 12, *available at* http://www.nber.org/papers/w20071.pdf ("Theoretical support for this conjecture comes from Amihud and Mendelson (1986) and Constantinides (1986), who propose that investors with shorter holding periods self-

Furthermore, a fund may wish to take into account its assets in assessing historical flow data, since smaller funds may experience greater flow volatility.[279]

While historical redemption patterns are an important factor in assessing cash flows, a fund should be cognizant of the limitations of using past flow history to assess future cash flow needs. Therefore, a fund would be required to take into account other factors when considering cash flow projections, including its redemption policies.[280] Specifically, we believe a fund should generally consider the disclosures in its prospectus or advertising materials regarding the time period in which it will pay redemption proceeds (or endeavor to pay redemption proceeds),[281] and whether its redemption policies vary based on the distribution channels the fund employs. A fund whose policies require it to pay redeeming shareholders on a next-day basis could find itself with fewer options for managing high levels of redemptions than a fund that is bound only by the redemption timing requirements of rule 15c6-1. To illustrate, when a fund that pays redemption proceeds within one day receives a large redemption request and a fund that pays redemption proceeds within three business days pursuant to the timing requirements of rule 15c6-1 receives a redemption request of the same size, the first fund must satisfy the full request within one day, whereas the second fund has more time to space out the sale of portfolio assets in order to satisfy the redemption request. Even though the shareholder flows of the first

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select into assets with lower trading costs. Atkins and Dyl (1997) find support for this conjecture by showing that securities with lower bid-ask spread have higher trading volume. These theories and empirical evidence suggest that, due to the low trading costs of ETFs, a new clientele of high-frequency investors can materialize around the newly created securities. This clientele would not trade the less-liquid underlying assets if ETFs were not present.").

279 *See infra* notes 726 and 727.

280 Proposed rule 22e-4(b)(2)(iii)(A)*(2)*.

281 *See* Item 6(b) of Form N-1A (requiring a fund to briefly identify the procedures for redeeming shares); proposed amendments to Item 11 of Form N-1A (requiring funds to disclose the number of days in which a fund will pay redemption proceeds to redeeming shareholders, and explain if the number of days differs by distribution channel); *infra* section III.G.1.a (discussing proposed amendments to Item 11 of Form N-1A).

and second fund are identical, the redemption policies of the first fund magnify its liquidity risks by requiring that the fund pay redemptions quickly.[282] An ETF that typically pays redemption proceeds in kind should generally also consider that it has reserved the right to transact with authorized participants in cash, the circumstances in which it anticipates that it would pay redemption proceeds in cash, and how these policies impact its cash flow projections.

A mutual fund also would be required to consider its shareholder ownership concentration as a factor affecting its cash flow projections.[283] If a mutual fund's shares are concentrated in a relatively small group of shareholders, one shareholder's redemptions of fund shares could result in considerable cash outflows from the fund.[284] This in turn could increase the mutual fund's liquidity risk if the fund does not have procedures in place to manage large redemptions, particularly if the fund were to encounter unexpected redemptions from a large shareholder. For these reasons, we believe a mutual fund should consider the extent to which its shareholder concentration affects its liquidity risk, particularly taking into account other factors that could magnify shareholder concentration-related liquidity risk (*e.g.*, if a fund has an investment strategy that attracts shareholders who trade based on short-term price movements, shareholders could be more likely to redeem precipitously, and resulting unexpected redemptions by a shareholder with a large ownership stake could cause significant liquidity stresses to the fund).

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282 *See supra* note 270.

283 Proposed rule 22e-4(b)(2)(iii)(A)*(3)*.

284 We note that a relatively concentrated fund shareholder base may make it easier for funds to communicate with those shareholders about their anticipated future redemptions, and thus plan liquidity demands. However, those shareholders are under no legal obligation to forewarn the fund of their redemptions and so, particularly in times of stress, may not do so.

There are multiple ways that a mutual fund's distribution channels could affect its cash flows (including the predictability of the fund's cash flows), and the proposed rule would require a mutual fund to consider this factor in evaluating its cash flows and related liquidity risk.[285] First, a mutual fund's redemption practices could depend on its distribution channels. For example, mutual funds that are sold through broker-dealers will have to meet redemption requests within three business days, because rule 15c6-1 under the Exchange Act establishes a T+3 settlement period for securities trades effected by a broker or dealer. Second, to the extent that mutual fund shares are held through omnibus accounts, it could be difficult for a mutual fund to be fully aware of the composition of the underlying investor base,[286] including investor characteristics that could affect the mutual fund's short-term and long-term flows (*e.g.*, whether ownership in the mutual fund is relatively concentrated,[287] and whether the mutual fund's underlying investors share any common investment goals affecting redemption frequency and timing). Finally, a mutual fund's distribution channels could affect its cash flow predictions insofar as certain distribution channels are generally correlated with particular purchase and redemption patterns. For instance, investors in mutual funds distributed through a retirement plan channel or other planned savings channel (*e.g.*, funds underlying a 529 plan)[288] may be more likely to be long-term investors who do not trade based on short-term price movements, and their purchase and redemption patterns thus may be relatively predictable compared to those of other

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285 Proposed rule 22e-4(b)(2)(iii)(A)*(4)*.

286 *See, e.g.*, Board of the IOSCO, *Principles of Liquidity Risk Management for Collective Investment Schemes* (Mar. 2013), at 5, *available at* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD405.pdf ("The responsible entity should consider liquidity aspects related to its proposed distribution channels.").

287 *See supra* notes 283-284 and accompanying text.

288 A 529 plan is a tax-advantaged plan designed to encourage saving for future college costs that is sponsored by a state, state agency, or educational institution and is authorized by section 529 of the Internal Revenue Code.

investors. Investors in mutual funds distributed through certain channels also may have similar purchase and redemption characteristics relating to their financial and tax-related needs. For example, taxable investors who are considering purchasing mutual fund shares around capital gains distribution dates have an incentive to delay their purchases until after the distribution, but non-taxable shareholders (such as those who invest through IRAs and other tax-deferred accounts) face no such incentive for delaying purchases.[289]

Finally, a fund would be required to consider the degree of certainty surrounding its short-term and long-term cash flow projections.[290] A fund could consider the length of its operating history (including the fund's experience during points of market instability, illiquidity, or volatility), any observed purchase and redemption patterns, and the applicable other factors set forth in proposed rule 22e-4(b)(2)(iii)(A) in determining the level of certainty the fund has regarding its cash flows. A fund may find it instructive to employ ranges in considering cash flow projections and their relationship to liquidity risk. For instance, a fund that could reasonably project that its cash flows will fall within a relatively narrow range could more precisely assess its liquidity risk than a fund that could reasonably project a broader range of projected cash flows. If a fund has implemented policies to encourage certain shareholders (*e.g.*, large shareholders, or certain types of shareholders such as institutional shareholders) to provide advance notification of their intent to redeem a significant number of shares of the fund, this could increase the degree of certainty surrounding its cash flow projections.[291]

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289 *See* Johnson & Poterba, *supra* note 275; *see also supra* note 274 and accompanying text (discussing seasonality in mutual fund flows).

290 Proposed rule 22e-4(b)(2)(iii)(A)*(5)*.

291 We understand, based on staff outreach, that advance notification procedures are a relatively common liquidity risk management tool that funds currently employ. *See also* Invesco FSOC Notice Comment Letter, *supra* note 35, at 11 (noting that Invesco has advance notification arrangements regarding anticipated redemptions above certain levels in place with certain distribution partners).

b. Investment Strategy and Liquidity of Portfolio Assets

Under proposed rule 22e-4, a fund's procedures for assessing its liquidity risk must take into account the effects that the fund's investment strategy and the liquidity of its portfolio assets could have on the fund's liquidity risk.[292] A fund's investment strategy could increase or decrease the fund's liquidity risk in various ways. For example, whether a fund is actively or passively managed could have ramifications on the fund's liquidity. On one hand, a fund with a passive investment strategy could have less liquidity risk relative to an actively managed fund that invests in a similar portfolio, to the extent that the portfolio of the passively managed fund is built around a widely followed market index (securities that are components of such an index are generally more liquid than securities that are not).[293] An index-tracking fund also may be more likely to sell a "strip" of the portfolio (*i.e.*, a cross-section or representative selection of the fund's portfolio assets) to meet net redemptions, which minimizes the outcome that the fund would sell its most liquid assets first, in order to continue to closely track the applicable benchmark. On the other hand, index-based strategies could exhibit increased liquidity risk during periods when an index is being reconstituted, if the index reconstitution results in multiple funds simultaneously attempting to get into or out of the same portfolio position.[294] Index-based strategies also could experience increased liquidity risk when the assets in the index become less liquid due to market events, because the fund's manager will have less discretion to move the

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292 Proposed rule 22e-4(b)(2)(iii)(B).

293 *See supra* paragraph accompanying notes 215-216.

294 *See, e.g.*, Antti Petajisto, *The Index Premium and Its Hidden Cost for Index Funds*, 18 J. OF EMPIRICAL FIN. 271, 288 (2011), *available at* http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.372.3301&rep=rep1&type=pdf ("The annual index turnover cost from 1990 to 2005 is about 21-28 bp for the S&P 500 and 38-77 bp for the Russell 2000. This is the cost of mechanically tracking the index rather than holding an essentially similar index-neutral portfolio.").

fund's strategy away from the index's assets. In addition, index-based strategies that track less-liquid market indices may exhibit more liquidity risk than passively managed funds built around widely-followed market indices.[295]

The extent to which a fund's portfolio is diversified (or, relatedly, a fund's concentration in certain types of portfolio assets) could have ramifications on the fund's potential liquidity risk as well. A fund's status as a diversified investment company under the Investment Company Act,[296] its status as a regulated investment company under Subchapter M of the Internal Revenue Code,[297] and its principal investment strategies as disclosed in its prospectus all could affect the fund's liquidity risk.[298] For example, a fund constrained by various diversification requirements that needs to sell portfolio securities in order to meet redemption requests could be limited by its diversification obligations in determining which portfolio securities it will sell. Such a fund might need to unwind certain portfolio positions under unfavorable circumstances. A fund whose investment strategy requires it to invest a certain percentage of its assets in a particular asset class, industry segment, or securities associated with a particular geographic region could encounter similar limitations, if selling certain portfolio securities would cause the fund to not be in compliance with its investment strategies. On the other hand, a fund with a relatively more-diversified portfolio needing to sell portfolio assets to build liquidity would possibly be able to select assets for sale based on whether the markets for those assets are favorable. A relatively less-diversified fund may have fewer options (*i.e.*, because the markets for its portfolio

295 *See also* Jonathan Wheatley & Joel Lewin, *Emerging Market ETFs: Solving the Liquidity Problem or Storing it Up?*, FINANCIAL TIMES (Apr. 20, 2015), *available at* http://www.ft.com/cms/s/0/43c52f1e-e75e-11e4-a01c-00144feab7de.html (discussing ETFs built around emerging market corporate bond indexes).

296 *See* section 5(b)(1) of the Investment Company Act.

297 26 U.S.C. 851. To qualify as a regulated investment company, a fund must meet several diversification requirements at the close of each fiscal quarter of the taxable year. *See id.*

298 *See* Items 4(a), 9 of Form N-1A.

assets are uniform or correlated) and could thus be compelled to transact in unfavorable markets. Such fund also may need to trade larger dollar amounts of each asset, which may increase the price impact of the trades.

In addition to diversification or concentration issues, a fund's portfolio management decisions that are meant, in part, to decrease an undesirable tax impact on the fund could affect the fund's liquidity risk. For example, a fund whose portfolio includes foreign securities might manage its portfolio to avoid securities transaction taxes imposed by other jurisdictions.[299] Similarly, a fund could be managed using an active tax loss harvesting strategy to opportunistically realize losses that may be used to offset future gains.[300] The sale of certain portfolio assets to meet liquidity needs might adversely affect these, and comparable, management practices. Consequently, a fund whose tax management strategy makes its portfolio managers unwilling to sell certain portfolio assets in order to meet redemptions could face increased liquidity risk compared to a similarly situated fund, because it could have fewer desirable options to generate cash to pay redemptions (and thus could have increased risk that it would need to sell portfolio assets under unfavorable circumstances in order to meet redemptions) than another, similar fund.

While we believe consideration of a fund's investment strategy is an important factor in assessing a fund's liquidity risk, we caution that different types of funds within the same broad investment strategy may demonstrate different levels of liquidity (and thus, presumably, different

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299 *See, e.g.*, Karl Habermeier & Andrei Kirilenko, *Securities Transaction Taxes and Financial Markets*, IMF Working Paper (May 2001), *available at* http://www.imf.org/external/pubs/ft/wp/2001/wp0151.pdf (discussing, among other things, the effects of transaction taxes on liquidity).

300 *See, e.g.*, Scott J. Donaldson & Francis M. Kinniry Jr., *Tax-Efficient Equity Investing: Solutions for Maximizing After-Tax Returns*, Vanguard Investment Counseling & Research (2008), *available at* https://personal.vanguard.com/pdf/flgtei.pdf.

levels of liquidity risk).[301] The liquidity of a fund's portfolio assets directly affects the amount of liquidity risk associated with the fund. A fund should consider the portions of the fund's net assets that are invested in each of the six liquidity categories set forth in proposed rule 22e-4(b)(2)(i). All else being equal, funds with relatively greater portions of their assets invested in less liquid assets would tend to have greater liquidity risk than funds holding relatively fewer less liquid assets.

c. Use of Borrowings and Derivatives for Investment Purposes

Proposed rule 22e-4 would require a fund to take into account the potential effects of the use of borrowings and derivatives for investment purposes (for example, to enhance returns) on its liquidity risk.[302] Funds may borrow from a bank under section 18 of the Investment Company Act. In addition to the asset coverage limitations imposed by section 18,[303] any such borrowing would be subject to the terms agreed between a fund and the bank, including terms relating to the maturity date of the borrowing and any circumstances under which the borrowing may be required to be repaid. In addition, as noted above, funds that borrow for investment purposes, for example through financing transactions such as reverse repurchase agreements and short sales, generally do so in reliance on the guidance we provided in Release 10666, under which funds cover their obligations under such transactions by segregating certain liquid assets.[304] Segregated assets are considered to be unavailable for sale or disposition, including for redemptions, unless

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301 *See infra* note 627 and accompanying text.

302 Proposed rule 22e-4(b)(2)(iii)(C). Although the use of borrowings and derivatives is a distinct factor under proposed rule 22e-4(b)(2)(iii), a fund should also consider the potential impact of borrowings and derivatives in its assessment of other factors set forth in proposed rule 22e-4(b)(2)(iii), such as the fund's cash flow projections and its investment strategy and liquidity of portfolio assets.

303 *See infra* note 321.

304 *See supra* section III.B.2.i.

replaced by other appropriate non-segregated assets of equal value.[305] This means that a fund that receives significant redemption requests may need to unwind a portion of its financing transactions in order make more liquid assets available for sale to fulfill such requests. Furthermore, if a fund seeks to unwind its financing transactions in a declining market, it may need to dispose of a greater amount of its more liquid holdings in order to repay its borrowings, thereby reducing the amount of liquid assets it has available to meet redemptions. Consequently, a fund's assessment of its liquidity risk should include an evaluation of the nature and extent of its borrowings and the potential impact of borrowings on the fund's overall liquidity profile.

The use of derivatives, such as futures, forwards, swaps and written options, may also affect a fund's liquidity risk. Funds use derivatives for a wide range of purposes, including hedging or risk mitigation, but also to obtain leverage or investment exposures.[306] As noted above, funds that use derivatives under which they have an obligation to pay typically do so in reliance on the guidance we provided in Release 10666 and in related no-action letters issued by our staff, and therefore segregate liquid assets in respect of their obligations under derivatives transactions.[307] Derivatives may therefore raise concerns that are similar to those discussed above in the context of borrowings. Funds also may be required to dispose of assets in order to post required margins with respect to their short sale transactions. In addition, some derivatives transactions – particularly those that are complex or entered into OTC – may be less liquid, have longer settlement periods, or be more difficult to price than other types of investments, which potentially increases the amount of time required to unwind such transactions.

305 *See* Release 10666, *supra* note 241.

306 *See generally* Investment Company Derivatives Use Concept Release, *supra* note 242, at 13-17.

307 *See supra* section III.B.2.i.

Even highly liquid derivatives may present liquidity risk for some funds. For example, some funds use derivatives for cash and liquidity management purposes. A large-cap equity fund with a temporary cash position may purchase equity index futures that have lower transaction costs, shorter settlement periods and greater liquidity than a direct investment in equity securities, in order to obtain a degree of exposure to large-cap equities. While "equitizing" its temporary cash position in this manner may mitigate the potential performance lag associated with a cash holding, it also exposes the fund to market risk.[308] Accordingly, a fund's assessment of liquidity risk should take into account the manner and extent of its derivatives use and the structure and terms of its derivatives transactions.

In addition to the liquidity of the derivatives positions themselves, assessing liquidity risk generally may include an evaluation of the potential liquidity demands that may be imposed on the fund in connection with its use of derivatives, including any variation margin or collateral calls the fund may be required to meet.[309] To the extent the fund is required to make payments to a derivatives counterparty, those assets would not be available to meet shareholder redemptions.

d. Holdings of Cash and Cash Equivalents, As Well As Borrowing Arrangements and Other Funding Sources

Proposed rule 22e-4 would require a fund to consider its cash and cash equivalent holdings, as well as its borrowing arrangements and other funding sources, in assessing its liquidity risk.[310] Current U.S. generally accepted accounting principles define cash equivalents

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308 Investment Company Derivatives Use Concept Release, *supra* note 242, at n.46 and accompanying text.

309 *See* In re OppenheimerFunds, Inc., et al., Investment Company Act Release No. 30099 (June 6, 2012) ("OppenheimerFunds Release") (settled action) (alleging the adviser made misleading statements regarding two fixed income mutual funds that suffered significant losses during the 2008 financial crisis primarily due to their use of total return swaps to obtain exposure to commercial mortgage-backed securities and noting that the funds "had to raise cash for anticipated [total return swap] contract payments by selling depressed bonds into an increasingly illiquid market.").

310 Proposed rule 22e-4(b)(2)(iii)(D).

as short-term, highly liquid investments that are readily convertible to known amounts of cash and that are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.[311] Examples of items commonly considered to be cash equivalents include certain Treasury bills, agency securities, bank deposits, commercial paper, and shares of money market funds.[312] Cash and cash equivalents are extremely liquid (in that they either are cash, or could be easily and nearly immediately converted to known amounts of cash without a loss in value), and significant holdings of these instruments generally decrease a fund's liquidity risk because the fund could use them to meet redemption requests without materially affecting the fund's NAV.[313]

Entering into borrowing arrangements and agreements with other potential funding sources also could affect a fund's liquidity risk, as they could assist the fund in paying redeeming shareholders without the need to sell portfolio securities under circumstances that could impair the fund's NAV.[314] For example, in the past several decades, it has become increasingly common for fixed income funds to establish lines of credit with commercial banks.[315] When

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311 FASB Accounting Standards Codification paragraph 305-10-201.

312 *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at sections III.A.7 and III.B.6 (clarifying that the reforms to the regulation of money market funds adopted by the Commission in 2014 should not preclude an investment in a money market fund from being classified as a cash equivalent under U.S. GAAP under normal circumstances); Form PF: Glossary of Terms (defining "cash and cash equivalents").

313 However, a substantial investment in cash and cash equivalents could decrease a fund's total return and/or cause a fund to diverge from its investment strategy, and thus a fund may wish to calibrate its holdings of these instruments to manage the fund's liquidity risk while taking these concerns into consideration. *But see* Simutin, *supra* note 258(observing that actively managed equity funds with cash holdings in excess of the level predicted by fund attributes outperform their low abnormal cash peers by over 2% per year).

314 *See supra* note 35 (noting that most funds do not frequently draw on their lines of credit).

315 *See, e.g.*, Miles Weiss, *BlackRock Leads Funds Raising Credit Lines Amid Review*, BLOOMBERG (Jan. 21, 2015), *available at* http://www.bloomberg.com/news/articles/2015-01-21/blackrock-leads-funds-raising-credit-lines-amid-review (discussing an uptick in demand by funds for bank lines of credit); *see also* Fortune, *supra* note 270, at 64 (noting that lines of credit with banks were rarely available to funds prior to the mid-1980s); *infra* section III.C.5.a (Commission guidance on use of borrowing arrangements and other funding sources as a liquidity risk management control).

considering the extent to which a bank credit facility could affect a fund's liquidity risk, we believe a fund may find it instructive to evaluate the terms of the credit facility (*e.g.*, associated fees, the borrowing rate, and the time frame for repaying borrowed funds), the amount of the credit facility, whether the credit facility is committed or uncommitted,[316] and the financial health of the institution(s) providing the facility (especially to the extent that the fund also holds bonds or other securities issued by such institution(s), as a decrease in these securities' liquidity—caused, for example, by increased volatility of their trading prices—could contribute to an increased need to borrow from the institution). If a credit facility is shared among multiple funds within a fund family, a fund may wish to consider that the ability of that facility to mitigate the liquidity risk of one fund within the family hinges in part on the degree of liquidity risk associated with the other funds sharing the facility. A fund also may wish to consider any negative impact on the fund resulting from borrowing funds for liquidity risk management purposes, as opposed to managing liquidity through the fund's portfolio construction. For example, borrowing funds to pay redeeming shareholders (for example, to avoid making sales of assets into distressed markets) could be beneficial to redeeming shareholders but could ultimately disadvantage non-redeeming shareholders who would effectively bear the costs of borrowing.[317] In assessing the effects of the fund's borrowing arrangements on the fund's liquidity risk, a fund may find it useful to assess the purposes for which the fund has historically borrowed funds to pay redemption proceeds. Finally, if a fund holds bonds or other securities

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316 A committed line of credit represents a bank's obligation, in exchange for a fee, to make a loan to a fund subject to specified conditions. A bank can also provide an uncommitted or standby line of credit, in which the bank indicates a willingness, but no obligation, to lend to a fund. *See* Fortune, *supra* note 270, at 47.

317 *See* Heartland Release, *supra* note 47.

issued by a bank, the fund may wish to consider whether entering into a borrowing arrangement with the same bank that issued such securities increases correlated exposure to the bank.

A fund also could engage in interfund lending within a family of funds if the fund has obtained exemptive relief from the Commission permitting the arrangement.[318] When considering the extent to which an interfund lending arrangement could affect a fund's liquidity risk, we believe a fund may find it instructive to evaluate the terms of the arrangement (*e.g.*, the lending rate and the time frame for repaying borrowed funds), as well as any conditions required under exemptive relief, including limitations on the circumstances in which interfund lending may be used. For example, it is common for exemptive orders to permit interfund lending in circumstances in which there is a timing mismatch between when a fund is required to pay redeeming shareholders and when any asset sales that the fund has executed in order to pay redemptions will settle (*e.g.*, a fund may be required to pay redeeming shareholders within three business days, but the portfolio transactions the fund has executed in order to pay these shareholders may not settle for seven days). A fund can reasonably predict that it will repay borrowed money relatively quickly and reliably under these circumstances. Therefore this type of borrowing would tend to be very low risk, and thus entail less liquidity risk,[319] than borrowing money to pay redemptions without already having secured a price at which the assets used to cover the borrowing will be sold.

Finally, a fund could generate liquidity through repurchase transactions, whereby the fund could agree to sell securities to another party at a specified price with a commitment to buy the securities back at a later date for another specified price. A repurchase agreement is

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318 *See infra* note 320 and accompanying and following text.

319 *See supra* section III.C.1.c (discussing circumstances in which a fund's use of leverage and derivatives could increase the fund's liquidity risk).

structurally similar to a short-term loan, and thus a fund could use repurchase agreements to temporarily borrow cash to repay redeeming shareholders. A fund may find it instructive to consider how factors such as market conditions, supply and demand factors, whether the repurchase agreement is on a bilateral or tri-party basis, and counterparty credit risk could affect the ability of repurchase transactions to mitigate liquidity risk.

A fund's borrowing and other funding arrangements are subject to restrictions on affiliated transactions and leverage under the Investment Company Act and rules under the Act. For example, funds must obtain exemptive relief from the Commission before executing transactions that implicate section 17 of the Investment Company Act, which restricts transactions between an "affiliated person of a registered investment company or an affiliated person of such affiliated person" and that investment company.[320] Thus, as noted above, a fund must obtain exemptive relief before executing interfund lending arrangements. Additionally, funds' borrowing arrangements must be conducted in compliance with section 18 of the Investment Company Act, which limits a fund's ability to issue or sell "senior securities." For instance, section 18(f) of the Investment Company Act limits funds to bank borrowing with 300% asset coverage.[321] The Commission and its staff have also taken the position that reverse

[320] *See* Investment Company Act sections 17(a) (prohibiting first- and second-tier affiliates of a fund from borrowing money or other property from, or selling or buying securities or other property to or from the fund, or any company that the fund controls; 17(b) (permitting the Commission to grant an exemptive order permitting transactions that would otherwise be prohibited under section 17(a) if certain conditions of fairness are met); *see also* Investment Company Act section 17(d) (making it unlawful for first- and second-tier affiliates of a fund, the fund's principal underwriters, and affiliated persons of the fund's principal underwriters, acting as principal, to effect any transaction in which the fund or a company controlled by the fund is a joint or a joint and several participant in contravention of Commission rules); rule 17d-1(a) under the Investment Company Act (prohibiting first- and second-tier affiliates of a fund, the fund's principal underwriters, and affiliated persons of the fund's principal underwriters, acting as principal, from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which any such fund or company controlled by a fund is a participant unless an application regarding such enterprise, arrangement or plan has been filed with the Commission and has been granted).

[321] *See* Investment Company Act section 18(f) (prohibiting an open-end fund from issuing any senior security,

repurchase agreements may involve the issuance of a senior security subject to the requirements of section 18 and, under certain circumstances, a fund could need to "cover" the senior security by maintaining "segregated accounts."[322] These statutory and regulatory restrictions could constrain a fund's ability to use borrowing and other funding sources to meet redemption requests, and these limitations should be considered in assessing a fund's liquidity risk.

e. Request for Comment

We request comment on the proposed liquidity risk assessment requirement.

- Do commenters believe that the definition of "liquidity risk" in proposed rule 22e-4 is appropriate? Within the proposed definition, are the terms "reasonably foreseeable" and "without materially affecting the fund's NAV" clear? If not, how could the definition of "liquidity risk," and terms within the proposed definition, be made more appropriate and/or clear?
- How do funds currently assess their liquidity risk? Who at the fund and/or the adviser is tasked with assessing the fund's liquidity risk? Who should be tasked with assessing the fund's liquidity risk? Should the proposed rule specify the officers or functional areas that should be tasked with assessing a fund's liquidity risk?

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except that a fund may borrow from any bank so long as immediately after the borrowing there is asset coverage of at least 300% for all borrowings of the fund).

322 *See, e.g.*, Release 10666 *supra* note 241. In Release 10666, the Commission considered the application of section 18's restrictions on the issuance of senior securities to reverse repurchase agreements (among other types of agreements). The Commission concluded that such agreements may involve the issuance of senior securities subject to the prohibitions and asset coverage requirements of section 18. The Commission further stated that, although reverse repurchase agreements (among other types of agreements) are functionally equivalent to senior securities, these and similar arrangements nonetheless could be used by funds in a manner that would not warrant application of the section 18 restrictions. The Commission noted that in circumstances involving similar economic effects, such as short sales of securities by funds, Commission staff had determined that the issue of section 18 compliance would not be raised if funds "cover" senior securities by maintaining "segregated accounts." The Commission also discussed the specific attributes of segregated accounts, board obligations, and other related matters in Release 10666.

We also request comment on each of the proposed factors that each fund would be required to consider in assessing its liquidity risk.

- What factors do funds currently use to assess their liquidity risk, and do the proposed factors reflect factors that funds (and/or the adviser, as applicable) already consider when evaluating liquidity risk? Should any of the proposed factors not be required to be considered by a fund in assessing its liquidity risk? Should any of the proposed factors be modified? Are there any additional factors, besides the proposed factors, that a fund should be required to consider in assessing liquidity risk? Should any of the proposed factors be given additional weight and, if so, under what circumstances?
- Instead of codifying the proposed factors as part of proposed rule 22e-4, should we provide guidance on factors that might be appropriate for a fund to consider in assessing its liquidity risk?

We seek comment on the Commission's guidance discussed above regarding each of the proposed factors.

- Besides the guidance, are there any other specific issues associated with any of the proposed factors that a fund may wish to consider in assessing the fund's liquidity risk? Do commenters generally agree with the guidance that the Commission has proposed regarding the ways in which each of the proposed factors could contribute to a fund's liquidity risk? Should the staff provide additional guidance about the factors? Should we add a note to rule 22e-4 indicating that the release includes additional guidance regarding the proposed factors?

- Are there any factors or procedures that would be of particular use to a fund without a substantial operating history in assessing liquidity risk? Would a new fund look to purchase and redemption activity in similar funds to predict its flow patterns?

2. *Periodic Review of a Fund's Liquidity Risk*

a. Proposed Liquidity Risk Review Requirement

Proposed rule 22e-4(b)(2)(iii) would require a fund to periodically review the fund's liquidity risk, taking into account each of the factors of proposed rule 22e-4(b)(2)(iii)(A)-(D) (discussed above in sections III.C.1.a – III.C.1.d). We believe that the periodic review of a fund's liquidity risk is necessary to determine whether, in light of current circumstances, an adequate level of liquidity is being maintained. Like the proposed requirement to monitor the liquidity of portfolio assets,[323] the proposed liquidity risk review requirement would permit each fund to develop and adopt effective and individualized procedures to review the fund's liquidity risk, tailored as appropriate to reflect the fund's particular facts and circumstances. A fund would be required to consider each of the proposed rule 22e-4(b)(2)(iii)(A)-(D) factors in reviewing its liquidity risk. However, beyond this, rule 22e-4 does not include prescribed review procedures, nor does it specify the required risk review period or incorporate specific developments that a fund should consider as part of its review. A fund might generally consider whether its periodic review procedures should include procedures for evaluating regulatory, market-wide, and fund-specific developments affecting each of the proposed rule 22e-4(b)(2)(iii) risk factors. Because a fund's liquidity risk is directly related to the liquidity of the fund's portfolio assets (as reflected by proposed rule 22e-4(b)(2)(iii)(B), which requires consideration of the liquidity of a fund's portfolio assets as an element of the fund's liquidity risk assessment),

[323] *See* proposed rule 22e-4(b)(2)(i).

a fund may wish to adopt liquidity risk review procedures that reference the fund's procedures for monitoring portfolio assets' liquidity. For example, a fund's liquidity risk review procedures could specify that certain circumstances giving rise to a revision of a portfolio asset's liquidity classification[324] could necessitate a review of the fund's liquidity risk.

b. Request for Comment

We request comment on the proposed liquidity risk review requirement.

- How do funds currently review liquidity risk? How often do funds currently review this risk? To what extent do funds anticipate that the periodic review procedures that would be required under proposed rule 22e-4 would replicate procedures funds currently use to periodically evaluate liquidity risks facing the fund?
- Are there certain review procedures that the Commission should require and/or on which the Commission should provide guidance? Should the Commission specify how frequently a fund must review its liquidity risk? Should funds review liquidity risk at least as frequently as they conduct ongoing liquidity reviews? Should the Commission expand its guidance on regulatory, market-wide, and fund-specific developments that a fund's review procedures should cover?

3. Portfolio Liquidity: Minimum Investments in Three-Day Liquid Assets

a. Proposed Three-Day Liquid Asset Minimum Requirement

Proposed rule 22e-4(b)(2)(iv)(A) would require each fund to determine the fund's "three-day liquid asset minimum" as part of its liquidity risk management program.[325] As

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324 *See, e.g., supra* paragraph accompanying notes 251-254.

325 Under proposed rule 22e-4(b)(2)(iv)(C), a fund would be prohibited from acquiring any less liquid asset if, immediately after the acquisition, the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets.

proposed, the fund's three-day liquid asset minimum would be defined as the percentage of the fund's net assets to be invested in three-day liquid assets.[326] In determining its three-day liquid asset minimum, a fund would be required to consider the factors a fund would be required to consider in assessing its liquidity risk under proposed rule 22e-4(b)(2)(iii).[327] These factors include an assessment of short-term and long-term cash flow projections, taking into account certain specified considerations discussed further below; the investment strategy and liquidity of the fund's portfolio assets; the use of borrowings and derivatives for investment purposes (for example, to enhance returns),[328] and holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources. These factors are based, in part, on staff outreach to funds and third-party service providers that assess liquidity risk on behalf of funds, and they also incorporate considerations that we believe have historically contributed to liquidity risk in open-end funds.[329]

A fund's board would be required to approve the fund's three-day liquid asset minimum (including any changes to the fund's three-day liquid asset minimum),[330] and a fund would be required to maintain a written record of how the fund's three-day liquid asset minimum was determined (including an assessment of each of the factors proposed rule 22e-4 would require a fund to assess in making this determination).[331]

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326 We propose to define three-day liquid asset as any cash held by a fund and any position of a fund in an asset (or portion of the fund's position in an asset) that the fund believes is convertible into cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale. *See* proposed rule 22e-4(a)(8).

327 *See* proposed rule 22e-4(b)(2)(iv)(A).

328 *See* Investment Company Names Rule Release, *supra* note 36, at n.36 ("Whether a particular transaction is considered borrowing for investment purposes would depend on all facts and circumstances.").

329 *See supra* section III.C.1.

330 *See* proposed rule 22e-4(b)(3)(i).

331 *See* proposed rule 22e-4(c)(3) (each fund must maintain a written record of how the three-day liquid asset

We are proposing the requirement for each fund to determine a three-day liquid asset minimum to increase the likelihood that the fund will hold adequate liquid assets to meet redemption requests without materially affecting the fund's NAV. Although the Commission has stated that open-end funds have a general responsibility to maintain an appropriate level of portfolio liquidity, no requirements under the federal securities laws or Commission rules specifically oblige open-end funds (with the exception of money market funds) to maintain a minimum level of portfolio liquidity.[332] We believe that codifying a three-day liquid asset minimum requirement would result in a portfolio liquidity standard that fosters consistency in funds' consideration of the factors relevant to their liquidity risk management, while simultaneously permitting flexibility in implementation, which we believe is appropriate in light of the significant diversity of holdings and strategies within the fund industry.

We believe setting the minimum amount of liquid assets in the fund based on three-day liquid assets is appropriate for a number of reasons. Most funds sell at least some of their shares through broker-dealers, and thus, as a practical matter, are required as a result of rule 15c6-1 under the Exchange Act to meet redemptions within three business days.[333] While some mutual funds disclose in their prospectuses that they will generally pay redemption proceeds on a next-business day basis and many others do so as a matter of practice,[334] we are not proposing that

minimum, and any adjustments thereto, were determined, including assessment of the factors specified in proposed rule 22e-4(b)(2)(iii)(A)-(D), for a period of not less than five years (the first two years in an easily accessible place) following the determination of and each change to the three-day liquid asset minimum).

332 *See supra* section II.D.1.

333 *See, e.g.,* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 6 ("As a practical matter, three-day settlement requirements under Exchange Act Rule 15c6-1...effectively take most fund investments to a T+3 settlement timeline.").

334 *See id.* at 6 ("mutual funds normally process redemption requests by the next business day"); *see also* ICI FSOC Notice Comment Letter, *supra* note 16, at 17 ("For example, a mutual fund has by law up to seven days to pay proceeds to redeeming investors, although as a matter of practice funds typically pay proceeds within one to two days of a redemption request.").

funds maintain a minimum amount of assets that may be converted to cash within one day, given the impact such a minimum could have on investment strategies. Staff outreach has shown that, for the funds that typically do target a minimum amount of liquidity in the fund, they typically target either cash and cash equivalents or assets similar to our definition of three-day liquid assets. Accordingly, targeting such a minimum appears to be a common practice for those funds that do establish a target.

Consistent with the time period referenced in section 22(e) of the Act, we considered requiring that a fund determine a minimum amount of liquid assets based on assets convertible to cash within seven calendar days at a price that does not materially affect the value of that asset immediately prior to sale ("seven-day liquid assets"). Determining a minimum amount of seven-day liquid assets would require that a fund have a certain amount of liquidity to meet redemptions within the seven-day period required under the Act. However, we were concerned that requiring a minimum amount of seven-day liquid assets would not as well match regulatory requirements and disclosures that require most funds to meet redemption requests in shorter time periods and market practices and investor expectations that effectively require all funds to meet redemption requests in shorter time periods. We thus believe that a three-day liquid asset minimum more effectively advances our goals of reducing the risk that funds will be unable to meet redemptions and mitigating dilution.

We anticipate that the proposed requirement for a fund to consider certain factors, including the factors required in assessing the fund's liquidity risk, in determining its three-day liquid asset minimum would promote investor protection by reducing the risk funds will be unable to meet their redemption obligations, mitigating dilution, and elevating the overall quality of liquidity risk management across the fund industry. The consideration of certain factors also would require every fund to consider multiple aspects of its history, policies, strategy, and operations that could give rise to liquidity risk.

When determining its three-day liquid asset minimum, a fund must consider short-term and long-term cash flow projections, taking into account the following factors, which we discussed previously in connection with the assessment of a fund's liquidity risk:[335]

- the size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods;
- the fund's redemption policies;
- the fund's shareholder ownership concentration;
- the fund's distribution channels; and
- the degree of certainty associated with the fund's short-term and long-term cash flow projections.[336]

We believe consideration of cash flow projections is pivotal to setting an appropriate three-day liquid asset minimum. The primary goal of a minimum level of liquidity is to ensure that each fund is able to meet redemptions and to do so with minimal dilution of shareholders' interests. Doing so requires that the fund's adviser, to the best of its ability, understands potential levels of net redemptions and the causes and timing of those redemptions. To adequately make such projections, we believe a fund must consider the sub-factors described above. For example, it would be important to understand not just the magnitude of redemptions the fund tends to receive, but also how frequent redemptions of various sizes are and how volatile the fund's flows are. It also may be important to understand how the fund's redemption

335 *See supra* section III.C.1.a.

336 *See* proposed rule 22e-4(b)(2)(iii)(A).

activity compares to funds with similar investment strategies, for example, to understand whether the fund may have unique liquidity risks (or lack liquidity risks) that may make past redemption experiences less predictive of future redemption risk. It would be essential that the fund formulate its cash flow projections after considering the factors in both normal and stressed periods—minimum liquidity would not likely advance the Commission's goal of reducing the risk that funds will be unable to meet redemptions and mitigating dilution if funds can only meet redemptions in stressed conditions through sales of portfolio assets that create dilution and significantly increase the fund's liquidity risk. In addition, a fund, though not required to do so, may wish to consider employing some form of stress testing[337] or consider specific historical redemption scenarios in determining its three-day liquid asset minimum.

In formulating the fund's cash flow projections, a fund also must consider the fund's redemption policies, shareholder ownership concentration, and distribution channels. These are important structural features of a fund that can materially affect the risk of significant redemptions—and thus may cause a fund to set a higher three-day liquid asset minimum than one based on its redemption history alone. For example, a fund with a concentrated shareholder base has a high risk that only one or two shareholders deciding to redeem can cause the fund to sell a significant amount of assets, which depending on the liquidity of the fund's portfolio and how it meets those redemptions, can dilute remaining shareholders. Similarly, a fund whose redemption policy is to satisfy all redemptions on a next business day basis (T+1) or that is sold through distribution channels that historically attract investors with more volatile and/or unpredictable flows also should consider setting a higher three-day liquid asset minimum than a

337 *See supra* text following note 100; *see also supra* note 104 (discussing Commission initiative to require large investment companies and investment advisers to engage in annual stress tests as required by section 165(i) of the Dodd-Frank Act).

fund that—all else equal—does not face these risks. Finally, in setting a three-day liquid asset minimum it is critical that a fund consider the degree of certainty associated with the fund's short-term and long-term cash flow projections. Projections may only be as good as the extent and quality of information that informs them. For example, if a fund does not have great visibility into its shareholder base (*e.g.*, because the fund's shares are principally sold through intermediaries that do not provide shareholder transparency) or if a fund is uncertain about changing market conditions which are likely to materially affect the fund's level of net redemptions, it may make projections but be quite uncertain about those projections. In these circumstances, we would expect a fund to set its three-day liquid asset minimum to reflect this uncertainty, for example, by providing a cushion or multiple of its cash flow projections in the event realized net redemptions are significantly higher. A fund should have a three-day liquid asset minimum that will allow it to meet its net redemption projections.

In setting its three-day liquid asset minimum, a fund also must consider its investment strategy and the liquidity of portfolio assets. A finding of the DERA Study is that certain investment strategies typically have greater volatility of flows than other investment strategies. For example, the DERA Study indicates that the mean standard deviation of monthly net flows for alternative funds is 13.6% and for emerging market debt funds is 9.4%, but is only 2.7% for municipal bond funds and 4.9% for U.S. corporate bond funds.[338] Accordingly, all else equal, we generally would expect that an emerging market debt fund would have a higher three-day liquid asset minimum than a municipal bond fund. Similarly, the less liquid a fund's overall portfolio assets are, the more a fund may want to establish a higher three-day liquid asset minimum to avoid dilution when meeting investor redemptions.

338 DERA Study, *supra* note 39, at Table 6.

A fund also must consider its use of borrowings and derivatives in setting its three-day liquid asset minimum. A leveraged fund has an increased risk that it will be unable to meet redemptions and an increased risk of investor dilution compared to an equivalent fund with no leverage. For example, a fund with leverage through bank borrowings may have to meet margin calls if a security the fund provided to the bank to secure the loan declines in value. Such margin calls can render highly liquid portfolio assets unavailable to meet investor redemptions, which can increase dilution and the risk the fund will be unable to meet redemptions. Similarly, a fund that has significant fixed obligations to derivatives counterparties (for example, from a total return swap or writing credit default swaps) must pay out on these obligations when due, even if it means selling the fund's more liquid, high quality assets to raise cash.[339] A fund with a leveraged strategy thus, all else equal, should have a higher three-day liquid asset minimum than a fund that does not.

Finally, a fund must consider its holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources when determining its three-day liquid asset minimum. Unencumbered cash and cash equivalents are assets that the fund can typically readily deploy, in normal and stressed conditions, to meet redemptions. A fund can have cash on hand to meet redemptions from cash held in the fund's portfolio, cash received from investor purchases of fund shares, interest payments and dividends on portfolio securities, or maturing bonds. Our staff observed that several fund complexes targeted a minimum amount of cash or cash equivalent holdings in the fund because they assumed such holdings would allow the fund to meet redemptions in a stressed period without realizing significant discounts to fair value when the asset was sold. Accordingly, higher cash and cash equivalent holdings may make a

339 *See, e.g.,* OppenheimerFunds Release, *supra* note 309.

fund more comfortable that it can meet redemptions under stressed conditions with a lower three-day asset minimum than an equivalent fund whose three-day asset minimum was comprised primarily of non-cash equivalent assets. A fund also should consider whether it has a line of credit or other funding sources available to it to meet redemptions. As discussed further below, while we believe that liquidity risk management is best conducted primarily through portfolio construction, we recognize a line of credit can facilitate a fund's ability to meet unexpected redemptions.

Because each fund would be required to maintain a written record of how its three-day liquid asset minimum was determined, including an assessment of each of the factors discussed above,[340] our examination staff would be able to ascertain that funds are indeed considering the required factors. We expect that a board approving a fund's three-day liquid asset minimum would consider how the specified factors inform that minimum, and thus we believe that the proposed rule would cause fund boards to consider a comprehensive set of issues surrounding the fund's liquidity risk and risk management. Moreover, we believe that the board approval requirement associated with the three-day liquid asset minimum determination would add independent oversight over funds' liquidity risk management.

Although a fund would be permitted to determine its three-day liquid asset minimum under the analysis required by the proposed rule, we generally believe that it would be extremely difficult to conclude, based on the factors it would be required to consider, that a zero three-day liquid asset minimum would be appropriate. Under the proposed rule, a fund's three-day liquid asset minimum would be a control to manage the fund's liquidity risk, and as discussed above the fund's three-day liquid asset minimum would be required to be determined based on the

340 *See supra* note 331.

consideration of certain specified factors.[341] We believe that it would be extremely difficult to conclude, based on factors such as the fund's cash flow projections and redemption policies, that zero holdings of three-day liquid assets would allow the fund to manage its liquidity risk (in conjunction with any other liquidity risk management policies and procedures the fund adopts as part of its liquidity risk management program).

By way of example, consider a bank loan fund with a ten-year track record. The fund has a history of volatile cash flows that it projects will continue, with periods of market stress and reduced performance leading to increased net redemptions, and its largest net redemption during a one-week period was five percent of the fund's net assets. The fund does not have a concentrated shareholder base and is sold through several broker-dealers. The fund has 98 percent of its net assets invested in bank loans and loan participations that do not settle within three business days, one percent of its net assets invested in corporate bonds (which under this example we are assuming qualify as three-day liquid assets) and one percent of its net assets in cash and cash equivalents. The fund does not borrow or use derivatives for investment purposes, but does have a committed credit line in place with a bank. It would appear that such a fund, after assessing the factors required to be considered, would have a difficult time concluding that its existing three-day liquid asset holdings would be an adequate minimum given the liquidity risks inherent in the fund's portfolio and its redemption history.

We considered establishing a floor for the three-day liquid asset minimum. For example, we considered requiring that a fund set its three-day liquid asset minimum after consideration of the factors described above, but in no event could the minimum be below a certain specified percentage of the fund's net assets or a certain multiple of its average or worst net redemptions.

[341] *See* proposed rule 22e-4(b)(iv)(A).

A uniform percentage three-day liquid asset minimum floor could be difficult, however, given the diverse range of funds to which it would apply and the range of net redemptions within different types of funds indicated by the DERA Study. If set relatively high, a uniform percentage floor risks requiring excessive liquidity in some funds given their portfolio characteristics, investor base, and flow projections, which may unnecessarily constrain the fund's returns and investment in certain assets frustrating investors' goals in choosing to invest in the fund. If set relatively low, it may encourage some funds to set low levels of three-day liquid asset minimums that would not effectively manage liquidity risk or mitigate dilution. A floor also could be set based on a fund's historical redemptions. However, such a floor would not be forward-looking—a fund should be setting its minimum liquidity based in large part on projections of expected future redemptions. Such an approach risks a fund setting its minimum liquidity too low, for example during a period of rapid inflows that are likely to soon reverse. Conversely, continuing with the same example, it risks setting minimum liquidity too high after those flows have in fact reversed.

Accordingly, we preliminarily believe our proposed approach appropriately balances these considerations by requiring that a rigorous set of factors be considered and documented, and the three-day liquid asset minimum approved by the fund's board, but otherwise allow the minimum to be tailored to the nature of the fund and its cash flow projections. It should allow funds with different investment strategies, and whose cash flow and liquidity needs vary notably from one fund to the next, to manage their individual levels of liquidity risk in a way that best serves their investors.[342] We recognize that funds' three-day liquid asset minimums would likely

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342 *See, e.g.*, BlackRock FSOC Notice Comment Letter, *supra* note 50, at 6 (statement that among several overarching principles that provide the foundation for a prudent market liquidity risk management framework for collective investment vehicles is "[r]equiring that individual funds have sufficient sources of

vary from one fund to the next (even within the same strategy), depending on the factors that each fund would be required to consider. But we believe that consideration and documentation of the required factors, board oversight, and public disclosure of the fund's three-day liquid asset minimum should constrain funds from setting an inappropriately low minimum in light of the fund's liquidity needs and risks.[343]

We also note that assets eligible for inclusion in each fund's three-day liquid asset minimum holdings could include a broad variety of securities, as well as cash and cash equivalents. While one fund may conclude that it is appropriate to hold a significant portion of its three-day liquid assets in cash and cash equivalents, another could decide it is appropriate to hold equity, debt, derivatives or asset-backed securities as the majority of its three-day liquid asset minimum holdings. We believe that the proposed three-day liquid asset minimum requirement would allow funds to continue to meet a wide variety of investors' investment needs by obliging funds to maintain appropriate liquidity in their portfolios, while permitting funds to remain substantially invested in portfolio assets that conform to their investment strategies.

The proposed three-day liquid asset minimum requirement reflects liquidity management strategies that we understand from staff outreach that some—but not all—funds use. Based on staff outreach, we understand that funds of different sizes, with varying investment strategies, manage their liquidity by maintaining specified portions of their portfolios in more liquid assets.

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market liquidity to meet anticipated redemptions under a range of scenarios, including changes in market risk factors (e.g., interest rates) that may impact the value of portfolio securities and/or collateral and various levels of potential fund redemptions. This could be achieved by setting out principles for managing liquidity and redemption risk that should include maintaining sufficient levels of liquid assets, such as cash and liquid bonds as well as dedicated and shared loan facilities. The principles-based approach should provide appropriate flexibility to tailor practices to particular asset structures and fund redemption terms.").

343 *See infra* section III.D.1-2 (discussing board approval of the fund's three-day liquid asset minimum and any changes thereto), section III.G.2.c (discussing disclosure of a fund's three-day liquid asset minimum on proposed Form N-PORT).

Some funds invest a certain percentage of their assets in cash and cash equivalents; others invest in other types of more liquid portfolio securities corresponding with their investment strategies. To the extent that a fund already maintains a specified portion of its portfolio in more liquid assets, we anticipate that the proposed three-day liquid asset minimum requirement would formalize this risk management strategy, and augment it by requiring the fund to consider certain factors in determining the portion of assets that the fund will maintain in three-day liquid assets. More importantly, it would require the many funds that do not consider maintaining a minimum amount of liquidity, despite their obligations to meet redemptions within a certain time period, to do so.

b. Limiting Acquisition of Less Liquid Assets in Contravention of a Fund's Three-Day Liquid Asset Minimum

Under proposed rule 22e-4(b)(2)(iv)(C), a fund would not be permitted to acquire any less liquid asset if, immediately after the acquisition, the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets.[344] This provision of proposed rule 22e-4 would thus limit the acquisition of less liquid assets if such acquisition would result in the fund holding a smaller percentage of its net assets in three-day liquid assets than the percentage representing its three-day liquid asset minimum. The provision would not, however, require a fund to constantly have invested a certain portion of its net assets in three-day liquid assets. For example, if a fund's investments in three-day liquid assets were to temporarily drop below the fund's three-day liquid asset minimum, proposed rule 22e-4(b)(2)(iv)(C) would require the fund to acquire only three-day liquid assets until its investments in three-day liquid assets reach the

344 A fund's three-day liquid asset minimum would apply at the series level, not at the class level.

fund's three-day liquid asset minimum, but the proposed rule would not require the fund to divest less liquid assets and reinvest the proceeds in three-day liquid assets.[345]

While we believe that fund shareholders' interests are generally best served when the percentage of a fund's assets invested in three-day liquid assets is at (or above) the fund's three-day liquid asset minimum,[346] we believe that requiring a fund to maintain this percentage at all times could adversely affect shareholders and could potentially negate the liquidity risk management benefits of the proposed three-day liquid asset minimum requirement. For instance, if a fund were forced to sell less liquid assets at an inopportune time in order to reinvest the proceeds in three-day liquid assets, the fund might need to sell the less liquid assets at prices that incorporate a significant discount to the assets' stated value, or even at fire sale prices. These forced sales could produce significant negative price pressure on those assets and decrease the value of the assets still held by the fund, thereby decreasing the value of fund shares held by remaining investors, and possibly creating a first-mover advantage that harms investors who choose not to redeem their shares as quickly as others.[347] Also, if a fund needed to rebalance its portfolio frequently to maintain a specified percentage of the fund's net assets invested in three-day liquid assets, this could produce unnecessary transaction costs adversely affecting the fund's NAV, and could cause a fund to sell portfolio assets when it is not advantageous to do so (*e.g.*, when an asset's price is low, or when sales of an asset would have an undesirable tax

345 A fund's investments in three-day liquid assets could drop below the fund's three-day liquid asset minimum for a variety of reasons. For instance, the fund could sell its most liquid assets in order to obtain cash to meet redemption requests, thereby reducing its holdings of three-day liquid assets. Or, if the market value of a fund's three-day liquid assets falls relative to the market value of the fund's less liquid assets, the percentage of a fund's assets invested in three-day liquid assets could decrease. A fund's three-day liquid assets also could become less liquid if market conditions deteriorate.

346 *See supra* text preceding and following note 332.

347 *See infra* notes 690-698 and accompanying text.

impact). For these reasons, we are proposing a requirement that limits the acquisition of less liquid assets when such acquisition would result in a fund investing less than its three-day liquid asset minimum in three-day liquid assets, but we are not proposing to require that funds always maintain a certain portion of their portfolio assets in three-day liquid assets.[348]

c. Periodic Review of a Fund's Three-Day Liquid Asset Minimum

Under proposed rule 22e-4(b)(2)(iv)(B), each fund would be required to periodically review the adequacy of the fund's three-day liquid asset minimum, and in conducting such review would be required to take into account the factors a fund would be required to consider in determining its three-day liquid asset minimum. We believe the factors used to determine a fund's three-day liquid asset minimum also provide an appropriate framework for reviewing the adequacy of a fund's three-day liquid asset minimum because, as discussed below, changes in the assessment of the factors could provide a basis for adjusting the three-day liquid asset minimum. A fund would be required to complete this review no less frequently than semi-annually,[349] but could establish a more frequent periodic review period, and in addition could review the three-day liquid asset minimum even more frequently on an ad-hoc basis as

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348 This proposed acquisition test (in contrast to a maintenance test) reflects approaches that Congress and the Commission have historically taken in other parts of the Investment Company Act and the rules thereunder. *See, e.g.*, Investment Company Act section 5(c) (a registered diversified company that at the time of its qualification meets the diversification requirements specified in Investment Company Act section 5(b)(1) shall not lose its status as a diversified company because of any subsequent discrepancy between the value of its various investments and the requirements of section 5(b)(1), so long as any such discrepancy existing immediately after its acquisition of any security or other property is neither wholly nor partly the result of such acquisition); rule 2a-7(d)(3) (portfolio diversification requirements of rule 2a-7 are determined at the time of portfolio securities' acquisition); rule 2a-7(d)(4)(i) (limit on a money market fund's acquisition of illiquid securities if, immediately after the acquisition, the money market fund would have invested more than 5% of its total assets in illiquid securities); rule 2a-7(d)(4)(ii)-(iii) (minimum daily liquidity requirement and minimum weekly liquidity requirement of rule 2a-7 are determined at the time of portfolio securities' acquisition).

349 Proposed rule 22e-4(b)(2)(iv)(B).

conditions demand.[350] As discussed below, the fund's investment adviser or officers administering the fund's liquidity risk management program would be required to submit written reports to the fund's board concerning the adequacy of the fund's liquidity risk management program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation. Board approval would be required for any changes to the fund's three-day liquid asset minimum.[351] Each fund would be required to maintain a copy of the written reports provided to the board, as well as a written record of the fund's assessment of the factors set forth in rule 22e-4(b)(2)(iii)(A) through (D) and the determination of the three-day liquid asset minimum, and any reviews and adjustments to the fund's three-day liquid asset minimum.[352]

Because we anticipate that a fund would rely significantly on its three-day liquid assets in meeting fund redemptions, we view the three-day liquid asset minimum determination as a cornerstone of a fund's liquidity risk management, and we believe it is important for a fund to periodically reassess whether its three-day liquid asset minimum effectively assists the fund in managing its liquidity risk. We envision the determination of a fund's three-day liquid asset minimum as a dynamic process, incorporating new or updated information into the fund's assessment of factors, reflecting shareholder-related, fund-management-oriented, or market changes that could affect the fund's ability to meet redemptions. A fund's three-day liquid asset minimum could become outdated for multiple reasons. For example, a fund's shareholder ownership concentration could change or market events could reveal that shareholder redemption

350 *See infra* paragraph following note 352.

351 *See infra* section III.D (discussing the board's role in approving and overseeing a fund's liquidity risk management program); *see also* proposed rule 22e-4(b)(3)(i) and (ii). We note that a fund may hold more three-day liquid assets than required by the three-day liquid asset minimum. Thus, a fund may determine it is appropriate to increase its minimum holdings in three-day liquid assets without waiting for the next board meeting (or calling a special meeting) to formally approve an increase in the minimum.

352 *See supra* note 331.

patterns are different than anticipated under certain circumstances. Additionally, market events or national regulatory, monetary, and fiscal policies could affect the liquidity of a fund's portfolio assets. Any of these events, or similar events influencing a fund's cash flows, portfolio liquidity, or the other liquidity risk factors included in proposed rule 22e-4(b)(2)(iii), could alter the level of three-day liquid assets that a fund would determine appropriate to manage its liquidity risk.

Like the proposed requirements to perform an ongoing review of the liquidity of portfolio assets and to review periodically the fund's liquidity risk,[353] the proposed three-day liquid asset minimum review requirement would permit each fund to develop and adopt its own procedures for conducting this review, taking into account the fund's particular facts and circumstances. While each fund would be required to consider each of the proposed rule 22e-4(b)(2)(iii)(A)-(D) factors in periodically reviewing its three-day liquid asset minimum, rule 22e-4 would not otherwise include prescribed review procedures or incorporate specific developments that a fund should consider as part of its review. We believe that in developing comprehensive periodic review procedures, a fund should generally consider including procedures for evaluating regulatory, market-wide, and fund-specific developments affecting the fund's liquidity risk. A fund also may wish to adopt procedures specifying any circumstances that would prompt ad-hoc review of the fund's three-day liquid asset minimum in addition to the periodic review required by the proposed rule (as well as the process for conducting any ad-hoc reviews).

d. Request for Comment

We request comment on all aspects of the proposed three-day liquid asset minimum requirement.

353 *See supra* note 323 and accompanying text.

- Do commenters agree that the proposed three-day liquid asset minimum requirement would improve a fund's ability to meet redemption requests without materially affecting the fund's NAV? Are we correct that not all funds today target holding a minimum amount of more liquid assets?
- Do commenters agree that the proposed requirement would promote investor protection by enhancing funds' ability to meet their redemption obligations, mitigating dilution, and elevating the overall quality (comprehensiveness as well as independence) of liquidity risk management across the industry? Would the proposed requirement assist fund boards in overseeing funds' ability to meet redemption obligations?
- Should we define the three-day liquid asset minimum as proposed? Should we define three-day liquid assets as proposed? If not, why not? Are there other definitions that would be better? If so, what are they? Should we preclude certain assets or types of assets from being considered three-day liquid assets? If so, which assets or asset types and why? For example, should we prohibit funds from classifying as three-day liquid assets any assets that are subject, directly or indirectly, to a guarantee, put, wrap, swap, or other liquidity enhancement from a third party? Alternatively, should we require specific disclosure regarding such assets? If so, what should be included in the disclosure? Should we require that the fund more stringently or frequently monitor the liquidity of three-day liquid assets?
- Would an alternate liquid asset holdings requirement (*e.g.*, a seven-day liquid asset minimum requirement, a one-day liquid asset minimum requirement, or a buffer of cash and cash equivalents or a combination of the above) better accomplish these goals, and if so, what should that alternate requirement be and why? Should funds that disclose that

they will meet redemptions (or are otherwise required to meet redemptions) within less than three business days be required to have liquid asset minimum requirements that correspond to those shorter redemption windows (given that there may be liability under the antifraud provisions of the federal securities laws if a fund fails to meet redemptions within any shorter time disclosed in the fund's prospectus or advertising materials)? Conversely, should funds that disclose that under normal circumstances they expect to meet redemptions within a period that is longer than three business days (*e.g.*, within the seven days permitted under section 22(e)) be permitted to have liquid asset minimum requirements that correspond to those longer redemption windows? Which funds (and holding how much assets) are not subject to rule 15c6-1 under the Exchange Act? Would different minimum liquidity requirements for different open-end funds be confusing to investors?

- Instead of permitting each fund to determine the portion of liquid asset holdings that would most effectively enable it to manage its own liquidity risk, should the Commission instead mandate a standard level of required minimum liquid asset holdings across-the-board, or different levels depending on different investment strategies (or some other fund characteristic)? If so, at what level (*e.g.*, 1%, 5%, 10%), and what considerations would form the basis for the recommended level?
- Should the Commission set a floor below which a fund could not set its three-day liquid asset minimum? Should it do so only for funds that hold above a certain percentage of net assets in less liquid assets? If so, what percentage of less liquid assets should trigger the mandated floor on the three-day liquid asset minimum? What should the floor on the three-day liquid asset minimum be for such funds?

- In addition to specifying that a fund must determine its three-day liquid asset minimum, should the Commission also require a fund to limit its investment in a subset of less liquid assets held by a fund (*e.g.*, assets that can only be converted to cash in over 7 days, over 15 days, over 30 days, or over 90 days at a price that does not materially affect the value of that asset immediately prior to sale)? If so, what should this limit be? Should it be a set percentage of fund assets established by the Commission (*e.g.*, 5%, 10%, 20%, 30%), or should a fund be required to set its own limit, using the factors it would be required to consider in determining its three-day liquid asset minimum (or some other set of factors)? Should this limit apply to all funds, or only a subset of funds (*e.g.*, only funds with certain investment strategies, or whose three-day liquid asset minimums are below a certain threshold)? Would such a requirement be an effective substitute for the limit on 15% standard assets discussed below?
- Should we exclude certain funds from the proposed requirement to determine a three-day liquid asset minimum? For example, should a fund that only invests in three-day liquid assets be required to determine a three-day liquid asset minimum?
- Instead of a requirement that limits the acquisition of less liquid assets when such acquisition would result in a fund investing less than its required minimum in three-day liquid assets, would a requirement mandating that a fund always maintain a specified portion of its assets in three-day liquid assets better facilitate funds' liquidity risk management and promote investor protection? Should a fund be required to hold some minimum portion of assets in holdings that are likely to be liquid in stressed market environments? If so, what type of assets, at what level, and what considerations would form the basis for the recommended level?

- As noted above, the three-day liquid asset minimum would be tested each time the fund acquires new assets, and a fund would be permitted to fall below its three-day liquid asset minimum if it does so due to redemptions or market events. Once a fund falls below its three-day liquid asset minimum, any acquisition of new assets must be of three-day liquid assets until the fund is at or above its three-day liquid asset minimum. Should we limit the time period (*e.g.*, to 30 days, 60 days, or 90 days) in which a fund can be below its three-day liquid asset minimum so that a fund cannot persistently be below this level of liquidity? Would such an approach better promote investor protection? Would there be operational challenges with this requirement? Should we limit the extent to which a fund can fall below its three-day liquid asset minimum? If so, what extent should be the limit?
- Should the board be required to approve the fund's three-day liquid asset minimum and any changes to the three-day liquid asset minimum? Why or why not?

We request comment on how the three-day liquid asset minimum requirement (or a similar requirement) could affect the management of a fund's liquidity risk, decrease the probability that the fund will be able to meet redemption obligations only through activities that could materially affect the fund's NAV or risk profile, and mitigate dilution.

- What range of levels of three-day liquid assets do commenters anticipate different funds would determine to be appropriate, based on the factors the proposed rule would require a fund to consider? What types of securities do commenters anticipate that different funds would determine are or are not appropriate as three-day liquid asset minimum holdings?
- How many funds today target a minimum level of more liquid assets? If some funds indeed aim to invest a certain portion of their assets in more liquid assets for purposes of liquidity risk management, what types of assets do funds hold for these purposes, and

how do funds determine what portion of their net assets they intend to invest in these assets? What burdens and other difficulties, if any, would funds have in initially complying with the three-day liquid asset minimum requirement?

- What are the processes that commenters anticipate a fund would use for determining and reviewing its three-day liquid asset minimum under the proposed rule? Do commenters generally agree with the guidance that the Commission has provided regarding the processes a fund could use to determine and review its three-day liquid asset minimum? Should the minimum frequency of the fund's review of the adequacy of its three-day liquid asset minimum be shorter than semi-annually (such as quarterly) or longer (such as annually)?
- Should the Commission specify certain procedures that a fund must use in determining its three-day liquid asset minimum, such as requiring a fund to consider specific historical redemption scenarios? Should we require that the minimum not be less than, for example, a fund's highest historical level of net redemptions, its average level of net redemptions over some time period, or a multiple (*e.g.*, two times) of those levels?

We request comment on the proposed factors that each fund would be required to consider in determining and reviewing its three-day liquid asset minimum.

- To what extent do funds already consider the proposed factors when determining the portion of fund assets that should be invested in more liquid assets for purposes of liquidity risk management? Do commenters believe it is appropriate for a fund to consider the same set of factors in determining and reviewing its three-day liquid asset minimum as it considers in assessing and reviewing its liquidity risk? Are there other factors that would be preferable?

- Should any of the proposed factors not be required to be considered by a fund in determining and reviewing its three-day liquid asset minimum? Should any of the proposed factors be modified? Are there any additional factors, besides the proposed factors, that a fund should be required to consider?
- Instead of codifying the proposed factors as part of proposed rule 22e-4, should the Commission provide guidance on factors that may be appropriate for a fund to consider in determining and reviewing its three-day liquid asset minimum? Should the Commission provide additional guidance on the proposed factors?

4. *Portfolio Liquidity: Limitation on Funds' Investments in 15% Standard Assets*

a. 15% Standard Assets

Included in proposed rule 22e-4 is a limit on a fund's ability to acquire "15% standard assets." Specifically, proposed rule 22e-4(b)(2)(iv)(D) would prohibit a fund from acquiring any 15% standard asset if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in 15% standard assets. The provision would not require a fund to divest any holdings if 15% standard assets rise above 15% of its net assets.[354]

Under proposed rule 22e-4(a)(4), a 15% standard asset would be defined as any asset that may not be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund.[355] For purposes of the proposed definition, a

354 A fund's investments in 15% standard assets could rise above 15% of the fund's net assets for a variety of reasons. For instance, the fund could sell its most liquid assets in order to obtain cash to meet redemption requests, thereby increasing its holdings of 15% standard assets relative to its total holdings. Or, if the market value of a fund's 15% standard assets rises relative to the market value of the fund's other assets, the percentage of a fund's assets invested in 15% standard assets could increase. Assets that are not 15% standard assets also could become 15% standard assets if market conditions deteriorate. *See supra* note 345 (discussing similar considerations with respect to a fund's holdings of three-day liquid assets).

355 As discussed above, under the 15% guideline, a portfolio security or other asset is considered illiquid if it cannot "be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment." *See supra* note 93. Rule 2a-7(a)(20) defines

fund would not be required to take into account the size of the fund's position in the asset or the time period associated with receipt of proceeds of sale or disposition of the asset. We believe that assets included in the definition of 15% standard asset would be consistent with those currently classified as illiquid by funds under the 15% guideline, and that such a limit would be an important limitation on certain relatively illiquid holdings in funds' portfolios, such as private equity investments, securities acquired in an initial public offering, and real estate assets. As noted above, we believe that the 15% guideline has generally caused funds to limit their exposure to particular types of securities that cannot be sold within seven days and the proposed limit on 15% standard assets would continue to limit these exposures.

As discussed above, the Commission and staff have in the past provided guidance in connection with the 15% guideline.[356] We propose to withdraw this guidance because we believe this proposal provides a more comprehensive framework for funds to evaluate the liquidity of their assets. We request comment below on whether additional guidance is needed in connection with the definition of 15% standard asset.

We believe that the proposed limit on 15% standard assets and the proposed three-day liquid asset minimum each serve distinctly important, but interrelated, roles in managing liquidity risk. We therefore propose to require each fund to comply with the limit on 15% standard assets as well as the three-day liquid asset minimum requirement. While the three-day liquid asset minimum requirement would increase the likelihood that each fund holds adequate

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the term "illiquid security" to mean "a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund." We understand the terms "approximately the value at which the . . . fund has valued the investment" and "approximately the value ascribed to it by the fund" to have identical meanings. For the sake of consistency with the language of current rule 2a-7, the definition of 15% standard asset incorporates the "approximately the value ascribed to it by the fund" formulation.

356 *See supra* section II.D.2.

liquid assets to meet redemption requests without materially affecting the fund's NAV, the limit on 15% standard assets would increase the likelihood that a fund's portfolio is not concentrated in assets whose liquidity is limited and thus may serve as a limit on certain cases of fund illiquidity. While we considered requiring a different percentage-based ceiling on relatively illiquid holdings, we ultimately decided that proposing the 15% standard would effectively accomplish our intended goals while disrupting funds' existing practices to the least extent possible.

While this definition is similar to the definition of an asset that cannot be converted to cash within seven days under the proposed liquidity classification framework, we note several key differences between the definitions. When determining whether an asset may be sold or disposed of within seven calendar days for purposes of assessing whether the asset is a 15% standard asset, a fund need not consider whether it can receive the proceeds of such sale or disposition within the same seven-day time period. In contrast, the classification framework takes into consideration whether a fund could convert an asset to cash—that is, sell the asset and receive cash for the sale within this period. Also, the definition of 15% standard asset does not require a fund to consider any specific factors in determining the circumstances under which an asset may be sold or disposed of. The definition of less liquid asset, on the other hand, requires a fund to consider, as applicable, certain market, trading, and asset-specific factors set forth in proposed rule 22e-4(b)(2)(ii).[357] These factors include the size of a fund's position in a particular portfolio asset relative to the asset's average daily trading volume and (as applicable) the number

357 Proposed rule 22e-4(a)(6).

of units of the asset outstanding, which a fund is not required to assess in determining whether an asset is a 15% standard asset.[358]

To provide an example of the distinctions between the proposed 15% standard and the proposed three-day liquid asset minimum, consider a fund that holds a very large block of a particular security "X". Because the fund holds a large block of the issue, it may determine, based on the liquidity classification factors required to be considered under the proposed rule, that it could convert a certain percentage (*e.g.*, 70%) of its position to cash in fewer than three business days, but that it would take more than three business days to convert the remainder of its position to cash. Under the proposed rule, 70% of the fund's position in security "X" would be considered three-day liquid assets, and the other 30% would be considered to be less liquid assets. The fund would take these classifications into account when considering whether the further acquisition of less liquid assets would cause the fund to not be in compliance with its three-day liquid asset minimum. However, even though 30% of the fund's position in security "X" would be considered to be less liquid assets, the fund's position in security "X" would not also be considered to be 15% standard assets. This is because, as discussed above, a fund is not required to assess position size in determining whether a particular portfolio asset is a 15% standard asset. Thus, if a fund can sell a standard size lot of its holdings in that position within seven days at approximately the value ascribed to it by the fund, the entire position would be deemed not to be a 15% standard asset.

Consider as well a scenario in which a fund holds shares of security "Y," and the fund determines, based on the liquidity classification factors required to be considered under the proposed rule, that it can *sell* security "Y" within seven days at approximately the value ascribed

358 *See supra* section II.D.2.

to it by the fund, but whose sale(s) will not also *settle* until the tenth day. Security "Y" would fall into the 8-15 day liquidity classification category and would be considered a less liquid asset because it would not be able to be converted to cash within three business days. However, because the fund would be able to sell its shares of security "Y" within seven days at approximately the value ascribed to it by the fund, security "Y" would not be considered to be a 15% standard asset. This is because a fund is required to consider whether it would be able to sell an asset within seven days, but not also whether those asset sales would settle within this period, in determining whether a particular portfolio asset is a 15% standard asset.[359]

Conversely, consider a fund that holds shares of security "Z," a privately placed security that the fund determines cannot be sold within seven days at approximately the value ascribed to it by the fund. Under the proposed rule, security "Z" would be considered a less liquid asset, because it would not be able to be converted to cash (that is, sold, with the sale settled) within three business days. Security "Z" also would be considered to be a 15% standard asset, because it would not be able to be sold within seven days at approximately the value ascribed to it by the fund. The fund would take these classifications into account when it is considering whether the further acquisition of less liquid assets or 15% standard assets would cause the fund to not be in compliance with its three-day liquid asset minimum *or* the 15% standard.

The scenarios depicted in the preceding paragraphs demonstrate that the same asset could be deemed to be a less liquid asset but *not* also deemed to be a 15% standard asset, and also illustrate the different roles that the proposed three-day liquid asset minimum and the 15% standard play in liquidity risk management. The proposed 15% standard would provide an across-the-board limitation on the acquisition of certain relatively illiquid holdings. The

[359] *See* proposed rule 22e-4(a)(4).

proposed definition of less liquid asset, on the other hand, is meant to identify those assets that would generally not be able to be converted to cash to meet redemption requests, and the proposed three-day liquid asset minimum is meant to tailor a fund's acquisition of these holdings to correspond with its particular liquidity needs. Thus, the proposed 15% standard acts as a cap on the amount of relatively illiquid assets that a fund may hold, while the proposed three-day liquid asset minimum acts as a floor on the amount of three-day liquid assets that a fund must hold.

b. Request for Comment

We request comment on the proposed 15% standard.

- Do commenters agree that the Commission should include the 15% standard in proposed rule 22e-4? Would the 15% standard enhance funds' ability to manage liquidity risk?
- Do commenters agree that the three-day liquid asset minimum requirement and the 15% standard serve distinct roles in managing liquidity risk? Is there a single alternative standard that would be an effective substitute for the three-day liquid asset minimum requirement and the 15% standard?
- Should the Commission instead adopt a different restriction on funds' investments in assets whose liquidity is extremely limited, and if so, what should this restriction be? For example, should we adopt a different percentage limit on funds' investments in 15% standard assets? Should we instead limit funds' investments in some other subset of assets with extremely limited liquidity, such as assets that can only be converted to cash in over 7 days, over 15 days, over 30 days, or over 90 days at a price that does not materially affect the value of that asset immediately prior to sale? If we did the latter, what should the limit be? Should it be a set percentage of fund assets established by the

Commission (*e.g.*, 5%, 10%, 20%, 30%), or should a fund be required to set its own limit, using the factors it would be required to consider in determining its three-day liquid asset minimum (or some other set of factors)? Should this limit apply to all funds, or only a subset of funds (*e.g.*, only funds with certain investment strategies, or whose three-day liquid asset minimums are below a certain threshold)?

- As noted above, the 15% standard would be tested each time the fund acquires new assets, and a fund would be permitted to hold more than 15% of its net assets in 15% standard assets if it does so due to redemptions or market events. Once a fund rises above the 15% limit, any acquisition of new assets must be of non-15% standard assets until the fund is at or below the 15% standard. Would a requirement mandating that a fund divest excess 15% standard assets if its holdings of these assets rise above 15% of its net assets better facilitate funds' liquidity risk management and promote investor protection? Or should we limit the time period (*e.g.*, to 30 days, 60 days, or 90 days) in which a fund holds more than 15% of its net assets in 15% standard assets so that a fund cannot persistently be above the 15% standard? Alternatively, we note that certain Canadian mutual funds are subject to illiquid asset restrictions that provide that a fund: (i) must not acquire illiquid assets if more than 10% of the fund's net assets would be made up of illiquid assets; (ii) must not have invested more than 15% of the fund's net assets in illiquid assets for a period of 90 days or more; and (iii) must, as quickly as is commercially reasonable, take all necessary steps to reduce the percentage of its net assets made up of illiquid assets to 15% or less if more than 15% of the fund's net assets is made up of illiquid assets.[360] Should we adopt similar requirements? Would such requirements better promote investor protection?

- Should the Commission modify the proposed definition of 15% standard assets to require that funds take into account the time period associated with receipt of proceeds of sale or disposition of an asset?
- Do commenters agree with the proposal to withdraw current guidance associated with the 15% guideline? Do commenters believe additional guidance is needed in connection with the proposed definition of 15% standard asset? If so, what guidance should the Commission provide?
- What assets do funds currently consider to be limited by the 15% guideline? Do commenters believe that assets that would meet the proposed definition of 15% standard asset are consistent with assets that funds currently classify as illiquid under the 15% guideline? If not, what types of assets would be classified differently?
- What are funds' current practices for determining whether a portfolio asset is limited by the 15% guideline, and what factors do funds currently use to make this determination? Who at the fund and/or the adviser is tasked with determining whether a portfolio asset is limited by the 15% guideline, and how often is each asset reviewed? Do funds expect to engage in the same practices for determining whether an asset is a 15% standard asset?
- Would it be beneficial to funds for the Commission to include as part of the rule certain types of securities whose acquisition would be limited by the 15% standard, or other factors for funds to consider in determining whether an asset is a 15% standard asset? Do commenters believe that confusion could arise between the definition of a 15% standard

360 *See* Canadian Securities Administrators, National Instrument 81-102 – Investment Funds at section 2.4.

asset and the definition of a less liquid asset under the proposed rule, and if so, how could this confusion be reduced?

- Rule 2a-7 currently defines the term "illiquid security" to mean "a security that cannot be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund."[361] Should we amend rule 2a-7 to clarify that "illiquid security" has the same definition as "15% standard asset?"

5. *Policies and Procedures Regarding Redemptions in Kind*

a. Use of Redemptions in Kind

Along with ETFs, which commonly redeem shares in kind, many mutual funds reserve the right to redeem their shares in kind instead of in cash.[362] Mutual funds that reserve the right to redeem in kind may use in-kind redemptions to manage liquidity risk under exceptional circumstances.[363] A fund, for example, could choose to redeem in kind when faced with significant redemptions, because this would result in the redeeming shareholder (and not the fund and its remaining shareholders) bearing any liquidity costs associated with dispositions of

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[361] Rule 2a-7(a)(20).

[362] *See, e.g.*, Adoption of (1) Rule 18f-1 Under the Investment Company Act of 1940 to Permit Registered Open-End Investment Companies Which Have the Right to Redeem In Kind to Elect to Make Only Cash Redemptions and (2) Form N-18F-1, Investment Company Act Release No. 6561 (June 14, 1971) [36 FR 11919 (June 23, 1971)] ("Rule 18f-1 and Form N-18F-1 Adopting Release") (stating that the definition of "redeemable security" in section 2(a)(32) of the Investment Company Act "has traditionally been interpreted as giving the issuer the option of redeeming its securities in cash or in *kind*.").

[363] *See* Karen Damato, *'Redemptions in Kind' Become Effective for Tax Management*, WALL STREET JOURNAL (Mar. 10, 1999), *available at* http://www.wsj.com/articles/SB921028092685519084 ("'Redemptions in kind' are typically viewed by fund managers as an emergency measure, a step they could take to meet massive redemptions in the midst of a market meltdown.").

Besides using in-kind redemptions as an emergency measure to manage liquidity risk, funds may also use in-kind redemptions for other reasons. For example, funds may wish to redeem certain investors (particularly, large, institutional investors) in kind, because in-kind redemptions could have a lower tax impact on the fund than selling portfolio securities in order to pay redemptions in cash. This, in turn, could benefit the remaining shareholders in the fund. *See, e.g.*, *id.* ("If a fund has to sell appreciated stocks to pay a redeeming shareholder, it realizes capital gains. Unless the fund has offsetting capital losses, those gains are distributed as taxable income to all remaining fund holders. By contrast, when funds distribute stocks from their portfolios, there is no tax event for the continuing holders.").

portfolio assets. We understand that many funds also use in-kind redemptions if a large shareholder is redeeming to transition to a separately managed account with a similar investment strategy.

There are often logistical issues associated with paying in-kind redemptions, and this limits the availability of in-kind redemptions under many circumstances.[364] For instance, in-kind redemptions could entail complex operational issues that would be imposed on both the fund and on investors receiving portfolio securities.[365] Moreover, some shareholders are generally unable or unwilling to receive in-kind redemptions.[366] Some funds also have waived the right to redeem in kind with respect to certain relatively small redemption requests under rule 18f-1 under the Investment Company Act, which allows a fund to abide by different in-kind redemption policies for different shareholders without being deemed to create a class of senior securities prohibited by section 18(f)(1) of the Act.[367]

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364 *See, e.g.,* Invesco FSOC Notice Comment Letter, *supra* note 35, at 11 (noting that while "Invesco has on occasion exercised rights to redeem in kind, in practice such rights are exercised infrequently").

365 Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 30551 (June 5, 2013) [78 FR 36834 (June 19, 2013)] ("2013 Money Market Fund Reform Proposing Release"), at n.473.

366 *See, e.g.*, Fortune, *supra* note 270, at 47 ("A fund redeeming in kind does so at the risk of its reputation and future business . . ."). In the context of money market funds, we requested comment on whether we should require redemptions in kind for redemptions in excess of a certain size threshold, to ease liquidity strains on the fund and reduce the risks and unfairness posed by significant sudden redemptions. *See* Money Market Fund Reform; Proposed Rule, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)] ("2009 Money Market Fund Reform Proposing Release"), at section III.B. Commenters generally opposed this type of reform for a variety of reasons, all of which likely would apply equally to funds other than money market funds. For example, most commenters stated that in-kind redemptions would be technically unworkable due to complex valuation and operational issues that would be imposed on both the fund and on investors receiving the in-kind distribution. *See* 2013 Money Market Fund Reform Proposing Release, *supra* note 365, at section III.B.9.c.

367 Under rule 18f-1, any registered open-end fund that has the right to redeem in kind could file with the Commission, on Form N-18F-1, a notification of election committing itself to pay in cash all requests for redemptions by any shareholder of record, limited in amount during any ninety-day period to the lesser of $250,000 or 1 percent of the net asset value of the fund at the beginning of the period. *See* Rule 18f-1 and Form N-18F-1 Adopting Release, *supra* note 362.

We believe that, as part of a fund's management of its liquidity risk, a fund that engages in or reserves the right to engage in in-kind redemptions should adopt and implement written policies and procedures regarding in-kind redemptions, and we have included this requirement in proposed rule 22e-4.[368] We expect these policies and procedures would address the process for redeeming in kind, as well as the circumstances under which the fund would consider redeeming in kind. Through staff outreach to funds, we understand that while many funds disclose that they have reserved the right to redeem in kind, most of these funds consider redemptions in kind to be a last resort or emergency measure, and many do not have policies or procedures in place that would govern in-kind redemptions. Because the management and personnel capacity of funds facing heavy redemptions and other liquidity stresses would likely be strained as funds attempt to manage these pressures, policies and procedures that dictate the fund's in-kind redemption procedures (which, as discussed above, could be quite complicated and could apply differently to different types of shareholders) would increase the likelihood that in-kind redemptions would be a feasible risk management tool.[369]

b. Requests for Comment

- Our understanding is that redemptions in kind are not used extensively outside ETFs. Is this assumption correct? Do funds that engage in redemptions in kind have policies and procedures regarding those redemptions? Are there steps that funds can take to make redemptions in kind easier to implement?
- Under rule 18f-1, any registered open-end fund that has the right to redeem in kind could file with the Commission a notification of election committing itself to pay in cash all

[368] See proposed rule 22e-4(b)(2)(iv)(E).

[369] *See infra* notes 552-554 and accompanying text.

requests for redemptions by any shareholder of record, limited in amount during any ninety-day period to the lesser of $250,000 or 1 percent of the net asset value of the fund at the beginning of the period.[370] Would re-visiting and eliminating funds' ability to limit in-kind redemptions clarify that the Investment Company Act permits funds to redeem shares in kind as well as in cash?

6. *Discussion of Additional Liquidity Risk Management Tools*

While proposed rule 22e-4 specifies that each fund would be required to adopt a liquidity risk management program incorporating certain specified elements, a fund's program could incorporate liquidity risk management tools beyond the requirements of the proposed rule. We understand that many funds currently engage in certain practices that would not be required by proposed rule 22e-4, but which could enhance funds' ability—in conjunction with the policies and procedures required to be adopted under the proposed rule—to manage liquidity risk. Specifically, we understand based on staff outreach that it is relatively common for funds to establish lines of credit to manage liquidity risk, and that funds may use borrowed money or draw on other funding sources to meet shareholder redemptions, typically during periods of significantly limited market liquidity. We also understand that it is relatively common for certain funds (particularly, funds with strategies involving investment in relatively less liquid portfolio securities) to invest in ETFs to enhance the liquidity of the fund's portfolio. Below we provide guidance funds may wish to consider in using these tools and their role in a fund's liquidity risk management program. We note that the liquidity risk management tools discussed below do not comprise an exhaustive list of liquidity risk management controls or procedures

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[370] *See supra* note 362 and accompanying text.

that a fund could consider implementing, nor are we currently proposing to mandate that a fund use these tools as part of its liquidity risk management program.

In addition, there are currently several tools that a fund could use, generally under emergency circumstances, to pay redeeming shareholders during periods in which the fund encounters limited liquidity. As discussed above, many funds reserve the right to redeem their shares in kind instead of in cash, although we understand that many funds that do so consider in-kind redemptions to be a last resort or emergency measure. As a separate emergency measure, money market funds (but not other funds) are currently permitted, under certain circumstances, to permanently suspend shareholder redemptions and liquidate the fund. Below we request comment on whether this tool would be useful and appropriate for the Commission to make available to funds besides money market funds.

a. Borrowing Arrangements and Other Funding Sources

As discussed above, entering into borrowing arrangements and agreements with other potential funding sources could strengthen a fund's management of liquidity risk, as they could be used to pay redeeming shareholders without the need to sell portfolio securities at significantly discounted prices. For example, a fund could establish a committed or uncommitted line of credit with a commercial bank, engage in interfund lending within a family of funds, or use repurchase transactions to generate liquidity.[371] Proposed rule 22e-4(b)(2)(iii)(D)

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371 *See, e.g.*, SIFMA IAA FSOC Notice Comment Letter, *supra* note 16, at nn.73-75 (stating that 79% of SIFMA AMG survey respondents report having access to a line of credit to manage outflows from their mutual funds, that 64% have drawn on that line of credit at some point within the last five years, and that 8% of SIMFA AMG members surveyed state that they engage in interfund lending to address liquidity issues); BlackRock FSOC Notice Comment Letter, *supra* note 50, at 6 (statement that among several overarching principles that provide the foundation for a prudent market liquidity risk management framework for collective investment vehicles is identifying backup sources of liquidity such as temporary borrowings). *But see* Fidelity FSOC Notice Comment Letter, *supra* note 20, at 20 ("During the time period since its inception in 2001, the committed bank line of credit has never been used."); Comment Letter of PIMCO on the FSOC Notice (Mar. 25, 2015), at Appendix-2 ("In practice, it is rare for funds to...draw on

would require a fund to consider its borrowing arrangements and other funding sources in assessing its liquidity risk, and above we provide guidance on particular aspects of these activities that could affect a fund's liquidity risk.[372] We anticipate that a fund could consider this guidance in assessing whether entering into borrowing or other funding arrangements would assist the fund in managing its liquidity risk, as well as determining the terms under which such arrangements would best help the fund to manage its liquidity risk. We also anticipate that this guidance could be used in reviewing existing borrowing arrangements and the use of other funding sources to assess whether these activities would continue to help the fund effectively manage its liquidity risk. In evaluating borrowing arrangements or other funding sources for purposes of managing liquidity risk, a fund should take into account restrictions on affiliated transactions and leverage under the Investment Company Act and rules under the Act.[373] A fund also may wish to consider any negative impact on the fund resulting from borrowing funds for liquidity risk management purposes, as opposed to managing liquidity through the fund's portfolio construction.[374]

b. Use of ETF Portfolio Holdings as a Liquidity Risk Management Tool

We understand that certain funds, particularly funds with investment strategies involving relatively less liquid portfolio securities (such as micro-cap equity funds, high-yield bond funds

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these lines of credit."); Invesco FSOC Notice Comment Letter, *supra* note 35, at 12 (stating that it has a line of credit for its floating rate fund and senior loan portfolio ETF, but that it has been used on a very infrequent basis).

372 *See supra* notes 315-318 and accompanying and following text.

373 *See supra* notes 320-322 and accompany and following text.

374 *See, e.g.*, Nuveen FSOC Notice Comment Letter, *supra* note 45, at 9-10 ("Funds without credit lines face the possibility of not being able to sell sufficient assets to raise cash to fund redemption requests, or having to sell assets at significantly discounted values. To the extent that a fund draws on a credit line to meet net redemptions (and thus temporarily leverages itself), it increases its market risk at a time when markets are stressed. While this can be potentially beneficial to long-term performance if the asset class recovers, it increases the risk of loss to remaining shareholders if markets continue to weaken.").

and bank loan funds), may invest a portion of their assets in ETFs with strategies similar to the fund's investment strategy because they view ETF shares as having characteristics that enhance the liquidity of the fund's portfolio.[375] Specifically, funds that invest in ETF shares have stated to Commission staff that they find that these shares are more readily tradable, are less expensive to trade, and have shorter settlement periods than other types of portfolio investments.[376] And unlike investments in cash, cash equivalents, and other highly liquid instruments, funds have suggested that investing in ETFs with the same (or a similar) strategy as the fund's investment strategy permits the fund to remain fully invested in assets that reflect the fund's investment concentrations, risks, and performance potential.

While we appreciate that ETFs' exchange-traded nature could make these instruments useful to funds in managing purchases and redemptions (for example, ETFs' settlement times could more closely reflect the time in which a fund has disclosed that it will typically redeem fund shares), funds should consider the extent to which relying substantially on ETFs to manage liquidity risk is appropriate. As discussed above, the liquidity of an ETF, particularly in times of declining market liquidity, may be limited by the liquidity of the market for the ETF's

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375 *See, e.g.*, Katy Burne, *Institutions Pour Cash Into Bond ETFs*, WALL STREET JOURNAL (Mar. 1, 2015), *available at* http://www.wsj.com/articles/institutions-pour-cash-into-bond-etfs-1425250969. Funds' investments in ETFs are subject to the Investment Company Act's limitations on investments in shares issued by other registered investment companies. *See* section 12(d)(1)(A) of the Investment Company Act.

376 The Commission's 2015 Request for Comment on Exchange-Traded Products requested comment on whether investors' expectations of the nature of the liquidity of an exchange-traded product (including an ETF) holding relatively less liquid portfolio securities differ from their expectations of the liquidity of the underlying portfolio securities. *See* 2015 ETP Request for Comment, *supra* note 11, at Question #49. *See e.g.*, Comment Letter of Vanguard on the 2015 ETP Request for Comment (Aug. 17, 2015) (stating that the disclosures made by ETFs in prospectuses, shareholder reports, and websites "ensures that investors and market participants have the necessary information to make informed investment decisions"); Comment Letter of ETF Radar on the 2015 ETP Request for Comment (Aug. 8, 2015) (stating that investor expectations of liquidity depend on the skill of the investor); Comment Letter of Danny Reich on the 2015 ETP Request for Comment (July 2, 2015) (stating that there is a "false assumption" that underlying assets have the same liquidity as the ETP, particularly with respect to bond ETPs).

underlying securities.[377] Thus, shares of an ETF whose underlying securities are relatively less liquid (taking into account the factors discussed in proposed rule 22e-4(b)(2)(ii)) may not be able to be counted on as an effective liquidity risk management tool during times of liquidity stress. In the case of a significant decline in market liquidity, if authorized participants were unwilling or unable to trade ETF shares in the primary market, and the majority of trading took place among investors in the secondary market, the ETF's shares could trade continuously at a premium or a discount to the value of the ETF's underlying portfolio securities. This could frustrate the expectations of secondary market investors who count on the creation and redemption process to align the prices of ETF shares and their underlying portfolio securities.[378] We therefore encourage funds to assess the liquidity characteristics of an ETF's underlying securities, as well as the characteristics of the ETF shares themselves, in classifying an ETF's liquidity under proposed rule 22e-4(b)(2)(i). We also encourage funds to consider the portion of a fund's three-day liquid assets that is invested in ETF shares, taking into account the foregoing concerns.

c. Suspension of Redemptions

Section 22(e) of the Investment Company Act permits a fund to suspend redemptions in specified unusual circumstances, including for any period during which an emergency exists (only as determined by Commission rules and regulations) as a result of which it is not reasonably practicable for the fund to liquidate its portfolio securities, or fairly determine the

377 *See supra note* 24 and accompanying text; *see also* Tyler Durden, *What Would Happen if ETF Holders Sold All at Once?*, ETF Daily News (Mar. 26, 2015), *available at* http://etfdailynews.com/2015/03/26/what-would-happen-if-etf-holders-sold-all-at-once/2/ ("Thus we can't get away from depending on the liquidity of the underlying high yield bonds. The ETF can't be more liquid than the underlying, and we know the underlying can become highly illiquid.").

378 *See supra* note 29 and accompanying text.

value of its net assets.[379] Rule 22e-3 exempts money market funds from section 22(e), permitting a money market fund to suspend redemptions and postpone payment of redemption proceeds in an orderly liquidation of the fund if, subject to other requirements, the fund's board makes certain findings.[380] The Commission has previously requested comment on whether the relief provided by rule 22e-3 should be available to types of open-end funds besides money market funds.[381] The Commission received only limited comments addressing the topic, with a few commenters generally supportive of extending the rule to all open-end funds,[382] and one commenter arguing that open-end funds should be required to seek individual exemptive orders from the Commission to obtain the relief provided by rule 22e-3.[383] We request specific comment below on whether proposing a rule similar to rule 22e-3, which would permit open-end funds other than money market funds to suspend redemptions and postpone payment of redemption proceeds in an orderly liquidation of the fund under certain circumstances, would protect the interests of its investors if the fund were to liquidate.

We also request comment below on whether the Commission should consider proposing rules that would permit funds to suspend redemptions under other circumstances not involving the liquidation of the fund.[384] As discussed above, private funds are often able to impose gates

379 See *supra* note 82.

380 *See supra* note 155 and accompanying text.

381 *See* 2009 Money Market Fund Reform Proposing Release, *supra* note 366.

382 *See* Comment Letter of the Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association on Money Market Fund Reform (Sept. 9, 2009); Comment Letter of Bankers Trust Company, N.A. on Money Market Fund Reform (Aug. 28, 2009).

383 *See* Comment Letter of Federated Investors, Inc. on Money Market Fund Reform (Sept. 8, 2009).

384 *See, e.g.,* BlackRock FSOC Notice Comment Letter, *supra* note 50, at 40 (stating that the Commission should "extend the authority to suspend redemptions under extraordinary redemptions, including an unmanageable spike in redemptions, to fund boards.").

and suspend redemptions to manage liquidity stress,[385] and rule 2a-7 likewise permits money market funds to temporarily suspend redemptions under certain circumstances.[386] Registered funds that are not money market funds, however, are significantly more limited in their current ability to suspend redemptions under the Investment Company Act.[387] Specifically, open-end funds may suspend redemptions for any period during which the NYSE is closed (other than customary weekend and holiday closings) and in three additional situations only if the Commission has made certain determinations.[388] These limited suspension rights are aimed at preventing funds and their advisers from interfering with shareholders' redemption rights for improper purposes,[389] and recognize the importance that shareholders place on daily redeemability of fund shares.

d. Request for Comment

We request comment on the above discussion and guidance regarding certain tools that a fund could use to manage liquidity risk beyond the requirements specified in proposed rule 22e-4.

- Are there any specific liquidity risk management policies or procedures, beyond those that would be required by proposed rule 22e-4(b)(2)(iv)(A)-(E), that funds should be required to implement? What procedures, separate from any that resemble those required by proposed rule 22e-4(b)(2)(iv)(A)-(E), do funds currently use to manage liquidity risk?

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385 *See supra* note 71 and accompanying text.

386 *See supra* note 154 and accompanying text.

387 *See supra* text accompanying note 379.

388 *See supra* note 82.

389 *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.1.

- Do commenters generally agree with our guidance discussed above on the use of borrowing arrangements and other funding sources, the use of ETFs to manage portfolio liquidity, and the use of redemptions in kind? Is any additional guidance needed on the liquidity risk management tools described in this section? Are there any other issues associated with specific liquidity risk management tools or techniques about which we should provide guidance? To the extent that funds use liquidity risk management tools outside those mentioned in this section, what guidance, if any, is needed regarding those tools?
- Regarding borrowing arrangements and other funding sources, would additional guidance be useful regarding specific types of borrowing arrangements?
- When using ETFs to manage liquidity, do funds consider the liquidity of the ETFs' portfolio securities? Why or why not?

We also request specific comment on several current rules that touch on liquidity risk management issues and the suspension of shareholder redemptions.

- Would proposing a rule similar to rule 22e-3 for funds other than money market funds protect the interests of fund investors if the fund were to liquidate? If so, under what circumstances should funds be permitted to suspend redemptions and postpone payment of redemption proceeds, and should a fund's board be required to make any finding in connection with a fund's suspension of redemptions?
- Should we consider proposing rules that would permit funds to suspend redemptions under other circumstances, such as rules that would specify certain emergency circumstances that would permit funds to suspend redemptions under section 22(e)? How could we define such emergency circumstances? For example, should we define

emergency circumstances to include situations where redemptions exceeded a high level over a certain period of time or where asset price volatility in the markets exceeded a certain level making it difficult for the fund to accurately price?

7. *Cross-Trades*

Funds, subject to the requirements of the Investment Company Act, are permitted to engage in "cross-trading," that is, securities transactions with certain of their affiliated persons, including other funds within the fund family. Some funds may seek to use cross-trading as an additional liquidity risk management tool. Rule 17a-7, however, includes conditions that limit the portfolio assets that may be cross-traded, and as discussed below, cross-trades that involve certain less liquid assets may not be eligible to rely on the rule. We propose below guidance relating to the use of cross-trading in response to investor redemptions.

Section 17 of the Investment Company Act restricts transactions between an "affiliated person of a registered investment company or an affiliated person of such affiliated person" and that investment company—for example, transactions between a fund and another fund managed by the same adviser.[390] A fund must therefore obtain exemptive relief from the Commission before entering into purchase or sale transactions with an affiliated fund, or execute such transactions subject to the provisions of rule 17a-7 under the Investment Company Act (permitting purchase and sale transactions among affiliated funds and other accounts, under certain circumstances).[391]

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390 *See supra* note 320 and accompanying text.

391 Rule 17a-7 under the Investment Company Act provides an exemption from section 17(a)'s prohibitions so long as certain conditions are met. In summary, rule 17a-7 requires, among other things, that: (i) the transaction at issue is a purchase or sale, for no consideration other than cash, for a security for which market quotations are readily available; (ii) the transaction be effected at the independent current market price for the security at issue; (iii) the transaction must be consistent with the policy of each fund participating in the transaction as set forth in its registration statement and reports filed under the

Cross-trading can benefit funds and their shareholders, for example by allowing funds that are mutually interested in a securities transaction that is consistent with the investment strategies of each fund to conduct such a transaction without incurring transaction costs and without generating a market impact.[392] However, cross-trades also have the potential for abuse. As the Commission has said, "[f]or example, an unscrupulous investment adviser might "dump" undesirable securities on a registered investment company or transfer desirable securities from a registered investment company to another more favored advisory client in the complex. Moreover the transaction could be effected at a price which is disadvantageous to the registered investment company."[393] Accordingly, rule 17a-7 requires that any cross-trades satisfy certain conditions designed to prevent such abuses, including the requirement that market quotations be readily available for each traded security and that if the security is only traded over the counter, the cross-trade be conducted at the average of the highest current independent bid and lowest current independent offer determined on the basis of reasonable inquiry.[394] In requiring market quotations for cross-traded securities, the Commission has stated that "[r]eliance upon such market quotations provides an independent basis for determining that the terms of the transaction

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Investment Company Act; (iv) no brokerage commission, fee (except for customary transfer fees) or other remuneration be paid in connection with the transaction; and (v) the fund's board, including a majority of the independent directors, adopts procedures that are reasonably designed to provide that the rule 17a-7 transactions comply with the conditions of the rule, approve changes to the procedures as the board deems necessary, and determines no less frequently than quarterly that all rule 17a-7 transactions made during the preceding quarter were effected in compliance with the approved procedures.

392 As noted above, rule 17a-7 requires that each cross-trade be consistent with the policy of each fund participating in the transaction and that no brokerage commissions, fees or other remuneration be paid in connection with the transaction. Because cross-trades are conducted privately between funds, they are not transparent to market trading reporting systems and thus are unlikely to generate a market impact.

393 Exemption of Certain Purchase or Sale Transactions Between a Registered Investment Company and Certain Affiliated Persons Thereof, Investment Company Act Release No. 11136 (Apr. 21, 1980) [45 FR 29067 (May 1, 1980)].

394 *See* rule 17a-7(b).

are fair and reasonable to each participating investment company and do not involve overreaching."[395]

Certain less liquid assets may be ineligible to trade under rule 17a-7 due to this requirement. Indeed, the less liquid an asset is, the more likely it may not satisfy rule 17a-7.[396] Accordingly, for assets that do not trade in active secondary markets, a fund should consider whether "market quotations are readily available" and a "current market price" is available and thus whether the asset may be cross-traded in accordance with rule 17a-7.

In addition, when considering whether cross-trading would be an effective and appropriate liquidity risk management tool, a fund's adviser should consider its duty to seek best execution for each fund potentially involved in the cross-trading transaction, as well as its duty of loyalty to each fund.[397] An adviser should not cause funds to enter into a cross-trade unless doing so would be in the best interests of each fund participating in the transaction. In assessing these factors, a fund should consider any negative impact on the fund resulting from the purchase of assets by one fund from an affiliated fund (that is, whether any risk-shifting between funds that results from trading assets is appropriate, considering the funds' strategies, risk profile, and liquidity needs before the transaction takes place) given the policy of each fund as recited in its registration statement and reports under the Act. We request comment on our guidance relating to cross-trading.

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395 Exemption of Certain Purchase or Sale Transactions Between a Registered Investment Company and Certain Affiliated Persons Thereof, Investment Company Act Release No. 11676 (Mar. 10, 1981) [45 FR 17011 (Mar. 17, 1981)]. The Commission historically declined to expand rule 17a-7 to cross-trades for which market quotations were not readily available and where independent current market prices were not available because these conditions increase the potential for abuse through cross-trades. *See id.*

396 *See supra* section III.B.2 (discussing proposed factors for classifying the liquidity of a portfolio position).

397 *See, e.g.*, In the Matter of Western Asset Management Co., Investment Company Act Release No. 30893 (Jan. 27, 2014) (settled action) (the adviser to funds engaging in cross-trading "has a fiduciary duty of loyalty to its clients and also must seek to obtain best execution for both its buying and selling clients").

- Does our guidance (combined with existing guidance) relating to rule 17a-7 provide sufficient protections for cross-trades involving assets that are only traded over the counter and, depending on the facts and circumstances, may be less liquid? If not, what additional guidance or protections might be warranted to protect funds and investors from unfairness or abuse in cross-trades?

D. Board Approval and Designation of Program Administrative Responsibilities

1. Initial Approval of Liquidity Risk Management Program

Proposed rule 22e-4(b)(3)(i) would require each fund to obtain initial approval of its written liquidity risk management program from the fund's board of directors, including a majority of independent directors.[398] The proposed rule specifies that this approval is required to include the fund's three-day liquid asset minimum. Directors, and particularly independent directors, play a critical role in overseeing fund operations, although they may delegate day-to-day management to a fund's adviser.[399] Given the board's historical oversight role, we believe it is appropriate to require a fund's board to approve the fund's liquidity risk management program. This requirement is designed to facilitate independent scrutiny by the board of directors of the liquidity risk management program – an area where there may be a conflict of interest between the investment adviser and the fund. For example, an adviser might have an incentive to set a low three-day liquid asset minimum in order to permit the fund to invest in

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398 In this release, we refer to directors who are not "interested persons" of the fund as "independent directors." Section 2(a)(19) of the Investment Company Act identifies persons who are "interested persons" of a fund.

399 *See* Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 112 (1940) at 109 (describing the board as an "independent check" on management); *Burks v. Lasker*, 441 U.S. 471 (1979) (citing Tannenbaum v. Zeller, 552 F.2d 402, 406 (2d. Cir. 1979)) (describing independent directors as "independent watchdogs"). *See also* Comment Letter of the Independent Directors Council on the FSOC Notice (Mar. 25, 2015), at 5 ("A fund board oversees the adviser's management of the portfolio's liquidity as part of its oversight of the fund's compliance program and portfolio management more generally.").

additional less liquid assets (because such assets may result in higher total returns for a fund), even though a low minimum may not reflect an appropriate alignment between the fund's portfolio liquidity profile and the fund's liquidity needs.

Directors may satisfy their obligations with respect to this initial approval by reviewing summaries of the liquidity risk management program prepared by the fund's investment adviser or officers administering the program, legal counsel, or other persons familiar with the liquidity risk management program. The summaries should familiarize directors with the salient features of the program and provide them with an understanding of how the liquidity risk management program addresses the required assessment of the fund's liquidity risk, including how the fund's investment adviser or officers administering the program determined the fund's three-day liquid asset minimum. In considering whether to approve a fund's liquidity risk management program, the board may wish to consider the nature of the fund's liquidity risk exposure. A board also may wish to consider the adequacy of the fund's liquidity risk management program in light of recent experiences regarding the fund's liquidity, including any redemption pressures experienced by the fund.

2. *Approval of Material Changes to Liquidity Risk Management Program and Oversight of the Three-Day Liquid Asset Minimum*

Proposed rule 22e-4(b)(3)(i) also would require each fund to obtain approval of any material changes to the fund's liquidity risk management program, including changes to the fund's three-day liquid asset minimum, from the fund's board of directors, including a majority of independent directors. As with the initial approval of a fund's liquidity risk management program, the requirement to obtain approval of any material changes to the fund's liquidity risk management program from the board is designed to facilitate independent scrutiny of material changes to the liquidity risk management program by the board of directors. We note that our proposal to require directors to approve material changes to the fund's liquidity risk management program differs from the requirements under rule 38a-1 under the Act, which does not require a fund board to approve changes to a fund's compliance policies and procedures.[400] Given that the fund's liquidity risk management program will be administered by a fund's investment adviser or officers (rather than a chief compliance officer),[401] we believe that board approval of material changes in this context will provide an important independent check on such administration.

The fund's board would be responsible under the proposed rule for reviewing a written report from the fund's investment adviser or officers administering the fund's liquidity risk management program, provided no less frequently than annually, that reviews the adequacy of the fund's liquidity risk management program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation.[402] This aspect of the proposed rule is designed to facilitate board oversight over the adequacy and effectiveness of the fund's liquidity risk management program, including the three-day liquid asset minimum and whether the three-day liquid asset minimum is providing an appropriate level of minimum liquidity to the fund in

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400 Rule 38a-1 requires that the fund's chief compliance officer provide a written annual report to the fund's board addressing, among other things, any material changes made to the fund's compliance policies and procedures since the date of the last report and any material changes to the fund's compliance policies and procedures recommended as a result of the fund's annual review of the adequacy of such policies and procedures and the effectiveness of their implementation.

401 Rule 38a-1 contains several provisions "designed to promote the independence of the chief compliance officer from the management of the fund." *See* Rule 38a-1 Adopting Release, *supra* note 90. These include: rule 38a-1(a)(4)(i) (designation and compensation of the chief compliance officer must be approved by the fund's board, including a majority of the fund's independent directors); rule 38a-1(a)(4)(ii) (the chief compliance officer can only be discharged from his or her responsibilities with the approval of the fund's board, including a majority of the fund's independent directors); rule 38a-1(a)(4)(iii) (the chief compliance officer must provide an annual report to the board addressing: (i) the operation of the policies and procedures of the fund and certain service providers since the last report; (ii) any material changes to the policies and procedures since the last report; (iii) any recommendations for material changes to the policies and procedures as a result of the annual review; and (iv) any material compliance matters since the date of the last report); and rule 38a-1(a)(4)(iv) (requiring the chief compliance officer to meet separately with the fund's independent directors at least once a year).

402 Proposed rule 22e-4(b)(3)(ii).

light of changes in the markets, the fund, and its shareholder base over time. To the extent that the board is being asked to approve a change in a fund's three-day liquid asset minimum, the written report should also provide directors with an understanding of how a change to the fund's three-day liquid asset minimum was determined to be appropriate. We believe that this review and its related report will provide the board with sufficient information to provide oversight over the adequacy and effective implementation of the fund's liquidity risk management program. As with the initial approval of each fund's liquidity risk management program, directors may also wish to consider the nature of the fund's liquidity risk exposure in approving any material changes, particularly with respect to the fund's three-day liquid asset minimum.

3. Designation of Administrative Responsibilities to Fund Investment Adviser or Officers

Proposed rule 22e-4(b)(3)(iii) would expressly require a fund to designate the fund's investment adviser or officers (which may not be solely portfolio managers of the fund) responsible for administering the fund's liquidity risk management program, which designation must be approved by the fund's board of directors. Designating the fund's investment adviser or officers responsible for the administration of the fund's liquidity risk management program, subject to board oversight, is consistent with the way we understand most funds currently manage liquidity.[403] The proposed designation also tasks the persons who are in a position to manage the fund's liquidity risks on a real-time basis with responsibility for administration of the liquidity risk management program. In administering a fund's liquidity risk management program, the fund's investment adviser or officers may wish to consult with the fund's portfolio

403 *See* FEDERAL REGULATION OF SECURITIES COMMITTEE, AMERICAN BAR ASSOCIATION, FUND DIRECTOR'S GUIDEBOOK (4th ed. 2015), at p. 82 ("Determining the liquidity of a security is primarily an investment decision that is delegated to the investment adviser, but directors may establish guidelines and standards for determining liquidity.").

manager, traders, risk managers, and others as necessary or appropriate (*e.g.*, to obtain information used in classifying the liquidity of a new portfolio position), but we note that the fund's portfolio managers may not be solely responsible for administering the program.

We understand, based on staff outreach, that some funds employ a dedicated risk management officer and task liquidity risk management to this officer, in consultation with the fund's portfolio management function. The board of a fund that employs a dedicated risk management officer (or an officer whose role includes risk management among other duties) may find it appropriate to designate administration of the fund's liquidity risk management program to this officer. We request comment below on whether a fund should be required to specifically task administration of the fund's liquidity risk management program to a dedicated risk officer, or whether we should otherwise specify the officer who must administer the fund's liquidity risk management program.

Because the administration of a fund's liquidity risk management program would be designated to a fund's investment adviser or officers, the investment adviser or officers should provide the board with enough information to oversee such administration. As discussed above, the fund's investment adviser or officers would therefore be required to provide the board with a written report on the adequacy of the fund's liquidity risk management program, including the three-day liquid asset minimum, and the effectiveness of its implementation, at least annually. To the extent that a serious compliance issue arises under the program, it may be appropriate to consider whether the event should be brought to the board's attention promptly.[404]

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404 See Rule 38a-1 Adopting Release, supra note 90 (noting, in the case of a rule 38a-1 compliance program, that "[s]erious compliance issues must, of course, always be brought to the board's attention promptly").

We understand that, in certain circumstances, a fund's service providers may assist a fund and its investment adviser in monitoring factors relevant to a fund's liquidity risk and managing the fund's liquidity risk. For example, third parties could provide data relevant to assessing fund flows. Also, a sub-adviser's portfolio management responsibilities would involve investing a fund's assets in accordance with the fund's three-day liquid asset minimum and any other liquidity-related portfolio requirements adopted by the fund.[405] While we understand that such actions could provide useful assistance to a fund in assessing, monitoring, and managing liquidity risk, we note that the primary parties responsible for a fund's liquidity risk management are the fund itself and any parties to whom the fund has designated responsibility for administering the fund's liquidity risk management program. A fund (or its investment adviser, to the extent the investment adviser has been given liquidity risk management responsibility) should thus oversee any liquidity risk monitoring or risk management activities undertaken by the fund's service providers, and we encourage a fund (or its investment adviser, as appropriate) to communicate regularly with its service providers as a part of its oversight and to coordinate the liquidity risk management efforts undertaken by various parties.

4. *Request for Comment*

We request comment on the proposed board approval and oversight requirements.

- Do fund boards currently approve procedures for classifying the liquidity of portfolio assets? Do fund boards take any additional steps to oversee the liquidity of portfolio assets? Should the Commission require boards, including a majority of independent

405 A fund could also formally designate a fund's sub-adviser as responsible for the fund's liquidity risk management program.

directors, to approve the initial liquidity risk management program, including the three-day liquid asset minimum?

- Should the Commission require boards to approve material changes to a fund's liquidity risk management program, including any changes to a fund's three-day liquid asset minimum? Should the Commission define what would constitute a "material change" to a fund's liquidity risk management program or provide additional guidance regarding what changes would constitute material changes? Alternatively, should the Commission require boards to approve all changes to a fund's liquidity risk management program? Or, similar to rule 38a-1 regarding a fund's compliance program, should there be no requirement for board approval of changes to the liquidity risk management program?
- Does the release provide adequate guidance to fund boards regarding their approval of the liquidity risk management program? Should we provide any additional guidance in this regard?
- Do commenters agree that it would be appropriate to require a fund to designate the fund's adviser or officers responsible for administering a fund's liquidity risk management program, subject to board approval? Is it appropriate to specify that those administering the program may not be solely the fund's portfolio managers? Would any small fund complexes have difficulty meeting the proposed requirement that the program may not be solely administered by the fund's portfolio manager? Is it appropriate to allow a fund to designate a fund sub-adviser responsible for administering a fund's liquidity risk management program? Should the Commission require a fund to task administration of the fund's liquidity risk management program to a specific officer of

the fund? Should the Commission require that a fund have a chief risk officer or risk committee administer the fund's liquidity risk management program?

- Should the Commission specify a shorter or longer frequency for review of a report on the fund's liquidity risk management program? Should the report to the board cover both the adequacy and effectiveness of the fund's liquidity risk management program as well as the adequacy of the fund's three-day liquid asset minimum? Alternatively, would a report reviewing the adequacy of the fund's three-day liquid asset minimum likely provide a review of the fund's liquidity risk management program overall given the factors that must be assessed in setting the three-day liquid asset minimum?
- Are there other aspects of the fund's liquidity risk management program about which the fund's investment adviser or officers responsible for administering the program should report to the board? Should we provide any additional guidance to fund boards in connection with the approval and oversight of a fund's liquidity risk management program?

E. Liquidity Risk Management Program Recordkeeping Requirements

We are proposing to require that each fund maintain a written copy of the policies and procedures adopted as part of its liquidity risk management program for five years, in an easily accessible place.[406] Each fund also would be required to maintain copies of any materials provided to its board in connection with the board's initial approval of the fund's liquidity risk management program and approvals of any subsequent material changes to the program, including any changes to the fund's three-day liquid asset minimum, and copies of written reports provided to the board that review the adequacy of the fund's liquidity risk management

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406 Proposed rule 22e-4(c)(1).

program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation.[407] Funds would have to maintain such records for at least five years after the end of the fiscal year in which the documents were provided to the board, the first two years in an easily accessible place.

Finally, we are proposing to require that each fund keep a written record of how its three-day liquid asset minimum, and any adjustments thereto, were determined, including the fund's assessment and periodic review of its liquidity risk in light of the factors incorporated in paragraphs (b)(2)(iii)(A) through (D) of proposed rule 22e-4.[408] Funds would have to maintain such records for a period of not less than five years, the first two years in an easily accessible place, following the determination of, and each change to, the fund's three-day liquid asset minimum.

The records discussed above are designed to provide our examination staff with a basis to determine whether a fund has adopted a liquidity risk management program in compliance with the requirements of proposed rule 22e-4. Specifically, such records would help our staff to determine whether a fund's program incorporates the elements required to be included under paragraph (b)(2) of proposed rule 22e-4. We also anticipate that these records would assist our staff in identifying weaknesses in a fund's liquidity risk management if violations do occur or are uncorrected.

The five-year retention period in proposed rule 22e-4(c) is consistent with that in rule 38a-1(d) under the Act. We believe consistency in these retention periods is appropriate because funds currently have program-related recordkeeping procedures in place incorporating a five-

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407 Proposed rule 22e-4(c)(2); *see also* proposed rule 22e-4(b)(3)(i)-(ii).

408 Proposed rule 22e-4(c)(3).

year retention period, which we believe would lessen the compliance burden to funds slightly, compared to choosing a different retention period, such as the six-year recordkeeping retention period under rule 31a-2 of the Act. Taking this into account, we believe a five-year retention period is a sufficient period of time for our examination staff to evaluate whether a fund is in compliance (and has been in compliance) with the liquidity risk management program requirements of the rule and anticipate that such information would become less relevant if extended beyond a five-year retention period. Furthermore, we believe that the proposed five-year retention period appropriately balances recordkeeping-related burdens on funds.

We request comment on the proposed liquidity risk management program recordkeeping requirements.

- Do commenters agree that the proposed recordkeeping requirements are appropriate? Specifically, are there any additional records associated with a fund's liquidity risk management program that a fund should be required to keep? Should a fund be required to keep a written record of how the liquidity classifications of each of the fund's positions in a portfolio asset were determined, including assessment of the factors set forth in proposed rule 22e-4(b)(2)(ii)? Should a fund be required to keep a written record of what liquidity classifications were determined for each of the fund's positions in a portfolio asset? Do commenters anticipate that, to the extent that data regarding certain factors that a fund would be required to consider in classifying its portfolio positions' liquidity could be obtained largely through automated systems, it would be possible to easily re-create a record of how past liquidity classifications assigned to a fund's portfolio positions were determined? Are there feasible alternatives to the proposed rule that would minimize recordkeeping burdens, including the costs of maintaining the required records?

- Do commenters agree that the five-year retention period for records that would be required to be kept pursuant to proposed rule 22e-4(c) is appropriate? If not, what retention period would commenters recommend? Would commenters recommend a six-year retention period? Why or why not?
- We specifically request comment on any alternatives to the proposed recordkeeping requirements that would minimize recordkeeping burdens on funds, the utility and necessity of the proposed recordkeeping requirements in relation to the associated costs and in view of the public benefits derived, and the effects that additional recordkeeping requirements would have on funds' internal compliance policies and procedures.[409]

F. Swing Pricing

Rule 22c-1 under the Investment Company Act, the "forward pricing" rule, requires funds, their principal underwriters, dealers in fund shares, and other persons designated in a fund's prospectus, to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to purchase or redeem.[410] When a fund trades portfolio assets as a result of purchase or redemption requests, costs associated with this trading activity can dilute the value of the existing shareholders' interests in the fund. This dilution occurs because the price at which shareholders transact in fund shares reflects the shares' current NAV that is

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409 *See* sections 30(c)(2)(A), 30(c)(2)(B), and 31(a)(2) of the Investment Company Act.

410 *See* rule 22c-1(a). Prior to adoption of rule 22c-1, investor orders to purchase and redeem could be executed at a price computed before receipt of the order, allowing investors to lock-in a low price in a rising market and a higher price in a falling market. The forward pricing provision of rule 22c-1 was designed to eliminate these trading practices and the dilution to fund shareholders which occurred as a result of backward pricing. Pricing of Redeemable Securities for Distribution, Redemption, and Repurchase, Investment Company Act Release No. 14244 (Nov. 21, 1984) [49 FR 46558 (Nov. 27, 1984)], at text following n.2.

next computed after the fund's receipt of the shareholders' purchase and redemption requests (generally, the fund's NAV calculated as of the close of the fund's primary underlying market, which is typically 4:00 p.m. Eastern Time),[411] but the fund's NAV will not generally reflect changes in holdings of the fund's portfolio assets and changes in the number of the fund's outstanding shares until the first business day following the fund's receipt of the shareholders' purchase and redemption requests.[412] Thus, the price that a purchasing shareholder pays for fund shares customarily does not take into account the market impact costs and trading costs that arise when the fund buys portfolio assets in order to invest proceeds of shareholder purchases. Likewise, the price that a redeeming shareholder receives for fund shares customarily does not take into account the market impact costs and trading costs that arise when the fund sells portfolio assets in order to meet shareholder redemptions. Going forward, however, the NAV of the fund shares held by existing shareholders does reflect these costs, and thus these costs are borne not by the purchasing or redeeming shareholders but by all existing fund shareholders.[413]

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411 *See supra* note 41 and accompanying text.

412 *See* rule 2a-4(a)(2) (providing that changes in holdings of portfolio securities shall be reflected in the fund's current NAV no later than in the first calculation on the first business day following the trade date); rule 2a-4(a)(3) (providing that changes in the number of outstanding shares of the registered company resulting from distributions, redemptions, and repurchases shall be reflected in the fund's current NAV no later than in the first calculation on the first business day following such change); *see also* BlackRock, *Swing Pricing: The Dilution Effects of Trading Activity* (Dec. 2011), *available at* http://www2.blackrock.com/content/groups/internationalsite/documents/literature/1111157589.pdf ("BlackRock Swing Pricing Paper").

413 *See* Association of the Luxembourg Fund Industry, *Swing Pricing: Survey, Reports & Guidelines* (Feb. 2011), *available at* http://www.alfi.lu/sites/alfi.lu/files/ALFI_Swing_Pricing.pdf ("Luxembourg Swing Pricing Survey, Reports & Guidelines"), at 13 ("[T]he single price at which investors buy and sell the fund's shares only reflects the value of its net assets. It does not take into account the dealing costs that arise when the portfolio manager trades as a result of capital activity incurring a spread on the underlying securities. In other words, the charges incurred fall not on the client who has just traded, but on all investors in the fund.").

To the extent that a fund were to apply a purchase fee or redemption fee, shareholders would, at least to a certain extent, bear the transaction-related costs associated with their purchase and redemption requests. *See infra* notes 421-422 and accompanying text; *see also* Securities and Exchange Commission, *Mutual Fund Fees and Expenses*, *available at* http://www.sec.gov/answers/mffees.htm.

While forward pricing captures the changes in portfolio assets' value that arise as a result of market-wide trading, it does not necessarily reflect any disparity between the market price of a portfolio asset at the end of the day (as determined for purposes of striking a fund's NAV) and the price that a fund receives for trading that asset. This scenario could arise, for example, in situations in which an asset's value changes throughout the day, and the price that a fund receives when trading that asset differs from the market value of the asset at the end of the day. It also could arise if a fund were forced to sell a relatively less liquid asset at an inopportune time, and thus had to accept a price for that asset that incorporates a significant discount to the asset's stated value.

To provide an illustration of a situation in which forward pricing may not result in a fund's NAV reflecting the price that a fund actually received when it sold portfolio assets, consider the following example. If a fund has valued portfolio asset X at $10 at the beginning of day 1, and market activity on day 1 (including the fund's sale of portfolio asset X) decreases the market value of portfolio asset X to $9 at the end of day 1, the fund's remaining holdings of portfolio asset X at the end of day 1 would be valued at $9 to reflect the asset's market value on that day. However, staff outreach has shown that it is common industry practice, as permitted by rule 2a-4, for the fund's current NAV to not reflect the actual price at which the fund has sold the portfolio assets until the next business day following the sale.[414] In the example above, if the fund selling portfolio asset X sold the asset during the day at $8 on day 1, the price that the fund received for these asset sales would not be reflected in the fund's NAV until day 2. Thus,

414 *See* 2a-4(a)(2) (providing that changes in holdings of portfolio securities shall be reflected in the fund's current NAV no later than in the first calculation on the first business day following the trade date). The next day's NAV would generally reflect the cash receivable from the sale instead of the value of the shares that were sold (although if the shares were sold and settled within a T+0 or T+1 timeframe, the next day's NAV would reflect the value of the shares that were sold).

redeeming shareholders would have received an exit price that would reflect portfolio asset X being valued at the close of the market at $9 on day 1, whereas remaining shareholders would hold shares on day 2 whose value reflects portfolio asset X being sold at $8 (the actual price that the fund received when it sold the asset on day one).

Similarly, as noted above, the price that a purchasing shareholder pays for fund shares normally does not take into account trading and market impact costs that arise when the fund buys portfolio assets to invest the proceeds received from shareholder purchases. For example, when a fund experiences net inflows, it may invest the proceeds of shareholder purchases over several days following the purchase of fund shares. Thus, the purchase price that shareholders receive on day 1 would not reflect any transaction fees associated with investing the proceeds of shareholder purchases on subsequent days, or any market activity (including the fund's purchase of portfolio assets) that increases the value of the fund's portfolio assets. To illustrate, if the fund's NAV on day 1 (and the purchase price an incoming shareholder were to receive on day 1) reflects portfolio asset X being valued at $10, but the fund were to purchase additional shares of portfolio asset X on day 2 at $11, the price that a purchasing shareholder pays on day 1 would not reflect the costs of investing the proceeds of the shareholder's purchases of fund shares. These costs instead would be reflected in the fund's NAV on days following the shareholder's purchase, and thus would be borne by all of the investors in the fund, not only the shareholders who purchased on day 1.

Certain foreign funds currently use "swing pricing," the process of adjusting the fund's NAV to effectively pass on the market impact costs,[415] spread costs,[416] and transaction fees and

415 Market impact costs are incurred when the price of a security changes as a result of the effort to purchase or sell the security. Stated formally, market impacts are the price concessions (amounts added to the purchase price or subtracted from the selling price) that are required to find the opposite side of the trade and

charges stemming from net capital activity (*i.e.*, flows into or out of the fund) to the shareholders associated with that activity, in order to protect other shareholders from dilution arising from these costs. Investment management industry representative associations operating in certain European jurisdictions have adopted guidelines on swing pricing procedures in recent years,[417] and a survey conducted by the Association of the Luxembourg Fund Industry ("ALFI") several years ago confirmed a strong directional trend towards the adoption of swing pricing among major market participants in that jurisdiction, which is a significant jurisdiction for the organization of UCITS funds in Europe.[418] Likewise, several comments from asset managers

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complete the transaction. Market impact cost cannot be calculated directly. It can be roughly estimated by comparing the actual price at which a trade was executed to prices that were present in the market at or near the time of the trade. *See* Concept Release: Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs, Investment Company Act Release No. 26313 (Dec. 18, 2003) [68 FR 74819 (Dec. 24, 2003)] ("Transaction Cost Concept Release").

416 Spread costs are incurred indirectly when a fund buys a security from a dealer at the "asked" price (slightly above current value) or sells a security to a dealer at the "bid" price (slightly below current value). The difference between the bid price and the asked price is known as the "spread." *See* Transaction Cost Concept Release, *supra* note 415. For equity securities listed on an exchange, the costs associated with trading the security typically take the form of brokerage commissions, as opposed to spread costs.

417 *See, e.g.*, Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413; Association Francaise de la Gestion Financière, *Charte de bonne conduit pour le Swing Pricing et les droits d'entrée et de sortie ajustables acquis aux fonds* (2014), *available at* http://www.afg.asso.fr/index.php?option=com_content&view=article&id=5459%3Acharte-de-bonne-conduite-pour-le-swing-pricing-et-les-droits-dentree-et-de-sortie-ajustables-acquis-aux-fonds&catid=527%3A2014&lang=fr.

The European Commission's 2009 revised Undertakings for Collective Investment in Transferable Securities ("UCITS") Directive does not specifically provide for swing pricing, but does provide that "[t]he rules for the valuation of assets and the rules for calculating the sale or issue price and the repurchase or redemption price of the units of a UCITS shall be laid down in the applicable national law, in the fund rules or in the instruments of incorporation of the investment company." *Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities*, OFFICIAL J. OF THE EUROPEAN UNION (Nov. 2009), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:en:PDF, at Article 85.

418 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413; *see also* BlackRock Swing Pricing Paper, *supra* note 412 (discussing the results of the ALFI survey). The results of the ALFI survey indicated that the majority of respondents were already using swing pricing, and the number of fund managers using swing pricing had tripled over the previous five years.

received in response to the FSOC Notice[419] noted favorably that funds regulated under the UCITS Directive use swing pricing to allocate transaction costs to purchasing and redeeming shareholders.[420]

Commission rules and guidance do not currently address the ability of a fund to use swing pricing to mitigate potential dilution of fund shareholders. The Commission has previously recognized that excessive trading of mutual fund shares could dilute the value of long-term investors' shares,[421] however, and in response to this, the Commission adopted rule 22c-2 under the Investment Company Act. Rule 22c-2, among other things, permits a fund to impose a fee of up to two percent on shareholders' redemptions and requires fund boards to consider imposing redemption fees under certain circumstances.[422] While redemption fees (or purchase fees) could mitigate dilution arising from shareholder transaction activity,

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419 *See supra* note 16.

420 *See* Comment Letter of AllianceBernstein L.P. on the FSOC Notice (Mar. 25, 2015) (noting that UCITS funds may utilize swing pricing to "accurately reflect the costs borne by other shareholders stemming from transaction costs"); BlackRock FSOC Notice Comment Letter, *supra* note 50, at 5 and 39 (recommending that policy makers consider a "mechanism to allocate transaction costs to redeeming shareholders as a way to provide a price signal for the price of market liquidity and to reimburse or buffer a fund's remaining shareholders"); *see also* Nuveen FSOC Notice Comment Letter, *supra* note 45, at n.26 ("The SEC could also study proposals to change the pricing mechanisms for mutual fund subscriptions and redemptions in such a way that, under certain pre-specified circumstances, subscribing and redeeming shareholders would bear the cost of portfolio transactions necessary to invest cash for new subscriptions and to fund redemptions."); Occupy the SEC FSOC Notice Comment Letter, *supra* note 45, at 13 (stating that investors buying or selling large amounts of fund shares impose costs on the fund that results in inequitable outcomes as long-term investors subsidize those who trade more actively and that for funds that hold illiquid assets these externalities can become quite material).

421 *See, e.g.*, Mutual Fund Redemption Fees, Investment Company Act Release No. 26782 (Mar. 11, 2005) [70 FR 13328 (Mar. 18, 2005)] ("Rule 22c-2 Adopting Release") at n.7 and accompanying text.

422 Rule 22c-2 prohibits a fund from redeeming shares within seven days after the share purchase unless the fund meets three conditions. *See* rule 22c-2(a). First, the board of directors must either: (i) approve a redemption fee (in an amount not to exceed two percent of the value of shares redeemed), or (ii) determine that imposition of a redemption fee is either not necessary or not appropriate. Second, the fund (or its principal underwriter or transfer agent) must enter into a written agreement with each financial intermediary under which the intermediary agrees to, among other things: (i) provide, at the fund's request, identity and transaction information about shareholders who hold their shares through an account with the intermediary; and (ii) execute instructions from the fund to restrict or prohibit future purchases or exchanges. Third, the fund must maintain a copy of each written agreement with a financial intermediary for six years.

implementing a fee requires coordination with the fund's service providers, which could entail operational complexity. On the other hand, adjusting a fund's NAV, like imposing a fee, could pass on transaction-related costs to purchasing and redeeming shareholders, but could be simpler to implement because this adjustment would occur pursuant to the fund's own procedures (as opposed to involving the intermediaries' systems) and would be factored into the process by which a fund strikes its NAV. However, the Commission has not addressed whether a fund might adjust its current NAV to lessen dilution of the value of a fund's outstanding securities, and the Commission's current valuation guidance could raise questions about making such a NAV adjustment.[423]

Because we believe that swing pricing could be a useful tool in mitigating potential dilution of fund shareholders, we are proposing rule 22c-1(a)(3), which would permit certain mutual funds (but not ETFs or money market funds) to use swing pricing under certain circumstances. Proposed rule 22c-1(a)(3) specifies the conditions under which we believe swing pricing would be appropriately used. Below we describe in detail the proposed requirements that a fund using swing pricing would be obliged to follow, the objectives of the proposed rule, and certain considerations that a fund should generally assess in determining whether swing pricing would be an effective tool to prevent fund dilution and promote fairness among all its shareholders. The proposed rule is designed to promote *all* shareholders' interests and promote practices that seek to ensure that a fund's shares are purchased and redeemed at a fair price.[424]

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423 For example, adjusting a fund's NAV in order to effectively require shareholders who are purchasing or redeeming shares of the fund to bear the costs associated with their purchases or redemptions could be viewed as a temporary change in a fund's valuation policies that might conflict with long-standing Commission guidance that a fund's valuation policies be "consistently applied." *See* Accounting for Investment Securities by Registered Investment Companies, Investment Company Act Release No. 6295 (Dec. 23, 1970) [35 FR 19986 (Dec. 31, 1970)] ("ASR 118").

424 *See* Rule 38a-1 Adopting Release, *supra* note 90, at text following n.40 (noting that the pricing

We also believe that the proposed rule would provide a set of operational standards that would allow U.S. funds to gain comfort using swing pricing as a new means of mitigating potential dilution. We recognize that implementing swing pricing could give rise to a number of operational issues and questions, and we provide guidance and request comment on relevant operational considerations below.

1. *Proposed Rule 22c-1(a)(3)*

a. Overview and Objectives of Proposed Rule

Under proposed rule 22c-1(a)(3), a registered open-end investment company (but not a registered investment company that is regulated as a money market fund,[425] and not including an exchange-traded fund[426]) would be permitted to establish and implement policies and procedures providing for the fund to adjust its current NAV to mitigate dilution of the value of its outstanding redeemable securities as a result of shareholder purchase and redemption activity.[427] Specifically, a fund[428] would be permitted to establish and implement swing pricing policies and procedures that would require a fund to adjust its NAV under certain circumstances, provided that the fund's board (including a majority of directors who are not interested persons of the

requirements of the Investment Company Act are "critical to ensuring fund shares are purchased and redeemed at fair prices and that shareholder interests are not diluted.").

425 *See* rule 2a-7.

426 Proposed rule 22c-1(a)(3)(v)(A) would define "exchange-traded fund" as "an open-end management investment company or a class thereof, the shares of which are traded on a national securities exchange, and that operates pursuant to an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission."

427 Proposed rule 22c-1(a)(3). Under the proposed rule, "swing pricing" would be defined as "the process of adjusting a fund's current net asset value per share to mitigate dilution of the value of its outstanding redeemable securities as a result of shareholder purchase and redemption activity, pursuant to the requirements set forth in [proposed rule 22c-1(a)(3)]." *See* proposed rule 22c-1(a)(3)(v)(C).

428 For purposes of this section III.F and the discussions of proposed rule 22c-1(a)(3) in this document, the term "fund" denotes a fund as defined in proposed rule 22c-1(a)(3), that is, "a registered open-end management investment company (but not a registered open-end management investment company that is regulated as a money market fund under § 270.2a-7 or an exchange traded fund as defined in [proposed rule 22c-1(a)(3)(v)(A)])."

fund)[429] must approve these policies and procedures, and the policies and procedures must include certain specified elements.[430] A fund's swing pricing policies and procedures must provide that the fund will adjust its NAV by an amount designated as the "swing factor" once the level of net purchases into or net redemptions from the fund has exceeded a specified percentage of the fund's net asset value known as the "swing threshold."[431] A fund would be required to adopt policies and procedures for determining and periodically reviewing its swing threshold. A fund's swing pricing policies and procedures also would be required to include policies and procedures for determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached. While the swing factor could vary depending on the facts and circumstances, a fund's policies and procedures for determining its swing factor must take certain specified factors into account.[432] A fund's board must approve the swing pricing policies and procedures (including the fund's swing threshold), as well as any material change thereto,[433] and the board would be required to designate the fund's adviser or officers responsible for administering the policies and procedures.[434] A fund would be required to abide by certain

429 Proposed rule 22c-1(a)(3)(ii)(A).

430 Proposed rule 22c-1(a)(3)(i).

431 Proposed rule 22c-1(a)(3)(i)(A). Under the proposed rule, "swing factor" would be defined as "the amount, expressed as a percentage of the fund's net asset value and determined pursuant to the fund's swing pricing procedures, by which a fund adjusts its net asset value per share when the level of net purchases or net redemptions from the fund has exceeded the fund's swing threshold." Proposed rule 22c-1(a)(3)(v)(B). We request comment on this definition in section III.F.1.e below.

"Swing threshold" would be defined as "the amount of net purchases into or net redemptions from a fund, expressed as a percentage of the fund's net asset value, that triggers the initiation of swing pricing." Proposed rule 22c-1(a)(3)(v)(D). We request comment on this definition in section III.F.1.c below.

432 Proposed rule 22c-1(a)(3)(i)(D).

433 Proposed rule 22c-1(a)(3)(ii)(A).

434 Proposed rule 22c-1(a)(3)(ii)(B).

recordkeeping requirements relating to its swing pricing policies and procedures and any NAV adjustments made pursuant to these policies and procedures.[435]

In determining whether the fund's level of net purchases or net redemptions has exceeded the fund's swing threshold, the person(s) responsible for administering the fund's swing pricing policies and procedures[436] would be permitted to make such determination on the basis of information obtained after reasonable inquiry.[437] As discussed below, swing pricing requires the net cash flows for a fund to be known, or reasonably estimated, before determining whether to adjust the fund's NAV on a particular day.[438] Because the deadline by which a fund must strike its NAV may precede the time that a fund receives final information concerning daily net flows from the fund's transfer agent or principal underwriter, we believe it is appropriate to permit the person responsible for administering swing pricing policies and procedures to determine whether net purchases or net redemptions have exceeded the fund's swing threshold on the basis of information obtained after reasonable inquiry. The operational processes associated with swing pricing are discussed in more detail below at section III.F.2.a.

Under the proposed rule, in-kind purchases and in-kind redemptions would be excluded from the calculation of net purchases and net redemptions for purposes of determining whether a fund's net purchases or net redemptions exceed its swing threshold.[439] When a fund investor purchases or redeems shares of a fund in kind as opposed to in cash, this does not necessarily cause the fund to trade any of its portfolio assets. We therefore believe that the risk of dilution as

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435 *See infra* section III.F.1.g; proposed rule 22c-1(a)(3)(iii); proposed amendment to rule 31a-2(a)(2).

436 *See infra* section III.F.1.f.

437 Proposed rule 22c-1(a)(3)(i)(A).

438 *See infra* section III.F.2.a.

439 Proposed rule 22c-1(a)(3)(i)(A).

a result of shareholder purchase and redemption activity is lower with respect to in-kind purchases and in-kind redemptions, and thus swing pricing would not be permitted unless a fund's net purchases or net redemptions that are made in cash (and not in kind) exceed the fund's swing threshold.

We are proposing rule 22c-1(a)(3) to provide funds with a tool to mitigate the potentially dilutive effects of shareholder purchase and redemption activity. Funds would be able to adopt swing pricing policies and procedures in their discretion (although, once these policies and procedures are adopted, a fund would be required to adjust its NAV when net purchases or net redemptions cross the swing threshold, unless the fund's board approves a change to the fund's swing threshold). When a fund that has adopted swing pricing experiences net purchases exceeding the swing threshold, it would adjust its NAV upward, which would effectively require purchasing shareholders to cover near-term costs associated with the fund investing in additional portfolio assets. Conversely, when a fund that has adopted swing pricing experiences net redemptions exceeding the swing threshold, it would adjust its NAV downward, which would effectively require redeeming shareholders to cover near-term costs associated with the fund selling portfolio assets. In both cases, swing pricing would result in the costs of trading portfolio assets (along with transaction fees and charges relating to these trades) being passed on to purchasing and redeeming shareholders.

As discussed above, some foreign funds currently use swing pricing, which suggests that these funds consider swing pricing to be a valuable and effective means of decreasing dilution. Indeed, one investment manager conducted a study of its funds whose prices swung over a one-year period (over fifty funds) and found that the performance of each of these funds would have been impaired, in some cases quite considerably, had the manager not implemented a swing pricing policy.[440] Likewise, ALFI has noted that studies have shown that "[f]unds that apply swing pricing show superior performance over time compared to funds (with identical investment strategies and trading patterns) that do not employ anti-dilution measures," and that "[s]wing pricing helps preserve investment returns as the value to long-term investors normally exceeds the value of the swing factor applied on entry to or exit from the fund."[441] We believe that the swing pricing policies contemplated by the proposed rule, which are similar to those used by some foreign funds, could mitigate dilution arising from shareholders' purchase and redemption activity.[442] As opposed to purchase and redemption fees or liquidity fees, which could also prevent fund dilution arising from purchase or redemption activity,[443] swing pricing would occur pursuant to the fund's own procedures and would not require coordination with the fund's service providers because the swing pricing adjustment would be factored into the process by which a fund strikes its NAV.[444] In addition to mitigating potential dilution arising from purchase and redemption activity, swing pricing also could help deter redemptions motivated by

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440 *See* BlackRock Swing Pricing Paper, *supra* note 412.

441 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 12. *But see infra* paragraph following note 447 (noting that swing pricing could increase the volatility of a fund's NAV in the short term, which could increase tracking error and could make a fund's performance deviate from the fund's benchmark during the period of volatility to a greater degree than if swing pricing had not been used).

442 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 12. The Commission has previously recognized that costs arising from certain types of redemption activity (namely, short-term trading strategies, such as market timing) could dilute the value of long-term investors' shares. *See* Rule 22c-2 Adopting Release, *supra* note 421.

443 As discussed above, the Commission has previously recognized that excessive trading of fund shares could dilute the value of long-term investors' shares, and in response to this, adopted rule 22c-2, which permits a fund to impose redemption fees, and requires fund boards to consider imposing redemption fees, under certain circumstances. *See supra* notes 421-422.

In addition, money market funds are permitted to use liquidity fees under rule 2a-7. *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.5; *see also* discussion of money market fund liquidity fees in section III.F.1.b *infra*. Liquidity fees (including "dilution levies" used by certain UCITS) are also used in some foreign jurisdictions, as a distinct liquidity risk management tool separate from swing pricing. *See infra* notes 467-468 and accompanying text.

444 *See supra* note 422 and accompanying and following text.

any first-mover advantage. That is, if remaining shareholders understood that redeeming shareholders would bear the estimated costs of their redemption activity, it would reduce their incentive to redeem quickly because there would be less risk that they would bear the costs of other shareholders' redemption activity.

In considering the swing pricing proposal, we considered proposing a rule that would permit "dual pricing" as opposed to swing pricing. We understand that certain foreign funds use dual pricing as an alternative means of mitigating potential dilution arising from shareholder transaction activity. A fund using dual pricing would not adjust the fund's NAV by a swing factor when it faces high levels of net purchases or net redemptions, but instead would quote two prices—one for incoming shareholders (reflecting the cost of buying portfolio securities at the ask price in the market), and one for outgoing shareholders (reflecting the proceeds the fund would receive from selling portfolio securities at the bid price in the market).[445] While we believe that dual pricing also could mitigate potential dilution, we believe that swing pricing is a preferable alternative because we believe it would be simpler to implement and for investors to understand. Swing pricing would permit a fund to continue to transact using one price, as they do today (instead of transacting using separate prices for purchasing and redeeming shareholders), and also would permit a fund to price its shares without adjustment unless the level of net purchases or net redemptions were to cross the fund's swing threshold.

We recognize that swing pricing may involve potential disadvantages to funds as well as potential advantages, and the provisions of proposed rule 22c-1(a)(3) are designed to maximize the relative advantages and respond to potential concerns associated with swing pricing. While

[445] *See, e.g.*, *supra* note 423 for a discussion of different methods of valuing portfolio assets, as considered in ASR 118.

swing pricing protects against dilution at the fund level and could act as a deterrent against redemptions motivated by any first-mover advantage, the potential disadvantages of swing pricing (described in more detail below) include increased performance volatility and the fact that the precise impact of swing pricing on particular purchase and redemption requests would not be known in advance and thus may not be fully transparent to investors. Under proposed rule 22c-1(a)(3), swing pricing would be a voluntary tool for funds, and thus a fund would be able to weigh the potential advantages and disadvantages of swing pricing in relation to the fund's particular circumstances and risks, as well as the other tools the fund uses to manage risks relating to dilution and liquidity.

The swing pricing requirements in proposed rule 22c-1(a)(3) aim to minimize NAV volatility (and related tracking error) associated with swing pricing to the extent possible. Swing pricing could increase the volatility of a fund's NAV in the short term, because NAV adjustments would occur when the fund's net purchases or net redemptions pass the fund's swing threshold. Thus, the fund's NAV would show greater fluctuation than would be the case in the absence of swing pricing. This volatility might increase tracking error (*i.e.*, the difference in return based on the swung NAV compared to the fund's benchmark) during the period of NAV adjustment, and could make a fund's short-term performance deviate from the fund's benchmark to a greater degree than if swing pricing had not been used.[446] Volatility and tracking error related to swing pricing could, therefore, result in investors incorrectly perceiving the short-term relative performance of a fund. This could potentially cause market distortions if investors were to incorrectly rate the performance of funds that use swing pricing compared to funds that do not,

446 *But see supra* notes 440-441 and accompanying text (noting that swing pricing has been found to benefit fund performance over the long term).

and shifted their invested assets from funds that use swing pricing to funds that do not as a result of this perception. Volatility and tracking error related to swing pricing also may activate alerts in monitoring systems that follow fund performance, which could in turn trigger purchases or redemptions in automated fund advisory services whose algorithms are driven by fund performance. However, we believe that the use of partial swing pricing, described below, would significantly reduce the performance volatility potentially associated with swing pricing. In addition, swing pricing should have a minimal effect on longer-term performance volatility and longer-term tracking error. Taking these considerations into account, we do not believe that volatility would generally be a significant deterrent to funds using swing pricing. We do request comment below on the potential effects of swing pricing on funds' performance volatility and any potential market distortions that could result if some funds adopt swing pricing but other, similarly situated funds do not.

Proposed rule 22c-1(a)(3) envisions partial swing pricing (that is, a NAV adjustment would not be permitted unless net purchases or net redemptions exceed a threshold set by the fund and approved by the fund's board) and not full swing pricing (that is, a NAV adjustment *any time* the fund experiences net purchases or net redemptions). Some foreign funds employ full swing pricing,[447] and there are certain advantages to full swing pricing (*e.g.*, a fund using full swing pricing would not be required to determine an appropriate swing threshold).[448] However, we believe partial swing pricing would generally cause lower NAV volatility than full swing pricing. The use of partial swing pricing also recognizes that net purchases and net redemptions

447 *But see* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 6 (of the respondents surveyed by ALFI, the majority employed a partial swing approach, with only a select few choosing the full swing method).

448 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 17.

below a certain threshold might not require a fund to trade portfolio assets,[449] and therefore a NAV adjustment, and any associated NAV volatility, might not be appropriate if purchases and redemptions would not result in costs associated with asset purchases and sales.

We recognize that there are other trade-offs that a fund would have to consider in determining to implement swing pricing. For example, application of a swing factor would affect all purchasing and redeeming shareholders equally, regardless of whether the size of an individual shareholder's purchases or redemptions alone would create material trading costs for the fund. This could cause certain shareholders to experience benefits or costs, relative to the other shareholders in the fund, that otherwise would not exist. For example, an investor who purchases fund shares on a day when a fund adjusts its NAV downward would pay less to enter the fund than if the fund had not adjusted is NAV on that day. And, while a small investor's redemption requests would not likely create significant liquidity costs for the fund on its own, if this investor were to redeem on the same day that the fund's net redemptions cross the swing threshold, his or her redemption proceeds would be reduced by the NAV adjustment. These concerns, however, are partially mitigated by the fact that shareholders could be assured that the same threshold level of net purchase and net redemption activity (as approved by the fund's board) would consistently trigger the use of swing pricing, unless the fund's board and a majority of the fund's independent directors were to approve a change in the fund's swing threshold.[450] Furthermore, we believe that investors who purchase shares on a day that a fund adjusts its NAV downward would not create dilution for non-redeeming shareholders (even though the purchasing shareholders may be receiving a lower price than would be the case if the NAV was

449 For example, a fund may not need to sell portfolio assets to pay redemptions below a certain threshold if it maintains a certain percentage of its net assets in cash or cash equivalents.

450 *See infra* section III.F.1.f.

not adjusted downward). Under these circumstances, shareholders' purchase activity would provide liquidity to the fund, which could reduce the fund's liquidity costs and thereby could decrease the swing factor. This could potentially help redeeming shareholders to receive a more favorable redemption price than they otherwise would have if there had been less purchase activity on that day, but would not affect the interests of non-redeeming investors.

We believe that an adequate level of transparency about swing pricing is critical for investors to understand the risks associated with investing in a particular fund. As discussed in section III.G below, proposed disclosure and reporting requirements regarding swing pricing would assist shareholders in understanding whether a particular fund has implemented swing pricing policies and procedures and has used swing pricing. We are not, however, proposing to require a fund to publicly disclose its swing threshold, because of concerns that certain shareholders may attempt to time their transactions based on this information,[451] as well as concerns that disclosure could be confusing or potentially misleading insofar as it could give an inaccurate view of funds' relative risks and benefits. For example, a shareholder might assume that Fund X with a swing threshold of 5% is inherently more risky and thus a "worse" investment than Fund Y with a swing threshold of 7% because a lower level of net flows would cause Fund X to adjust its NAV than Fund Y. But the relative performance and risks of both funds could depend on additional considerations, even excluding differences in the various market, credit, liquidity, and other risks associated with the funds' portfolio assets. These considerations could include the swing factors the funds would use to adjust their NAV and the

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451 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 8 (of the respondents surveyed by ALFI, the majority of those that used swing pricing "were reluctant to disclose the level of [swing] threshold they apply . . . [and some] commented that the act of disclosing these details was contradictory to the principle of investor protection and therefore avoided disclosing the threshold." ALFI noted that "[o]n balance it appears that the majority of promoters prefer not to disclose thresholds to ensure clients do not actively manage trades below the trigger level of the partial swing.").

frequency with which each fund would encounter net purchases or net redemptions that cross the fund's swing threshold. Although funds would not be required to disclose their swing threshold, the use of partial swing pricing as opposed to full swing pricing could give shareholders comfort that, under circumstances in which the fund is experiencing relatively low purchases or redemptions, the fund's NAV will likely not be adjusted.

Request for Comment

We seek comment on the general swing pricing process as contemplated by proposed rule 22c-1(a)(3). We seek specific comment on the process a fund would use to determine and review its swing threshold and to calculate the swing factor it would use to adjust its NAV, and on the proposed approval and oversight requirements associated with swing pricing policies and procedures, below.

- Do commenters agree that swing pricing could be a useful tool for U.S. registered funds in mitigating potential dilution of fund shareholders? Do commenters believe that dilution arising from costs associated with certain purchases or redemptions of fund shares is a significant problem that funds currently face, have historically faced under certain market conditions, or might be expected to face in the future?
- Do commenters agree that the proposed rule should require a fund that adopts swing pricing policies and procedures to adjust the fund's NAV when the fund's level of net purchases or redemptions exceeds the fund's swing threshold? Or should the proposed rule instead only require a fund that adopts swing pricing policies and procedures to adjust the fund's NAV when the fund's level of net redemptions exceeds the swing threshold? Alternatively, should the proposed rule permit a fund to choose whether to adopt swing pricing policies and procedures that would: (i) require the fund to adjust its

NAV when the fund's level of net purchases or redemptions exceeds the fund's swing threshold; or (ii) require the fund to adjust its NAV only when the fund's level of net redemptions exceeds the fund's swing threshold? Are there greater concerns about the potential for dilution associated with net redemptions than those associated with net purchases?

- Should a fund be permitted to use full swing pricing, as opposed to the partial swing pricing contemplated by the proposed rule? Why or why not?
- Under the proposed rule, when net purchases or net redemptions of a fund that has adopted swing pricing policies and procedures exceed the fund's swing threshold, the price that *all* purchasing or redeeming shareholders would receive for fund shares would be adjusted pursuant to the fund's swing pricing policies and procedures. Should a fund instead be permitted to exempt certain shareholders (for example, purchasing shareholders on days when the fund's share price is adjusted downward, or small shareholders whose purchase or redemption activity would not likely create significant liquidity costs for the fund) from receiving an adjusted share price on a day when the fund's net purchases or redemptions exceed the swing threshold? Why or why not?
- Would the use of purchase fees, redemption fees and/or liquidity fees (either separately or in combination) be a more or less effective means of mitigating potential dilution than swing pricing? Why or why not? Would the use of purchase fees, redemption fees and/or liquidity fees (either separately or in combination) entail burdens and costs that are higher or lower than the burdens and costs associated with swing pricing? What types of operational challenges would arise with swing pricing as opposed to purchase fees, redemption fees, and liquidity fees? Are purchase fees, redemption fees, and liquidity

fees feasible for those funds whose shares are primarily held through third-party intermediaries?

- Would the use of dual pricing be a more or less effective means of mitigating potential dilution than swing pricing? What types of operational challenges would arise with swing pricing vs. dual pricing?
- Would allowing funds to require certain investors to accept in-kind redemptions in certain circumstances be a more or less effective means of mitigation potential dilution than swing pricing in those circumstances?
- Do commenters agree that the swing pricing framework contemplated by proposed rule 22c-1(a)(3) responds as effectively as possible to the potential concerns associated with swing pricing? Specifically, we request comment on the extent to which the swing pricing requirements incorporated into the proposed rule would reduce volatility and respond to transparency-related concerns. Would any performance volatility that could result from swing pricing result in market distortions if some funds adopt swing pricing but other, similarly situated funds do not? Do commenters believe that the use of partial swing pricing, as opposed to full swing pricing, would mitigate concerns that the swing pricing would increase a fund's volatility? Do these proposed requirements also effectively respond to transparency-related concerns associated with swing pricing, and would the proposed disclosure requirements regarding swing pricing also respond to transparency concerns? Would any alternative or additional swing pricing requirements more effectively respond to potential concerns about volatility or transparency (or any other concerns) associated with swing pricing?

- As proposed, rule 22c-1(a)(3) would permit, but not require, a fund to adopt swing pricing policies and procedures. What process do commenters anticipate that a fund may use to weigh the potential advantages and disadvantages of swing pricing in relation to the fund's particular circumstances and risks? Should each fund's board be required to determine whether swing pricing is appropriate for each fund? Should all funds, or a particular subset of funds (*e.g.*, funds whose three-day liquid asset minimums are below a certain level, or whose less liquid assets are above a certain level) be required to use swing pricing? Do commenters expect funds would decide that swing pricing would be an effective anti-dilution tool, in spite of potential concerns about volatility or transparency (or any other potential concerns)?
- Proposed rule 22c-1(a)(3) would permit the person(s) responsible for administering a fund's swing pricing policies and procedures to make the determination of whether the fund's level of net purchases or redemptions has exceeded the fund's swing threshold "on the basis of information obtained after reasonable inquiry." Do commenters agree that this would be appropriate? Why or why not? Is the phrase "information obtained after reasonable inquiry" clear? If not, how could this term be clarified within the context of the proposed rule?
- As proposed, rule 22c-1(a)(3) would require a fund to exclude any purchases or redemptions that are made in kind and not in cash when determining whether the fund's level of net purchases or net redemptions has exceeded the fund's swing threshold. Is this exclusion appropriate? Why or why not?

b. Scope of Proposed Rule

Proposed rule 22c-1(a)(3) would apply to all registered open-end management investment companies, with the exception of money market funds and ETFs.[452] While rule 22c-1(a) generally applies to all registered investment companies issuing redeemable securities,[453] we believe that only open-end mutual funds (and, as discussed below, not UITs or ETFs) are generally susceptible to the risk that shareholder redemption activity could dilute the value of outstanding shares held by existing shareholders. And as discussed below, we believe money market funds, while potentially susceptible to this risk, already have extensive tools at their disposal to mitigate potential shareholder dilution.

All investment companies that fall within the scope of proposed rule 22e-4, with the exception of ETFs, would be permitted to use swing pricing under proposed rule 22c-1(a)(3), and a fund may decide to adopt swing pricing policies and procedures as part of the liquidity risk management program it would be required to implement under proposed rule 22e-4. Under proposed rule 22c-1(a)(3), swing pricing would be voluntary for funds, and some fund complexes may decide to use swing pricing for certain funds within the complex but not others, or establish different swing thresholds for different funds within the complex.[454] As discussed

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452 As discussed above, for purposes of the proposed amendments to rule 22c-1, "exchange-traded fund" includes an ETMF.

453 Rule 2a-7 provides exemptions from rule 22c-1 for money market funds, to permit certain money market funds to use the amortized cost method and/or the penny-rounding method to calculate its NAV, and to permit a money market fund to impose liquidity fees and temporarily suspend redemptions. *See* rule 2a-7(c)(1)(i); rule 2a-7(c)(2).

454 Outside the U.S., it is a common industry practice for funds within a fund complex each to have an individual swing threshold, or for some funds within a complex to use swing pricing while others do not. *See, e.g.*, BlackRock Swing Pricing Paper, *supra* note 412; J.P. Morgan Asset Management, *Swing pricing: The J.P. Morgan Asset Management Approach in the Luxembourg Domiciled SICAVs*, JPMorgan Funds and JPMorgan Investment Funds Insight (June 2014), *available at* http://www.jpmorganassetmanagement.de/DE/dms/Swing%20Pricing%20%5bMKR%5d%20%5bIP_EN%5d.pdf ("J.P. Morgan Asset Management Swing Pricing Paper").

above, funds would be required to exclude any purchases and redemptions that are made in kind, and not in cash, in determining whether the fund's level of net purchases or net redemptions has exceeded the fund's swing threshold.[455] This could functionally limit the ability of a fund that often permits in-kind purchases and in-kind redemptions to use swing pricing, or discourage such a fund from adopting swing pricing policies and procedures, because the fund's level of net purchases or net redemptions as calculated pursuant to proposed rule 22c-1(a)(3) may never (or rarely) reach the fund's swing threshold as determined pursuant to the proposed rule.

We are not proposing to include closed-end investment companies, UITs, ETFs or money market funds within the scope of proposed rule 22c-1(a)(3). Closed-end investment companies do not issue redeemable securities and therefore would not incur costs associated with shareholder purchase and redemption activity that would necessitate swing pricing. Similarly, where a UIT sponsor maintains a secondary market in units of a UIT series, we believe that the series is unlikely to ever need to use swing pricing. In addition, since UITs do not frequently trade their underlying securities, but instead maintain a relatively fixed portfolio, investor flows do not generally affect the portfolio, and thus purchases and sales of UIT shares would not likely produce dilutive effects to existing shareholders.[456]

Although we believe that ETFs could experience liquidity risk and thus have included them within the scope of proposed rule 22e-4,[457] we are proposing not to include ETFs within the scope of proposed rule 22c-1(a)(3) because we believe—as described more fully below—that ETFs' purchase and redemption practices do not generally entail the risk of dilution as a result of authorized participants' purchase and redemption activity, and that swing pricing could impede

455 *See supra* note 439 and accompanying paragraph.

456 *See, e.g.*, *supra* notes 136 and 141 and accompanying text.

457 *See supra* section III.A.2.

the effective functioning of an ETF's arbitrage mechanism. Unlike mutual funds, which typically internalize the costs associated with purchases and redemptions of shares, ETFs typically externalize these costs by charging a fixed and/or variable fee to authorized participants who purchase creation units from, and sell creation units to, an ETF. The fixed and/or variable fees are imposed to offset both transfer and other transaction costs that may be incurred by the ETF (or its service providers), as well as brokerage, tax-related, foreign exchange, execution, market impact and other costs and expenses related to the execution of trades resulting from such transaction. The amount of these fixed and variable fees typically depends on whether the authorized participant effects transactions in kind versus in cash and is related to the costs and expenses associated with transaction effected in kind versus in cash. When an authorized participant redeems ETF shares by selling a creation unit to the ETF, for example, the fees imposed by the ETF defray the costs of the liquidity that the redeeming authorized participant receives, which in turn mitigates the risk that dilution of non-redeeming authorized participants would result when an ETF redeems its shares.

In addition to our belief that ETFs' purchase and redemption practices would generally not entail the risk of dilution for existing shareholders, we are also not including ETFs within the scope of the proposed rule because we believe that swing pricing could impede the effective functioning of an ETF's arbitrage mechanism.[458] As discussed above, the effective functioning of the arbitrage mechanism is necessary in order for an ETF's shares to trade at a price that is at or close to the NAV of the ETF.[459] If an ETF were to adopt swing pricing policies and

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458 As discussed previously, ETMF market makers would not engage in the same arbitrage as ETF market makers because all trading prices of ETMF shares are linked to NAV. *See* supra note 32 and accompanying text. ETMFs would charge transaction fees that mitigate the risk of dilution, and therefore we do not propose to include ETMFs within the scope of proposed rule 22c-1(a)(3).

459 *See, e.g.*, *supra* note 14 and accompanying text.

procedures, as conceptualized under the proposed rule, an authorized participant would not know whether the ETF's NAV would be adjusted by a swing factor on any given day and therefore may not be able to assess whether an arbitrage opportunity exists.[460] The Commission has historically considered the effective functioning of the arbitrage mechanism to be central to the principle that all shareholders be treated equitably when buying and selling their fund shares.[461] Therefore, we believe that the implementation of swing pricing by an ETF could raise concerns about the equitable treatment of shareholders, to the extent that swing pricing could impede the effective functioning of the arbitrage mechanism.

We are also not proposing to include money market funds within the scope of proposed rule 22c-1(a)(3). Money market funds are subject to extensive requirements concerning the liquidity of their portfolio assets. Also, a money market fund (other than a government fund) is permitted to impose a liquidity fee on redemptions if its weekly liquid assets fall below a certain threshold, and these fees serve a similar purpose as the NAV adjustments contemplated by swing pricing.[462] That is, money market fund liquidity fees allocate at least some of the costs of

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460 *See supra* note 451 and accompanying paragraph (noting that a fund would not be required to disclose its swing threshold under the proposed rule).

461 *See, e.g.*, Spruce ETF Trust, et al., Investment Company Act Release No. 31301 (Oct. 21, 2014) [79 FR 63964 (Oct. 27, 2014)] (notice of application for exemptive relief) (to the extent that investors would have to exit at a price substantially below the NAV of the ETF, this would be "contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that all shareholders be treated equitably when buying and selling their fund shares"); Precidian ETFs Trust, et al., Investment Company Act Release No. 31300 (Oct. 21, 2014) [79 FR 63971 (Oct. 27, 2014)] (notice of application for exemptive relief) ("A close tie between market price and NAV per share of the ETF is the foundation for why the prices at which retail investors buy and sell ETF shares are similar to the prices at which Authorized Participants are able to buy and redeem shares directly from the ETF at NAV. This close tie between prices paid by retail investors and Authorized Participants is important because section 22(d) and rule 22c-1 under the Act are designed to require that all fund shareholders be treated equitably when buying and selling their fund shares.").

462 *See* rule 2a-7(c)(2); *see also* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.

providing liquidity to redeeming rather than existing shareholders,[463] and also generate additional liquidity to meet redemption requests.[464] We therefore believe that money market funds already have liquidity risk management tools at their disposal that could accomplish comparable goals to the swing pricing that would be permitted under proposed rule 22c-1(a)(3).

We also believe that the liquidity fee regime permitted under rule 2a-7 is a more appropriate tool for money market funds to manage the allocation of liquidity costs than swing pricing. First, while funds would be able to adopt swing pricing policies and procedures at their discretion, rule 2a-7 requires a money market fund under certain circumstances to impose a 1% liquidity fee on each shareholder's redemption, unless the fund's board of directors (including a majority of its independent directors) determines that such fee is not in the best interests of the fund, or determines that a lower or higher fee (not to exceed 2%) is in the best interests of the fund.[465] Money market funds also have unique minimum liquid asset requirements, and we believe the use of liquidity fees is appropriately tied to those requirements. Finally, we anticipate that open-end funds that adopt swing pricing policies and procedures would be required under such procedures to adjust their NAV on a relatively regular basis (whenever the fund's net purchases or net redemptions exceed the fund's swing threshold). In contrast, money market fund investors (particularly, investors in stable-NAV money market funds) are particularly sensitive to price volatility,[466] and we anticipate liquidity fees will be used only in

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463 *See, e.g.*, 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at n.139 and accompanying text.

464 *See id.* at n.120.

465 *See supra* note 462.

466 For example, retail and government money market funds are permitted to maintain a stable NAV, reflecting in part our understanding that investors in these products have a low tolerance for NAV volatility. *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.B.3.c. Investors in floating NAV money market funds also could be sensitive to principal volatility, as we recognized in adopting requirements that all money market funds disclose their daily net asset value (rounded to the

times of stress when money market funds' internal liquidity has been partially depleted. We note that some foreign jurisdictions have a similar conception of liquidity fees as a distinct tool separate from swing pricing. For example, in Europe, UCITS may use swing pricing and apply "dilution levies."[467] While many UCITS use swing pricing as a matter of normal course, dilution levies may be considered a liquidity risk management tool that is used in connection with stressed conditions.[468]

Request for Comment

We seek comment on the scope of proposed rule 22c-1(a)(3).

- Do commenters agree that the proposed rule should apply to all registered open-end management investment companies except money market funds and open-end ETFs?
- Do commenters agree that the risk of investor dilution is low for closed-end investment companies and UITs, and thus closed-end investment companies and UITs should not be included within the scope of proposed rule 22c-1(a)(3)?
- Do commenters agree that the risk of investor dilution is low for ETFs, whether ETFs purchase and redeem in cash or in kind? Why or why not? Do commenters agree that swing pricing could adversely affect the effective functioning of an ETF's arbitrage mechanism? Why or why not? Regardless of these considerations, should ETFs be permitted to use swing pricing, and do commenters anticipate that ETFs would use swing pricing if the scope of proposed rule 22c-1(a)(3) were expanded to include ETFs?

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fourth decimal place) on their websites, and as we discussed in the economic analysis of the 2014 Money Market Fund Reform Adopting Release. *See id.* at section III.E.9 and section III.K.

467 *See, e.g.*, BlackRock Fund Structures Paper, *supra* note 30, at 6; *see also supra* note 422 and accompanying and following text (discussing redemption fees that are currently permitted under rule 22c-2 and noting that, while redemption fees could mitigate dilution arising from redemption activity, implementing a fee requires coordination with the fund's service providers, which could entail operational complexity).

468 *See* BlackRock Fund Structures Paper, *supra* note 30, at 6.

- If the scope of the proposed rule were expanded to include ETFs, are there any swing pricing operational considerations specific to ETFs that we should address? For example, if an ETF were to adopt swing pricing, how should we address any shareholder fairness implications that could result if certain authorized participants were to transact in cash and others were to transact in kind on a day when the fund swings its NAV? Should ETFs be permitted to use swing pricing in addition to imposing transaction fees on authorized participants, or as an alternative to such fees? Should we address implications of the proposed rule on exemptive relief that has been granted to existing ETFs? Should we also consider the implications of the proposed rule on an ETF that operates as a share class of a fund that also offers mutual fund share classes, or on an ETF that operates as a feeder fund investing in a master fund alongside mutual fund feeder funds?
- We seek comment on how the utilization of swing pricing by an ETF could affect the capital markets, in particular, market-making in the ETF. If the scope of the rule were expanded to include ETFs, would market makers and other market participants that contribute to ETF market-making be less willing to do so if it were unclear when an ETF that has adopted swing pricing policies and procedures would adjust its NAV, and to what extent swing pricing would affect the ETF's end-of-day NAV?
- The proposed definition of "exchange-traded fund" in rule 22c-1 would include ETMFs. While no ETMF has been launched yet, if an ETMF were to begin operations pursuant to applicable exemptive relief, it would arrange for an independent third party to disseminate the intraday indicative value of the ETMF's shares, which an investor would use to estimate the number of shares to buy or sell based on the dollar amount in which

the investor wants to transact.[469] To what extent would a NAV adjustment effected by swing pricing make an investor's estimate less accurate, given that such adjustment would not be reflected in the intraday indicative value of the ETMF's shares disseminated during the trading day?

- Do commenters agree that money market funds already have liquidity risk management tools at their disposal that could accomplish comparable goals to swing pricing, and that the liquidity fee regime permitted under rule 2a-7 is a more appropriate tool for money market funds to manage the allocation of liquidity costs than swing pricing? Would there be any reason to extend the scope of proposed rule 22c-1(a)(3) to floating NAV money market funds?

c. Determining the Fund's Swing Threshold

Under proposed rule 22c-1(a)(3), a fund's swing pricing policies and procedures must provide that the fund is required to adjust its NAV once the level of net purchases or net redemptions from the fund has exceeded a set, specified percentage of the fund's net asset value known as the "swing threshold."[470] A fund would be required to adopt policies and procedures for determining its swing threshold,[471] and as discussed below, the swing threshold and any changes thereto must be approved by the fund's board of directors.[472] In specifying its swing threshold, a fund would be required to consider:

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469 *See* ETMF Notice, *supra* note 15.

470 Proposed rule 22c-1(a)(3)(i)(A). Under the proposed rule, "swing threshold" would be defined as "the amount of net purchases into or net redemptions from a fund, expressed as a percentage of the fund's net asset value, that triggers the initiation of swing pricing." Proposed rule 22c-1(a)(3)(v)(D). We request comment on this definition at the end of this section III.F.1.c.

471 Proposed rule 22c-1(a)(3)(i)(B).

472 *See infra* section III.F.1.f.

- The size, frequency, and volatility of historical net purchases or net redemptions of fund shares during normal and stressed periods;
- The fund's investment strategy and the liquidity of the fund's portfolio assets;
- The fund's holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources; and
- The costs associated with transactions in the markets in which the fund invests.[473]

In order to effectively mitigate possible dilution arising in connection with shareholder purchase and redemption activity, a fund's swing threshold should generally reflect the estimated point at which net purchases or net redemptions would trigger the fund's investment adviser to trade portfolio assets in the near term, to a degree or of a type that may generate material liquidity or transaction costs for the fund. As discussed below, we believe that a consideration of the factors set forth above would permit a fund to estimate this point. The liquidity or transaction costs associated with purchase or redemption activity can dilute the value of existing shareholders' interests in the fund, and the purpose of swing pricing is to lessen this potential dilution. Trading assets to meet purchase or redemption requests is not in and of itself an indication that a fund will incur material liquidity or transaction costs. For example, trading smaller levels of very liquid assets would likely not produce significant costs to the fund. However, trading portfolio assets to a significant degree, or trading relatively less liquid assets within a short time frame in order to invest proceeds from purchases or satisfy redemption

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[473] Proposed rule 22c-1(a)(3)(i)(B).

These factors overlap significantly with factors that we understand are commonly considered by funds that use swing pricing in other jurisdictions, in order to determine a fund's swing threshold. For example, the Luxembourg Swing Pricing Survey, Reports & Guidelines provides that factors influencing the determination of the swing threshold ordinarily include: (i) fund size; (ii) type and liquidity of securities in which the fund invests; (iii) costs (and hence, the dilution impact) associated with the markets in which the fund invests; and (iv) investment manager's investment policy and the extent to which the fund can retain cash (or near cash) as opposed to always being fully invested). *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 14.

requests, could generate material costs to the fund that could dilute the value of fund shares held by existing investors.

We believe that evaluating the factors that proposed rule 22c-1(a)(3) would require a fund to consider in specifying its swing threshold would assist a fund in determining what level of net purchases or net redemptions would generally lead to a trade of portfolio assets that would result in material costs to the fund. Assessing the size, frequency, and volatility of historical net purchases and net redemptions of fund shares would permit a fund to determine its typical levels of net purchases and net redemptions and the levels the fund could expect to encounter during periods of unusual market stress, as well as the frequency with which the fund could expect to see periods of unusually high purchases or redemptions. We believe that comparing the fund's historical flow patterns with the fund's investment strategy, the liquidity of the fund's portfolio holdings, the fund's holdings of cash and cash equivalents and borrowing arrangements and other funding sources, and the costs associated with transactions in the markets in which the fund invests would allow a fund to predict what levels of purchases and redemptions would result in material costs under a variety of scenarios.

The first three factors that proposed rule 22c-1(a)(3)(i)(B) would require a fund to consider in specifying the fund's swing threshold correspond with certain of the factors a fund would be required to consider in assessing its liquidity risk.[474] This is because evaluating a fund's liquidity risk, or the risk that the fund could not meet expected and reasonably foreseeable

474 *See* proposed rule 22e-4(b)(2)(iii)(A)*(1)*, proposed rule 22e-4(b)(2)(iii)(B), proposed rule 22e-4(b)(2)(iii)(D) (requiring a fund to consider, in assessing its liquidity risk, the "size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods," the fund's "investment strategy and liquidity of portfolio assets," and the fund's "holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources," respectively).

requests to redeem its shares without materially affecting the fund's NAV,[475] is a similar exercise to determining the fund's swing threshold (which, as discussed above, should generally reflect the estimated point at which net purchases or net redemptions would trigger the fund's investment manager to trade portfolio assets in the near term, to a degree or of a type that may generate material liquidity or transaction costs for the fund). For this reason, we believe that the issues a fund would consider in assessing the extent to which the (i) size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods, (ii) the fund's investment strategy and portfolio liquidity, and (iii) the fund's holdings of cash and cash equivalents, borrowing arrangements and other funding sources would affect the fund's liquidity risk also are relevant when a fund determines its swing threshold. These issues are discussed in detail above.[476]

In assessing the fourth factor, the costs associated with transactions in the markets in which the fund invests, a fund may wish to consider, as applicable, market impact costs[477] and spread costs[478] that the fund typically incurs when it trades its portfolio assets (or assets with comparable characteristics if data concerning a particular portfolio asset is not available to the fund). A fund also may wish to consider, as applicable, the transaction fees and charges that the fund typically is required to pay when it trades portfolio assets.[479] These could include brokerage commissions and custody fees, as well as other charges, fees, and taxes associated with portfolio

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475 *See* proposed rule 22e-4(a)(7).

476 *See supra* sections III.C.1.a, III.C.1.b, and III.C.1.d.

477 *See supra* note 415.

478 *See supra* note 416.

479 A fund would be required to take transaction fees and charges into account when determining the swing factor that would be used to adjust the fund's NAV when the level of net purchases or net redemptions from the fund has exceeded the fund's swing threshold. Proposed rule 22c-1(a)(3)(i)(D)*(1)*. *See infra* note 493 for a discussion of the proposed definition of "transaction fees and charges."

asset purchases or sales (for example, transfer taxes and repatriation costs for certain foreign securities, or transaction fees associated with portfolio investments in other investment companies).

We understand that because proposed rule 22c-1(a)(3) does not specify a minimum "floor" for a fund's swing threshold, a fund could set a swing threshold representing a very low level of net purchases or net redemptions. This could result in the fund effectively practicing full swing pricing (that is, adjusting the fund's NAV whenever there is *any* level of net purchases or net redemptions) instead of partial swing pricing. However, we do not anticipate that a fund would generally wish to set a very low swing threshold, because we believe that a fund would not want to incur the increased NAV volatility associated with full (or nearly full) swing pricing. We also are not currently proposing a swing threshold floor because we believe that different levels of net purchases and net redemptions would create a risk of dilution for funds with different strategies, shareholder bases, and other liquidity-related characteristics, and thus it would be difficult to determine a swing threshold floor that would be appropriate across the scope of funds that would be permitted to use swing pricing.[480]

We recognize that requiring a fund to adopt a swing threshold could create the potential for shareholder gaming behavior because a fund's shareholders could attempt to time their purchases and redemptions based on the likelihood that a fund would or would not adjust its NAV. However, we do not think that potential gaming is a significant concern, because it would be difficult for shareholders to determine when the fund's net purchases or net redemptions cross the swing threshold. As discussed above, a fund would not be required to publicly disclose its

480 We note that, in Europe, there are no across-the-board swing threshold floors applicable to UCITS that use swing pricing.

swing threshold.[481] Also, funds are not required to disclose their daily net flows and do not usually do so.[482] For a shareholder to effectively "game" the swing pricing, it would have to know the daily flows on the day that shareholder was purchasing or redeeming and those flows would have to not materially change after the shareholder placed its order, all of which may be unlikely. Accordingly, even if a fund were to reveal its swing threshold, it may be difficult for shareholders to determine when the fund's net purchases or net redemptions exceed the swing threshold. We note that, to the extent a fund does decide to disclose its swing threshold, we believe it would not be appropriate for a fund to disclose it selectively to certain investors (*e.g.*, to only disclose the fund's swing threshold to institutional investors), as we believe this could assist certain groups of shareholders in strategically timing purchases and redemptions of fund shares, potentially disadvantaging shareholders who do not know the fund's swing threshold.[483]

<u>Request for Comment</u>

We request comment on the definition of "swing threshold" set forth in proposed rule 22c-1(a)(3) and the process a fund would use to determine its swing threshold.

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481 *See supra* paragraph accompanying note 451.

482 However, as proposed earlier this year, a fund would be required to disclose flow information on proposed Form N-PORT monthly, and information contained on reports for the last month of each fiscal quarter would be made public. *See infra* note 561.

483 Like selective disclosure of fund portfolio holdings, we believe that selective disclosure of a fund's swing threshold could facilitate fraud and have adverse ramifications for a fund's investors if certain investors are given the opportunity to use this information to their advantage to the detriment of other investors. *See, e.g.*, Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings, Investment Company Act Release No. 26418 (Apr. 16, 2004) [69 FR 22300 (Apr. 23, 2004)] (discussing harm that could result from selective disclosure of fund portfolio holdings and adopting amendments to Form N-1A that would—among other things—require funds to disclose their policies and procedures with respect to the disclosure of their portfolio securities and any ongoing arrangements to make available information about their portfolio securities).

- Is the definition of "swing threshold," as set forth in proposed rule 22c-1(a)(3) appropriate and clear? If not, how could this definition be clarified or made more effective within the context of the proposed rule?
- Should a fund be permitted to adopt two swing thresholds—one for net redemptions and one for net purchases? Would this be more operationally difficult than adopting one swing threshold that would be used for net redemptions as well as net purchases, and if so, why?
- Should any of the proposed factors not be required to be considered by a fund in determining and reviewing its swing threshold? Should any be modified? Are there any additional factors, besides the proposed factors, that a fund should be required to consider? Should we set a minimum floor for a fund's swing threshold (*e.g.*, one percent, or some other percentage, of the fund's net asset value) to prevent a fund from setting a very low swing threshold? If so, what should it be and why?
- Do commenters agree that the swing threshold requirements under proposed rule 22c-1(a)(3) would not raise significant concerns regarding the potential for shareholder gaming behavior, because it would be difficult for shareholders to determine when the fund's net purchases or net redemptions cross the swing threshold? If commenters believe that the swing pricing framework contemplated by proposed rule 22c-1(a)(3) *would* raise significant concerns regarding the potential for shareholder gaming behavior, how could these concerns best be alleviated?

d. Periodic Review of a Fund's Swing Threshold

Proposed rule 22c-1(a)(3) would require a fund's swing pricing policies and procedures to include policies and procedures providing for the periodic review, no less frequently than annually, of the fund's swing threshold.[484] In conducting such review, a fund would be required to consider the factors included in proposed rule 22c-1(a)(3)(i)(B).[485] Any change to the fund's swing threshold, including those deemed appropriate as a result of this review would be deemed to be a material change to the fund's swing pricing policies and procedures that must be approved by the fund's board.[486] Beyond specifying certain factors that a fund would be required to consider in reviewing its swing threshold, proposed rule 22c-1(a)(3) does not include prescribed review procedures, nor does it specify the required risk review period or incorporate specific developments that a fund should consider as part of its review. A fund may wish to adopt procedures specifying that the swing threshold will be reviewed more frequently than annually (*i.e.*, semi-annually or monthly), and/or specifying any circumstances that would prompt ad-hoc review of the fund's swing threshold in addition to the periodic review required by the proposed rule (as well as the process for conducting any ad-hoc reviews). Like a fund's liquidity risk review procedures, we believe that funds should generally consider procedures for evaluating market-wide, and fund-specific developments affecting each of the proposed rule 22c-1(a)(3)(i)(B) factors in developing comprehensive procedures for reviewing a fund's swing threshold.[487]

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484 Proposed rule 22c-1(a)(3)(i)(C).

485 *Id.*

486 Proposed rule 22c-1(a)(3)(ii)(A) ("The fund's board of directors, including a majority of directors who are not interested persons of the fund, shall approve . . . any material change to the [fund's swing pricing] policies and procedures (including any change to the fund's swing threshold).").

487 *See supra* section III.C.2.a.

Request for Comment

We request comment on the process a fund would use to review its swing threshold.

- Are there certain procedures that we should require, and/or on which we should provide guidance, regarding a fund's periodic review of its swing threshold? Should we expand our guidance on the market-wide, and fund-specific developments that a fund's swing threshold review procedures should cover?
- Do commenters agree that a fund that adopts swing pricing policies and procedures should be required to review its swing threshold at least annually? Do commenters anticipate that a fund that adopts swing pricing procedures would voluntarily choose to review its swing threshold any more frequently than annually? Alternatively, should a fund be required to review its swing threshold any more or less frequently than annually?

e. Calculating the Swing Factor the Fund Will Use to Adjust its NAV

Under proposed rule 22c-1(a)(3), a fund's swing pricing policies and procedures would be required to provide that the fund must adjust its NAV by an amount designated as the "swing factor" each time the fund's net purchases or net redemptions have exceeded the fund's swing threshold.[488] A fund's swing pricing policies and procedures would be required to specify how the swing factor to be used to adjust the fund's NAV will be determined.[489] As discussed in more detail below, the swing factor would be the amount, expressed as a percentage of the fund's net asset value, that takes into account any near-term costs expected to be incurred by the fund as

488 Proposed rule 22c-1(a)(3)(i)(A). Under the proposed rule, "swing factor" would be defined as "the amount, expressed as a percentage of the fund's net asset value and determined pursuant to the fund's swing pricing procedures, by which a fund adjusts its net asset value when the level of net purchases into or net redemptions from the fund has exceeded the fund's swing threshold." Proposed rule 22c-1(a)(3)(v)(B). We request comment on this definition at the end of this section III.F.1.e.

489 Proposed rule 22c-1(a)(3)(i)(D).

a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's NAV.[490] It also must take into account information about the value of assets purchased or sold by the fund to satisfy net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's NAV (if that information would not be reflected in the current NAV of the fund computed on that day).[491]

We anticipate that, because these considerations could vary depending on the facts and circumstances, the swing factor that a fund would determine appropriate to use in adjusting its NAV also could vary. We therefore believe that procedures for determining the swing factor generally should detail how each of the factors a fund would be required to consider under the proposed rule would assist the fund in calculating the swing factor. Below we provide examples of methods that a fund may wish to consider employing in calculating the swing factor.

We are proposing rule 22c-1(a)(3) to provide funds with a tool to mitigate the potentially dilutive effects of shareholder purchase and redemption activity, and the factors a fund would be required to consider in determining its swing factor are meant to enhance a fund's ability to estimate the costs associated with purchase and redemption activity that could dilute the value of the existing shareholders' interests in the fund. These costs include both market-related costs (that is, market impact costs and spread costs[492]) and transaction fees and charges associated with the fund trading portfolio assets.[493] The proposed swing factor determination requirement

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490 *Id.*

491 *Id.*

492 *See supra* notes 415-416.

493 "Transaction fees and charges" would be defined in proposed rule 22c-1(a)(3) to mean "brokerage commissions, custody fees, and any other charges, fees, and taxes associated with portfolio asset purchases and sales." Proposed rule 22c-1(a)(3)(v)(E). We request comment on the proposed definition of this term at the end of this section III.F.1.e.

incorporates an assessment of multiple sources of potential dilution, in order to cause a fund to take all relevant considerations into account when making this determination.

Specifically, proposed rule 22c-1(a)(3)(i)(D)*(1)* would require a fund's policies and procedures for determining the swing factor to take into account any near-term costs that are expected to be incurred as a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's NAV, including any market impact costs, spread costs, and transaction fees and charges arising from asset purchases or asset sales in connection with those purchases or redemptions, as well as any borrowing-related costs associated with satisfying those redemptions.[494] While a fund may be able to determine some of these costs with precision (*e.g.*, transaction fees and charges, and borrowing-related costs), we understand that other costs may only be able to be estimated by the fund, and the swing factor therefore would represent an estimate of the combined near-term costs associated with purchase or redemption activity. A fund may wish to consider certain of the factors it would evaluate for purposes of classifying the liquidity of its portfolio positions[495] in order to assess the costs associated with purchasing or selling portfolio assets. For example, a fund could use a portfolio asset's average daily trading volume[496] in determining the portion of a particular portfolio holding that it could sell each day

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494 The proposed costs that a fund would be required consider in determining its swing factor overlap significantly with costs that we understand funds that use swing pricing in other jurisdictions commonly consider when determining their swing factor. For example, the Luxembourg Swing Pricing Survey, Reports & Guidelines provides that the following should be considered when determining the swing factor: (i) the bid-offer spread of a fund's underlying portfolio assets, (ii) net broker commissions paid by the fund, (iii) custody transaction charges, (iv) fiscal charges (*e.g.*, stamp duty and sales tax), (v) any initial charges or exit fees applied to trades in underlying investment funds, and (vi) any swing factors or dilution amounts or spreads applied to underlying investment funds or derivative instruments. *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 7, 15-16.

495 *See supra* section III.B.2.

496 *See* proposed rule 22e-4(b)(2)(ii)(B).

without market impact. Likewise, a fund could refer to bid-ask spreads for a particular asset[497] to estimate the purchase price that the fund would pay for that asset. Indications of decreasing liquidity (for example, widening bid-ask spreads) would likely indicate increased market-related costs associated with certain portfolio assets. We anticipate that the particular transaction fees and charges that a fund would likely consider would include brokerage commissions and custody fees, as well as other charges, fees, and taxes associated with portfolio asset purchases or sales (for example, transfer taxes and repatriation costs for certain foreign securities, or transaction fees associated with portfolio investments in other investment companies). If a fund were to draw on a line of credit, or otherwise borrow money, in order to pay redemptions, this borrowing activity could result in costs to the fund that, like the costs associated with purchasing and selling portfolio assets, could dilute the value of the shares held by existing shareholders.[498] We are therefore proposing to require that a fund consider these costs, along with the costs associated with investing the proceeds from net purchases or assets sales to satisfy net redemptions, in determining the swing factor.

The proposed rule specifies that the determination of a fund's swing factor must take into account the *near-term* costs expected to be incurred by the fund as a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's NAV (emphasis added). The phrase "near-term" is meant to reflect that investing proceeds from net purchases or satisfying net redemptions could involve costs that may not be incurred by the fund for several days. For example, a fund could use cash to satisfy redemptions, which may result in minimal costs to the fund, but rebalancing the fund's portfolio to rebuild cash balances in the

497 *See* proposed rule 22e-4(b)(2)(ii)(D).

498 *See supra* section III.C.5.a.

next several days could cause the fund to incur costs that would be borne by the existing shareholders. The rule text specifies that the costs to be considered are those that are expected to be incurred by the fund as a result of the net purchase or net redemption activity that occurred on the day the swing factor is used to adjust the fund's NAV; this specification is designed to help ensure that the costs to be taken into account are those that are directly related to the purchases or redemptions at issue. Thus, while the term "near-term costs" does not envision a precise number of days, we believe that, in context, this term would not likely encompass costs that are significantly removed in time from the purchases or redemptions at issue.

Under proposed rule 22c-1(a)(3)(i)(D)*(2)*, a fund's policies and procedures for determining the swing factor would be required to consider information about the value of assets purchased or sold by the fund as a result of the net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's NAV, if that information would not be reflected in the current NAV of the fund computed that day. This factor is meant to reflect the fact that a fund's NAV will generally not reflect changes in holdings of the fund's portfolio assets and changes in the number of the fund's outstanding shares until the first business day following the fund's receipt of the shareholder's purchase or redemption requests.[499] Thus, the price that a shareholder receives for his or her purchase or sale of fund shares customarily does not take into account market-related costs that arise when the fund trades portfolio assets in order to meet shareholder purchases or redemptions. But these costs could dilute the value of fund shares held by existing shareholders and thus should be considered in determining the fund's swing factor.

[499] *See supra* note 412 and accompanying text.

A fund could take a variety of approaches to determining its swing factor, in light of the fact that the relevant factors to be used in determining the swing factor could vary, as well as the likelihood that the persons administering the fund's swing pricing policies and procedures may (to the extent that net purchases or net redemptions cannot be ascertained or reasonably estimated until close to the time that the fund must strike its NAV) have limited time to determine the swing factor each day the fund's net purchases or net redemptions exceed the swing threshold. For example, a fund may wish to set a "base" swing factor, and adjust it as appropriate if certain aspects required to be considered in determining the swing factor deviate from a range of pre-determined norms (for example, if spread costs generally exceed a certain pre-determined level). Alternatively or additionally, we request comment below on the extent to which a fund that uses swing pricing may wish to incorporate into its policies and procedures a formula or algorithm that includes the factors required to be considered for determining the swing factor. We also understand that it may be difficult to determine certain costs (particularly, certain market impact costs and spread costs) with precision, while other factors that a fund would be required to consider in determining its swing factor may be able to be ascertained more exactly (for example, transaction fees and charges, borrowing-related costs, and the value of assets purchased or sold by the fund as a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's NAV). For this reason, in establishing policies and procedures for determining the swing factor, a fund may wish to incorporate the use of reasonable estimates in these policies and procedures, to the extent the fund determines necessary or appropriate.[500]

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500 We understand that funds that use swing pricing in other jurisdictions may use reasonable estimates, such as those discussed in this paragraph, when determining their swing factor. *See, e.g.*, Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 15.

We are not proposing to require an upper limit on the swing factor that a fund would be permitted to use, on account of the difficulty of establishing an appropriate across-the-board limit that would permit funds with different investment strategies, under all market conditions, to determine a swing factor that reflects the costs associated with the potential shareholder purchase or redemption activity. These costs could vary widely across funds and under different market conditions, and we do not wish to limit the extent to which swing pricing could mitigate the dilution of existing shareholders. We believe that the lack of an upper limit on a fund's swing factor would not result in inappropriately high NAV adjustments, because the swing factor would be required to be determined with reference to the factors discussed above, and the policies and procedures for determining the swing factor would be required to be approved by the fund's board, which has an obligation to act in the interests of the fund.[501]

We do recognize that if we were to require an upper limit on the amount that a fund would be permitted to adjust its NAV, this could mitigate volatility, tracking error, and transparency concerns that could arise from the use of swing pricing.[502] A required swing factor limit would act as an upper bound on the extent to which a fund would be able to adjust its NAV and the NAV volatility resulting from this adjustment. Also, capping the swing factor that a fund would be permitted to use would provide transparency regarding the maximum amount that a shareholder could expect the share price that he or she receives upon purchase or redemption to be adjusted on account of swing pricing. However, as discussed above, we believe that the use of partial swing pricing could significantly reduce the performance volatility potentially

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501 *See infra* section III.F.1.f and note 517.

502 *See supra* section III.F.1.a.

associated with swing pricing,[503] and that proposed disclosure and reporting requirements regarding swing pricing will enhance transparency surrounding the use of swing pricing.[504]

Although we are not proposing to require an upper limit on the swing factor that a fund would be permitted to use, a fund would be permitted to adopt an upper limit on the swing factor it would apply, as part of the fund's swing pricing policies and procedures.[505] We understand that certain foreign domiciled funds that use swing pricing voluntarily limit the level of the swing factor to be applied, with such limits generally ranging from 1% - 3%.[506] These funds usually disclose the swing factor upper limit in the fund's offering documents.[507] To the extent that a fund chooses to adopt a swing factor upper limit as part of its swing pricing policies and procedures, this limit would be required to be approved by the fund's board (as part of the fund's swing pricing policies and procedures, which are subject to board approval).[508] Likewise, a change to a fund's swing factor upper limit would be deemed to be a material change to the fund's swing pricing policies and procedures that would require board approval.[509] As fund directors have an obligation to act in the interests of the fund,[510] we expect that a fund board approving a swing factor upper limit would generally determine that capping the swing factor would not unduly limit the extent to which swing pricing could mitigate the potentially dilutive effects of shareholder purchase and redemption activity. Also, because the upper limit would

503 *See supra* notes 447-449 and accompanying text.

504 *See supra* paragraph accompanying note 451.

505 *See* proposed rule 22c-1(a)(3)(i)(D).

506 Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 7.

507 *Id.*

508 *See infra* section III.F.1.f.

509 *See id.*; proposed rule 22c-1(a)(3)(ii)(A).

510 *See infra* note 517 and accompanying text.

affect the swing factor a fund would use to adjust its NAV when net purchases or net redemptions exceed the fund's swing threshold, the determination of the upper limit must take into account the same factors the fund would be required to consider in determining the swing factor.[511]

We request comment below on whether to require an upper limit on the swing factor that a fund would be permitted to use, and if so, the appropriate level of such limit. We also request comment on whether a fund should be permitted to adopt an upper limit on the swing factor it would apply, as part of the fund's swing pricing policies and procedures.

Request for Comment

We request comment on the definition of "swing factor" set forth in proposed rule 22c-1(a)(3) and the process a fund would use to calculate the swing factor that the fund would use to adjust its NAV.

- Is the definition of "swing factor," as set forth in proposed rule 22c-1(a)(3) appropriate and clear? If not, how could this definition be clarified or made more effective within the context of the proposed rule?
- We request comment on each of the considerations that a fund would be required to take into account in determining the swing factor, pursuant to proposed rule 22c-1(a)(3)(i)(D). Would these considerations reflect the estimated or actual costs associated with purchasing or selling portfolio assets in order to meet purchases or redemptions of fund shares? Should any aspect of proposed rule 22c-1(a)(3)(i)(D) not be required to be considered by a fund in calculating the swing factor? Should any of the considerations be modified, and is the definition of "transaction fees and charges," as set forth in the

511 Proposed rule 22c-1(a)(3)(i)(D).

proposed rule, appropriate and clear? Instead of codifying certain considerations that a fund must take into account in determining the swing factor, should we instead provide guidance on factors a fund may wish to consider in calculating the swing factor? Instead of using a swing factor to adjust a fund's NAV, is there an alternate means by which a fund should be permitted to adjust its NAV to mitigate potential dilution stemming from purchase or redemption activity (*e.g.*, pricing its assets on the basis of bid prices, as opposed to pricing using the mean of bid and asked prices)?

- We request comment on the approaches commenters believe a fund may take to determine its swing factor. For example, do commenters anticipate that a fund would set a "base" swing factor, and adjust it as appropriate if certain elements required to be considered in the swing factor deviate from a range of pre-determined norms? Do commenters believe that it would be feasible and likely that a fund may wish to use a formula or algorithm approach for determining the swing factor? What other approaches to determining the swing factor do commenters anticipate that a fund would be likely to take?
- Do commenters agree that the Commission should not require an upper limit on the swing factor that a fund would be permitted to use? Why or why not? If not, what upper limit would be appropriate (*e.g.*, 2%, or some other limit), and why? Should we specify different limits for different types of funds or investment strategies?
- Do commenters agree that a fund should be permitted to adopt an upper limit on the swing factor it would apply, as part of the fund's swing pricing policies and procedures? Why or why not? To the extent that a fund does adopt an upper limit on the swing factor it would apply, should the fund be required to disclose this upper limit to shareholders?

Should each fund that adopts swing pricing policies and procedures be required, not only permitted, to adopt an upper limit on the swing factor it would apply?

f. Approval and Oversight of Swing Pricing Policies and Procedures

Proposed rule 22c-1(a)(3)(ii)(A) would require a fund that has determined to engage in the use of swing pricing to obtain initial approval of its swing pricing policies and procedures (including the fund's swing threshold and any swing factor upper limit specified under the fund's swing pricing policies and procedures) from the fund's board, including a majority of independent directors. The proposed rule also would require a fund's board, including a majority of independent directors, to approve any material change to the fund's swing pricing policies and procedures (including any change to the fund's swing threshold, a change to any swing factor upper limit, or any decision to suspend or terminate the fund's swing pricing policies and procedures).[512] However, a fund's board would not be required to manage the administration of the fund's swing pricing policies and procedures. The proposed rule instead provides that a fund's board is required to designate the fund's investment adviser or officers responsible for administering the fund's swing pricing policies and procedures and determining the swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached.[513] This proposed designation requirement tasks administration for the fund's swing pricing policies and procedures to persons who we believe would be in a better position to evaluate fund flows on a real-time basis than the fund's board.

The proposed oversight requirements for a fund's board and its independent directors reflect the historical role that a fund's board and independent directors have held with respect to

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512 Proposed rule 22c-1(a)(3)(ii)(A).

513 Proposed rule 22c-1(a)(3)(ii)(B).

issues involving valuation. A fund's board historically has held significant responsibility regarding valuation- and pricing-related matters,[514] as well as in approving valuation and compliance-related policies and procedures.[515] Additionally, in the past we have stated that a fund's compliance policies and procedures, which must be approved by the fund's board (including a majority of independent directors), should include procedures for the pricing of portfolio securities and fund shares.[516]

We believe that the proposed board and independent director approval requirements would help ensure that a fund establishes and implements swing pricing policies and procedures that are in the best interests of all the fund's shareholders. Because fund directors have an obligation to act in the interests of the fund,[517] a board approving swing pricing policies and procedures might do so under the premise that such policies and procedures would not unduly disadvantage any particular group of shareholders, and that any disadvantages that could affect certain shareholders would generally be outweighed by the benefits to the fund as a whole. Furthermore, the proposed approval requirements would serve to assure shareholders that the

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514 *See, e.g.*, section 2(a)(41)(B) of the Investment Company Act and rule 2a-4 thereunder (when market quotations are not readily available for a fund's portfolio securities, the Investment Company Act requires the fund's board of directors to determine, in good faith, the fair value of the securities); rule 2a-7(c)(1)(i) and rule 2a-7(g)(1)(i)(A)-(C) (a stable NAV money market fund that qualifies as a retail or government money market fund may use the amortized cost method of valuation to compute the current share price provided, among other things, the board of directors believes that the amortized cost method of valuation fairly reflects the market-based NAV and does not believe that such valuation may result in material dilution or other unfair results to investors or existing shareholders).

515 *See, e.g.*, ASR 118, *supra* note 423 (a board, consistent with its responsibility to determine the fair value of each issue of restricted securities in good faith, determines the method of valuing each issue of restricted securities in the company's portfolio and the actual valuation calculations may be made by persons acting pursuant to the board's direction; the board must continuously review the appropriateness of the method used in valuing each issue of security in the company's portfolio); Rule 38a-1 Adopting Release, *supra* note 90, at text accompanying n.46 (stating that rule 38a-1 requires fund directors to approve written compliance policies and procedures that require each fund to "provide a methodology or methodologies by which the fund determines the fair value of the portfolio security").

516 *See* Rule 38a-1 Adopting Release, *supra* note 90, at nn.39-47 and accompanying text.

517 *See, e.g.*, Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24082 (Oct. 14, 1999) [64 FR 59826 (Nov. 3, 1999)] (discussing directors' duties of care and loyalty).

same level of net purchase or net redemption activity would consistently trigger the use of swing pricing, unless the fund's board and a majority of the fund's independent directors were to approve a change in the fund's swing threshold.

We believe that shareholders' interests would be best served by requiring the majority of a fund's independent directors, along with the fund's board, to approve the fund's swing pricing policies and procedures. As we have stated before, a fund's independent directors serve to guard investors' interests.[518] The decision to implement swing pricing, and determining the terms of swing pricing policies and procedures to be adopted by a fund, could occasionally produce conflicts for the fund and its adviser, and we believe that the proposed independent director approval requirement would help ensure that a fund's use of swing pricing would operate to the benefit of the fund's shareholders (even if this may not be in the best interest of the fund's adviser). For example, a fund's adviser could be reluctant to implement swing pricing to the extent it may make the fund's performance stray too far from, or appear more volatile than, the fund's benchmark, which could impact the ability of the fund to attract new investments. Approval of swing pricing policies and procedures by a majority of a fund's independent directors could make certain that the fund would use swing pricing in circumstances in which the board has determined swing pricing would serve shareholders' best interests, even if these interests may conflict with the adviser's.

While a fund's board would be required to approve the fund's swing pricing policies and procedures, the board would be required to designate the fund's adviser or officers responsible for the administration of these policies and procedures, including responsibility for determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is

[518] *See id.*

breached.[519] It is currently common industry practice for foreign domiciled funds that use swing pricing to appoint a committee to administer the fund's swing pricing operations.[520] A fund's board may wish to consider requiring the fund's swing pricing policies and procedures to be administered by a committee, and to specify the officers or functional areas that comprise the committee (taking into account any possible conflicts for the fund and the adviser related to swing pricing). The persons or committee tasked with swing pricing oversight may wish to meet periodically to determine the swing factor(s) the fund would use in a variety of circumstances, taking into account the factors and considerations discussed above in section III.F.1.e. A fund may wish to consider delineating the frequency with which these persons would meet in its policies and procedures; for example, a fund's policies and procedures might specify that these persons shall meet periodically, such as monthly or quarterly, or more frequently if market conditions require.[521] Because a fund may decide to adopt swing pricing policies and procedures as part of its liquidity risk management program, the fund's board may wish to provide that the persons (or functional areas) in charge of implementing these policies and procedures overlap with the persons (or functional areas) in charge of administering the liquidity risk management program.

Proposed rule 22c-1(a)(3) would require the determination of the swing factor to be reasonably segregated from the portfolio management function of the fund. For example, if a

519 Proposed rule 22c-1(a)(3)(ii)(B).

520 *See, e.g.*, BlackRock Swing Pricing Paper, *supra* note 412; J.P. Morgan Asset Management Swing Pricing Paper, *supra* note 454; Franklin Templeton Investments, Swing pricing: Investor protection against fund dilution, last visited Apr. 15, 2015, *available at* http://www.franklintempleton.co.uk/downloadsServlet?docid=hjs17mth ("Franklin Templeton Investments Swing Pricing Paper").

521 *See, e.g.*, BlackRock Swing Pricing Paper, *supra* note 412 (swing pricing committee meets at least monthly); J.P. Morgan Asset Management Swing Pricing Paper, *supra* note 454 (swing pricing committee meets at least quarterly); Franklin Templeton Investments Swing Pricing Paper, *supra* note 520 (swing pricing committee meets at least quarterly).

committee were tasked with determining the swing factor(s) the fund would use in a variety of circumstances, we believe it would be appropriate for the fund's portfolio manager to provide inputs to be used by that committee in determining the swing factor, but not to decide how those inputs would be employed in the swing factor determination. We believe that, in determining the swing factor, independence from portfolio management is important because the incentives of portfolio managers may not always be consistent with determining a swing factor that most effectively prevents dilution of existing shareholders' interests in the fund. For example, a fund's portfolio manager could have an incentive to determine a swing factor that is as low as possible, because the portfolio manager could be reluctant for the fund's short-term performance to appear relatively poor compared to other funds and the fund's benchmark.[522]

A fund's board would not be required to approve each swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached, although the board would be required to approve the policies and procedures for determining the swing threshold. This approval framework—along with the proposed segregation of the swing factor determination from the portfolio management function—is meant to strike a balance between ensuring appropriate board oversight over the policies and procedures for determining the swing factor, and independence with respect to the swing factor determination process, while recognizing that it may not be practicable for a fund's directors to be directly involved in the process of determining each swing factor. Because the persons administering the fund's swing pricing policies and procedures may have limited time to determine each swing factor to the extent that net purchases or net redemptions cannot be ascertained or reasonably estimated until close to the time that the fund must strike its NAV, we do not believe that it would generally be operationally

[522] *See supra* note 446 and accompanying text; *infra* section III.F.2.b.

feasible for a fund's board to approve each swing factor. Also, we do not believe that requiring a fund's board to approve each swing factor would be consistent with boards' historical oversight role.

Request for Comment

We seek comment on the proposed approval and oversight requirements associated with a fund's swing pricing policies and procedures.

- Do commenters agree that a fund's board, including a majority of the fund's independent directors, should be required to approve the fund's swing pricing policies and procedures (including the fund's swing threshold, and any swing factor upper limit specified under the fund's swing pricing policies and procedures), and any material changes thereto? Would these approval requirements ensure that a fund establishes and implements swing pricing policies and procedures that are in the interests of all of the fund's shareholders? Do commenters agree that the proposed independent director approval requirement would ensure that a fund's use of swing pricing benefits the fund's shareholders? Should the board be provided the option to not use swing pricing in a particular situation when swing pricing would have been warranted pursuant to a fund's swing pricing policies and procedures?
- Do commenters agree that it would be appropriate to require a fund's board to designate the fund's adviser or officers responsible for the administration of swing pricing policies and procedures, including responsibility for determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached? Do commenters agree that the determination of the swing factor should be reasonably segregated from the portfolio management of the fund? Would this pose any difficulty

for particular types of entities, for example funds managed by small advisers? Is there a better way to prevent conflicts between the portfolio manager's incentives and the process of determining a swing factor that most effectively prevents dilution of existing shareholders' interests in the fund? What officers (or functional areas) of a fund do commenters anticipate a fund's board would select to administer the fund's swing pricing policies and procedures, and do commenters anticipate that these persons (or functional areas) would overlap with the administrators of a fund's liquidity risk management program?

- Do commenters agree that a fund's board should not be required to approve each swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached, although the board would be required to approve the policies and procedures for determining the swing threshold? Why or why not?
- Should the Commission provide guidance as to the circumstances in which a possible misapplication of a firm's swing pricing policy could result in a material NAV error? For example, should the Commission explain whether an error would occur when the fund makes estimates under its swing pricing policy that is applied correctly, but the information, such as final shareholder flows, subsequently changes to a material degree? Should funds be required to have specific policies and procedures to address possible NAV errors?

g. Recordkeeping Requirements

Proposed rule 22c-1(a)(3) would require a fund to maintain a written copy of swing pricing policies and procedures adopted by the fund that are in effect, or at any time within the past six years were in effect, in an easily accessible place.[523] Additionally, we are proposing to expand current rule 31a-2(a)(2), which requires a fund to keep records evidencing and supporting each computation of the fund's NAV,[524] to reflect the NAV adjustments based on a fund's swing pricing policies and procedures. Specifically, a fund that adopts swing pricing policies and procedures would be required to preserve records evidencing and supporting each computation of an adjustment to the fund's NAV based on the fund's swing pricing policies and procedures.[525] For each NAV adjustment, such records should generally include, at a minimum, the fund's unswung NAV, the level of net purchases or net redemptions that the fund encountered (or estimated) that triggered the application of swing pricing, the swing factor that was used to adjust the fund's NAV, and relevant data supporting the calculation of the swing factor. The records required under the proposed amendments to rule 31a-2(a)(2) would be required to be preserved for at least six years from the date that the NAV adjustment occurred, the first two years in an easily accessible place.[526] The proposed six-year period for a fund to maintain a copy of its swing pricing policies and procedures in proposed rule 22c-1(a)(3) corresponds with the six-year recordkeeping period currently incorporated in rule 31a-2(a)(2). We believe that consistency in these retention periods is appropriate in order to permit a fund or Commission staff to review historical instances of NAV adjustments effected pursuant to the fund's swing pricing policies and procedures in light of the policies and procedures that were actually in place at the time the NAV adjustments occurred.

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523 Proposed rule 22c-1(a)(3)(iii).

524 *See* rule 31a-2(a)(2) (every registered investment company shall . . . "[p]reserve for a period not less than six years from the end of the fiscal year in which any transactions occurred, the first two years in an easily accessible place . . . all schedules evidencing and supporting each computation of net asset value of the investment company shares").

525 *See* proposed amendment to rule 31a-2(a)(2).

526 *See id.*

These proposed recordkeeping requirements would help our examination staff to ascertain whether a fund that has adopted swing pricing policies and procedures has done so in compliance with the requirements of proposed rule 22c-1(a)(3). They also would help our staff to determine whether a fund is taking into account the factors required to be considered under proposed rule 22c-1(a)(3)(i)(D) in calculating the swing factor.

Request for Comment

We seek comment on the proposed recordkeeping requirements associated with a fund's swing pricing policies and procedures.

- Do commenters agree that the proposed recordkeeping requirements are appropriate? Are there any additional records associated with a fund's swing pricing policies and procedures that a fund should be required to keep? Should rule 31a-2(a)(2) be amended to specifically require a fund to keep records evidencing the fund's consideration of each of the factors required to be considered in determining each swing factor used to adjust the fund's NAV? Do commenters agree that the six-year record retention period in proposed rule 22c-1(a)(3) and the proposed amendments to rule 31a-2(a)(2) is appropriate?

2. *Guidance on Operational Considerations Relating to Swing Pricing*

a. Operational Processes Associated with Swing Pricing

Swing pricing requires the net cash flows for a fund to be known, or estimated using information obtained after reasonable inquiry,[527] before determining whether to adjust the fund's NAV on any particular day (and, if the fund's swing factor varies depending on its net flows, to

[527] *See* proposed rule 22c-1(a)(3)(i)(A) (permitting the person(s) responsible for administering the fund's swing pricing policies and procedures to use "information obtained after reasonable inquiry" in determining whether the fund's level of net purchases or net redemptions has exceeded the fund's swing threshold).

determine the swing factor that the fund will use to adjust its NAV). A fund using swing pricing would need to monitor shareholder trades or flows of money in and out of the fund for purposes of determining whether the fund's net purchases or net redemptions would give rise to an NAV adjustment under its swing pricing policies and procedures.[528] Because the deadline by which a fund must strike its NAV may precede the time that a fund receives final information concerning daily net flows from the fund's transfer agent, a fund may wish to arrange for interim feeds of flows from its transfer agent or distributor in order to reasonably estimate its daily net flows for swing pricing purposes. A fund also may wish to implement formal or informal policies to encourage effective communication channels between the persons charged with implementing the fund's swing pricing policies and procedures, the fund's investment professionals, and personnel charged with day-to-day pricing responsibility (to the extent different persons comprise each of these groups).

In addition, there are unique operational considerations applicable to funds with multiple share classes. A fund with multiple share classes that uses swing pricing should consider the net purchase or net redemption activity of all share classes in determining whether its swing threshold has been breached.[529] Like a fund with only one share class, the purchase or redemption activity of certain shareholders (or a class of shareholders) within a multi-share-class fund could dilute the value of the existing shareholders' (or class of shareholders') interests in the fund.

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528 We have previously stated that a fund should adopt compliance policies and procedures that provide for monitoring shareholder trades or flows of money in and out of the fund for purposes of detecting market timing activity. *See* Rule 38a-1 Adopting Release, *supra* note 90, at nn.66-69 and accompanying text.

529 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 21 (discussing swing pricing considerations relevant to funds with multiple share classes).

b. Performance Reporting and Calculation of NAV-Based Performance Fees

For purposes of calculating the financial highlights and performance data to be included in a fund's prospectus and shareholder reports,[530] a fund using swing pricing should consider its NAV at the beginning and end of a reporting period, as well as its "ending redeemable value" on a particular day, to be its NAV as adjusted pursuant to its swing pricing policies and procedures (as applicable). Because a fund using swing pricing to adjust its NAV would, under certain circumstances, use the adjusted NAV as the price that shareholders receive for the purchase or redemption of shares, the adjusted NAV is the "net asset value calculated on the last business day before the first day of each [performance] period" and the "price calculated on the last business day of each [performance] period," as referenced in the instructions to Item 13 ("Financial Highlights Information") of Form N-1A. For the same reason, the adjusted NAV is the "ending redeemable value" of the fund's shares, as referenced in Item 26 ("Calculation of Performance Data") of Form N-1A. Likewise, because rule 482 under the Securities Act references Form N-1A with respect to performance data,[531] a fund using swing pricing also should use its adjusted NAV when calculating the standardized performance data to be included in the fund's advertising materials.

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530 *See* Items 13, 26 of Form N-1A.

531 Rule 482(d), 17 CFR 230.482.

If a fund using swing pricing pays NAV-based performance fees to its adviser,[532] the fund's NAV for purposes of calculating performance fees should be the NAV as adjusted pursuant to its swing pricing policies and procedures (as applicable). As discussed above, a fund's NAV used for performance reporting purposes would be the NAV as adjusted pursuant to swing pricing policies and procedures. We believe that the reported NAV and the NAV used for calculating performance fees (to the extent used) should be consistent in order to promote transparency regarding any performance fees paid to the fund's adviser, and to reflect the fact that the fund's performance likely has been affected by the transaction costs associated with shareholders' purchases and redemptions.

c. Fund Merger Considerations

When funds merge, and at least one of the merging funds uses swing pricing, there are a number of considerations relating to swing pricing that the funds generally should consider when determining the terms of the merger.[533] The boards of merging funds should consider whether a swing factor should be used to adjust the value of the absorbed fund's assets, if the absorbing

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532 Section 205(a)(1) of the Investment Advisers Act generally restricts an investment adviser from entering into, extending, renewing, or performing an investment advisory contract that provides for compensation to the adviser based on a share of capital gains on, or capital appreciation of, the funds of a client.

However, there are certain exemptions to this general restriction. *See* section 205(b)(2) of the Investment Advisers Act (providing that the section 205(a)(1) restriction does not apply to an investment adviser charging performance fees to a registered investment company if the fee is structured to comply with four requirements: (i) the fee is based on the investment company's NAV; (ii) the NAV is averaged over a "specified period"; (iii) the fee increases or decreases proportionately with the investment company's "investment performance" over the specified period; and (iv) the investment company's investment performance relates to the "investment record" of an "appropriate index" of securities prices or another measure of investment performance as specified by the Commission by rule, regulation, or order); *see also* rule 205-3 under the Investment Advisers Act 17 CFR 275.205-3 (providing an exemption to the section 205(a)(1) restriction and permitting an investment adviser to charge performance fees if the adviser's client is a "qualified client" as defined in rule 205-3(d)(1) (generally, a client having at least $1 million under management with the adviser immediately after entering into an advisory contract with the adviser, or a client the adviser reasonably believed had a net worth of more than $2 million at the time the contract was entered into)).

533 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 18-19 (discussing swing pricing considerations relevant to fund mergers).

fund uses swing pricing and it is applied on the day of the merger.[534] Although the manager of the absorbing fund may need to sell certain of the assets of the absorbed fund following the merger (*e.g.*, for consistency with the absorbing fund's investment strategy, or to comply with certain regulatory requirements[535]), we do not believe that the NAV of either the absorbing fund or the absorbed fund should be adjusted to counter any dilution resulting from these sales, because costs associated with these sales would result from the merger and would not be caused by shareholders' purchase or redemption activity. In light of potential complications arising when funds using swing pricing merge, the boards of merging funds should consider whether to temporarily suspend a fund's swing pricing policies and procedures ahead of the merger.[536] Under proposed rule 22c-1(a)(3), such suspension would be considered a material change to the fund's swing pricing policies and procedures and thus could be accomplished only by vote of the fund's board, including a majority of the fund's independent directors.[537] In any event, the swing threshold of the absorbing fund should be reviewed following a merger. Likewise, the persons in charge of administering the absorbing fund's swing pricing policies and procedures should consider the effects of the merger when considering what swing factor would be appropriate to use if the fund's swing threshold is breached following the merger.

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534 Directors overseeing fund mergers must take into account rule 17a-8 under the Investment Company Act (which sets forth requirements for mergers of affiliated investment companies), if applicable, as well as any relevant state law requirements. Rule 17a-8 requires a board, including a majority of the independent directors, to consider the relevant facts and circumstances with respect to a merger of affiliated funds and determine that the merger is in the best interests of each of the merging funds and that the interests of the shareholders of both the fund being acquired and the acquiring fund are not being diluted. We expect swing pricing considerations could be relevant to this determination.

See Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 18-19 (discussing issues associated with the use of swing pricing to adjust the value of the absorbed fund's assets).

535 *See, e.g., supra* paragraph accompanying notes 296-298.

536 *See supra* note 534.

537 *See* proposed rule 22c-1(a)(3)(ii)(A).

d. Request for Comment

We seek comment on the Commission's guidance discussed above regarding certain operational and accounting considerations relating to swing pricing. Do commenters generally agree with the Commission's guidance in this section III.F.2?

Along with this general request for comment on the Commission's guidance, we request specific comment on a number of individual guidance items.

- To what extent is it currently typical for a fund to receive interim feeds of flows from its transfer agent or distributor, and do these interim feeds generally permit a fund to reasonably estimate its net flows at the end of a business day? To what extent do financial intermediaries or other third parties provide interim feeds of flows?
- Should the Commission amend the proposed rule or provide guidance regarding pricing errors in the context of swing pricing? How do commenters anticipate that a fund using swing pricing may wish to update its pricing policies to provide clarity as to the application of swing pricing to the fund's policies concerning pricing errors? What policies do commenters anticipate that a fund's pricing policies could incorporate with respect to circumstances in which the fund's NAV was swung (or not swung) based on an estimate of net purchases or net redemptions that was later determined to be incorrect, but was based on information obtained after reasonable inquiry pursuant to proposed rule 22c-1(a)(3)(i)(A)?
- Do commenters agree that it is appropriate to require that a fund calculate performance fees based on the fund's NAV as adjusted pursuant to the fund's swing pricing policies and procedures (as applicable)? Why or why not? We specifically request comment on whether calculating a performance fee based on a fund's adjusted NAV could be viewed

as inappropriately increasing or decreasing the fee (*e.g.*, depending on whether the NAV was adjusted at the beginning or end of a measurement period).

- Besides the issues discussed in this section, what specific operational challenges do funds anticipate associated with swing pricing? Do commenters anticipate there would be circumstances in which a fund's structure (*e.g.*, a fund with multiple share classes, as discussed in section III.F.2.a) would cause swing pricing to be particularly complex to implement?
- With respect to a fund with multiple share classes that uses swing pricing, do commenters agree that the fund should consider the net purchase or net redemption activity of all share classes in determining whether its swing threshold has been breached? Or should a fund instead be permitted to consider the net purchase or redemption activity of each share class separately (which potentially could lead to NAV adjustments for certain share classes and not others, or different NAV adjustments for each share class, on the same day)? If so, should we amend rule 18f-3 to expressly allow this? What operational or other difficulties could result from permitting a fund with multiple share classes that uses swing pricing to consider the net purchase or redemption activity of each share class separately, and to potentially make different NAV adjustments for each share class on the same day?
- Besides the issues discussed in this section, are there any other operational issues associated with swing pricing about which we should provide guidance?

3. Master-Feeder Funds

With respect to master-feeder funds, we believe the use of swing pricing would generally be appropriate only with respect to the level (or levels) of the fund structure that actually transact in underlying portfolio assets as a result of net purchase or redemption activity.[538] For example, if shareholders of a feeder fund were to redeem feeder fund shares, the feeder fund would redeem from the master fund (and not sell portfolio assets) in order to pay redeeming shareholders. Likewise, if investors were to purchase shares of a feeder fund, the feeder fund would invest in the master fund with cash received from the feeder fund purchasing shareholders, and the master fund would invest this cash in portfolio assets. Thus, a feeder fund would not be permitted to use swing pricing under the proposed rule.[539] The master fund, on the other hand, would potentially need to purchase portfolio assets in order to invest purchasing shareholders' cash (as transferred through the feeder fund), or sell portfolio assets in order to pay redemption proceeds in exchange for feeder fund shares. Thus, to the extent that net purchases into or redemptions from the master fund (by one or more feeder funds, or any other investors in the master fund) exceed the fund's swing threshold, the swing factor should thus be applied to the master fund's NAV.[540] In this example, because the feeder fund invests in the master fund, the master fund's adjusted NAV would indirectly affect the NAV of the feeder fund.

Request for Comment

We seek comment on the application of swing pricing to master-feeder funds. Do commenters generally agree that feeder funds should not be permitted to use swing pricing? Why or why not?

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538 *See* Luxembourg Swing Pricing Survey, Reports & Guidelines, *supra* note 413, at 21-22 (discussing swing pricing considerations relevant to master-feeder fund structures).

539 *See* proposed rule 22c-1(a)(3)(iv).

540 Proposed rule 22c-1(a)(3) clarifies that, although feeder funds would not be permitted to use swing pricing, master funds would be permitted to do so. *See* proposed rule 22c-1(a)(3)(iv).

4. Financial Statement Disclosure Regarding Swing Pricing

The application of swing pricing would impact a fund's financial statements and disclosures in a number of areas, including a fund's statement of assets and liabilities, statement of changes in net assets, financial highlights and the notes to the financial statements. Currently, funds are required by Regulation S-X rule 6-04.19[541] to state the NAV on the statement of assets and liabilities. Similar to "ending redeemable value" discussed in performance reporting in section III.F.2.b above, for purposes of reporting the NAV in a fund's statement of assets and liabilities, a fund using swing pricing should consider its "purchase price" or "redemption price" on a particular day to be its NAV as adjusted pursuant to its swing pricing policies and procedures. We believe that disclosure of this price is important, as it allows investors to understand the value they would receive had they purchased or redeemed shares on the financial reporting period end date. Different from redemption fees, which may be charged to specific shareholders based on the length of time that the shareholder has owned shares of the fund, all shareholders in a fund would receive the NAV as adjusted pursuant to its swing pricing policies and procedures. As all shareholders would receive the NAV as adjusted pursuant to the fund's swing pricing policies and procedures, we are proposing to amend Regulation S-X rule 6-04.19 to require funds to disclose the NAV as adjusted pursuant to its swing pricing policies and procedures (if applicable).[542]

Swing pricing also would impact disclosures of capital share transactions included in a fund's statement of changes in net assets. A fund using swing pricing to adjust its NAV would

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541 *See* 17 CFR 210.6-04.19.

542 *See* proposed amendments to 210.6-04.19. We also propose amending Regulation S-X rule 6-02 to add a definition of swing pricing. Swing pricing would be defined as having the meaning given in proposed rule 22c-1(a)(3)(v)(C). *See* proposed 210.6-02(g).

make payments for shares redeemed and receive payments for shares purchased net of the swing pricing adjustment. For example, if a fund had an unadjusted NAV of $10.00 on a given day and the adjusted NAV pursuant to the fund's swing pricing policies and procedures was $9.90, shareholders would transact at $9.90 multiplied by the number of shares purchased or redeemed. The $0.10 difference between the adjusted and unadjusted NAV would be retained by the fund to offset transaction and liquidity costs. This $0.10 difference per share should be accounted for as a capital transaction and not included as income to the fund, because it is designed to reflect the near-term transactional and liquidity costs incurred as a result of satisfying shareholder transactions. Funds are required by Regulation S-X rule 6-09.4(b) to disclose the number of shares and dollar amounts received for shares sold and paid for shares redeemed.[543] In this example, Regulation S-X would require the dollar amount disclosed to be based on the $9.90 per share that was actually used for shareholder transactions.

Consistent with presentation of the impact of swing pricing on the statement of changes in net assets and performance reporting described in section III.F.2.b, a fund should include the impact of swing pricing in its financial highlights.[544] The per share impact of amounts retained by the fund due to swing pricing should be included in the fund's disclosures of per share operating performance.[545] Accordingly, we are proposing to amend Item 13 of Form N-1A to specifically require the per share impact of amounts related to swing pricing to be disclosed below the total distributions line in a fund's financial highlights. In order to properly reconcile with the adjusted NAV reported on the statement of assets and liabilities, we also are proposing

543 *See* 17 CFR 210.6-09.4(b).

544 *See* Item 13 of Form N-1A.

545 ASC 946-205-50-7 requires specific per share information to be presented in the financial highlights for registered investment companies, including disclosure of the per share amount of purchase premiums, redemption fees, or other capital items.

to clarify that "Net Asset Value, Beginning of Period" and "Net Asset Value, End of Period" are each the NAV as adjusted pursuant to the fund's swing pricing policies and procedures, if applicable.

Similarly, a fund's calculation of total return should use the NAV as adjusted pursuant to a fund's swing pricing policies and procedures as the redemption price calculated on the last business day of the period. We are proposing to amend Instructions 3(a) and 3(d) to Item 13 of Form N-1A to explicitly require funds to assume the NAV calculated on the last business day before the first day of each period and the price calculated on the last business day of each period shown should each be adjusted for the impact of swing pricing, if applicable. We believe that it is important for investors to understand the impact of swing pricing on the return that they would have received for the period presented in the fund's financial statements. We also are proposing to amend instructions to Item 26 regarding calculation of performance data to clarify that "ending redeemable value" should assume a value adjusted pursuant to swing pricing policies and procedures.

Finally, we are proposing to require funds that adopted swing pricing policies and procedures to state in a note to their financial statements the general methods used in determining whether the fund's net asset value per share will swing, whether the fund's net asset value per share has swung during the year, and a general description of the effects of swing pricing on the fund's financial statements.[546] We believe this information would be useful in further understanding the impact of swing pricing on a fund.

546 *See* proposed amendments to rule 6-03(n) of Regulation S-X.

Request for Comment

We seek comment on the financial statement disclosure considerations relating to swing pricing. Do commenters generally agree with the Commission's guidance discussed above regarding financial statement disclosure, as well as the proposed amendments to Regulation S-X?

Along with this general request for comment, we request specific comment on a number of individual issues discussed above.

- Should the Commission allow a fund to disclose the total return calculation on an unadjusted NAV basis as a supplement to the total return calculation in the financial highlights table, and/or in a fund's advertising materials?
- Should the dollar amount of purchases and redemptions disclosed in a fund's financial statements be presented based on unadjusted NAV, with the dollar amount retained by the fund because of swing pricing separately disclosed? Alternatively, should the dollar amount of purchases and redemptions be presented as the actual value received by the fund or paid to shareholders, which would include the impact of swing pricing? Why or why not?
- Should funds be required to disclose only the NAV as adjusted pursuant to a fund's swing pricing policies and procedures on the statement of assets and liabilities? Alternatively, should funds be required to disclose both unadjusted NAV and the NAV as adjusted pursuant to a fund's swing pricing policies and procedures on the statement of assets and liabilities?
- Should we require additional disclosures in notes to fund financial statements regarding swing pricing? If so, what additional information should be disclosed? Do commenters

believe that any of the proposed disclosures should be modified? Are any of the proposed disclosures unnecessary? Why or why not?

- Do commenters have any accounting or auditing concerns in connection with swing pricing? If so, please describe specific concerns.

G. Disclosure and Reporting Requirements Regarding Liquidity Risk and Liquidity Risk Management

Investors receiving relevant information about the operations of a fund and the principal risks associated with an investment in a particular fund are important in facilitating investor choice regarding the appropriate investments for their risk tolerances. Investors in open-end funds generally expect funds to pay redemption proceeds promptly following their redemption requests based, in part, on representations made by funds in their disclosure documents. Accordingly, information about how redemptions will be made and when investors will receive payment is significant to investors. Currently, funds are not expressly required to disclose how they manage the liquidity of their assets, and therefore limited information is available regarding whether the liquidity of a fund's portfolio securities corresponds with its liquidity needs related to redemption obligations. In addition to the proposed amendments to Form N-1A and Regulation S-X discussed above regarding financial reporting related to swing pricing, we are proposing amendments to Form N-1A, Regulation S-X, proposed Form N-PORT and proposed Form N-CEN to improve the ability of investors, the Commission staff, and other potential users to analyze and better understand a fund's redemption practices, its management of liquidity risks, and how liquidity risk management can affect shareholder redemptions. We are also proposing amendments to Form N-1A regarding disclosure of swing pricing.

1. Proposed Amendments to Form N-1A

a. Redemption of Fund Shares

Form N-1A is used by funds to register under the Investment Company Act and to register offerings of their securities under the Securities Act. In particular, Form N-1A requires funds to describe their procedures for redeeming fund shares, including restrictions on redemptions and any redemption charges.[547] Disclosure regarding other important redemption information, such as the timing of payment of redemption proceeds to fund shareholders, varies across funds as today there are no specific requirements for this disclosure under the form. Some funds disclose that they will redeem shares within a specific number of days after receiving a redemption request, other funds disclose that they will honor such requests within seven days (as required by section 22(e) of the Act), and others provide no specific time periods. Some funds disclose differences in the timing of payment of redemption proceeds based on the distribution channel through which the fund shares are redeemed, while others do not.

We believe that requiring consistency in disclosures and increasing the level of information provided among funds regarding the timing of payment after shareholder redemption of fund shares would give investors fuller information about their investments. Improvements are needed to enhance the ability of investors to evaluate and compare redemption policies across funds and to understand when a fund will actually pay redemption proceeds. Accordingly, we are proposing amendments to Item 11 of Form N-1A that would require a fund to disclose the number of days in which the fund will pay redemption proceeds to redeeming shareholders.[548] If the number of days in which the fund will pay redemption proceeds differs by distribution

547 *See* Item 11(c) of Form N-1A.

548 *See* proposed Item 11(c)(7) of Form N-1A.

channel, the fund also would be required to disclose the number of days for each distribution channel.[549]

We also are proposing amendments to Item 11 of Form N-1A that would require a fund to disclose the methods that the fund uses to meet redemption requests.[550] Under this requirement funds would have to disclose whether they use the methods regularly to meet redemptions or only in stressed market conditions. Methods to meet redemption requests may include, for example, sales of portfolio assets, holdings of cash or cash equivalents, lines of credit, interfund lending, and ability to make in-kind redemptions. To address transaction costs associated with shareholder activity, funds also may use redemption fees.[551]

Currently, Item 11(c)(3) of Form N-1A requires funds to disclose whether they reserve the right to redeem their shares in kind instead of in cash.[552] We propose to incorporate this disclosure requirement into proposed Item 11(c)(8) discussed above. We understand that the use of in-kind redemptions (outside of the ETF context) historically has been rare and that many funds reserve the right to redeem in kind only as a tool to manage liquidity risk under emergency circumstances or to manage the redemption activity of a fund's large institutional investors.[553] We also are aware that there are often logistical issues associated with redemptions in kind and that these issues can limit the availability of in-kind redemptions as a practical matter.[554] A fund should consider whether adding relevant detail to its disclosure regarding in-kind redemptions, or

549 *Id.*

550 *See* proposed Item 11(c)(8) of Form N-1A.

551 Funds also may use swing pricing to address transaction costs associated with shareholder purchases or redemptions. We have proposed amendments to Form N-1A regarding disclosure of swing pricing. *See* proposed Item 6(d) of Form N-1A.

552 *See* Item 11(c)(3) of Form N-1A

553 *See supra* section III. C.5.c.

554 *Id.*

revising its disclosure if the fund would be practically limited in its ability to redeem its shares in kind, would provide more accurate information to investors.

We are also proposing to amend Item 28 of Form N-1A to require a fund to file as an exhibit to its registration statement any agreements related to lines of credit for the benefit of the fund.[555] As previously mentioned, we understand based on staff outreach that it is relatively common for funds to establish lines of credit to manage liquidity risk and meet shareholder redemptions, typically during periods of significantly limited market liquidity.[556] We believe that requiring funds to include such agreements as exhibits to registration statements will increase Commission, investor, and market participant knowledge concerning the arrangements funds have made in order to strengthen their ability to meet shareholder redemption requests and manage liquidity risk and the terms of those arrangements. We also propose to include an instruction related to credit agreements noting that the specific fees paid in connection with the credit agreements need not be disclosed in the exhibit filed with the Commission to preserve the confidentiality of this information.

Overall, we believe that requiring funds to provide additional disclosure concerning the methods they use and the funding sources they have to fulfill their redemption obligations and whether those methods are used on a regular basis or only in stressed market conditions would improve shareholder and market participant knowledge regarding fund redemption procedures and liquidity risk management. In particular, increased knowledge of how and when a fund's redemption procedures may affect whether, for example, a shareholder would receive cash or

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555 *See* proposed Item 28(h) of Form N-1A.

556 *See supra* section III.C.5.a.

securities in kind or pay a redemption fee would be helpful for investors to better understand the impact of a fund's redemption procedures on shareholders.

b. Swing Pricing

Form N-1A currently requires a fund to describe its procedures for pricing fund shares, including an explanation that the price of fund shares is based on the fund's NAV and the method used to value fund shares.[557] If the fund is an ETF, an explanation that the price of fund shares is based on market price is required.[558] As discussed above, under proposed rule 22c-1(a)(3), a fund (with the exception of a money market fund or ETF) would be permitted, under certain circumstances, to use swing pricing to adjust its current NAV as an additional tool to lessen dilution of the value of outstanding redeemable securities through shareholder purchase and redemption activity.[559]

We are proposing to amend Item 6 of Form N-1A to account for this pricing procedure. Specifically, the proposed amendment would require a fund that uses swing pricing to explain the circumstances under which swing pricing would be required to be used as well as the effects of using swing pricing.[560] For a fund that invests in other funds (*e.g.*, fund-of-funds, master-feeder funds), the fund would be required to include a statement that its NAV is calculated based on the NAVs of the funds in which the fund invests, and that the prospectuses for those funds explain the circumstances under which those funds will use swing pricing and the effects of using swing pricing. We believe that these proposed disclosures would improve public understanding regarding a fund's use of swing pricing as well as the potential advantages and

557 *See* Item 11(a)(1) of Form N-1A.

558 *Id.*

559 *See supra* section III.F.

560 *See* proposed Item 6(d) of Form N-1A.

disadvantages of using swing pricing to manage dilution arising from shareholder purchase and redemption activity.

c. Request for Comment

We request comment on all aspects of the proposed amendments to Form N-1A.

- Would the proposed amendments regarding payment of redemption proceeds be helpful to fund shareholders? Should we modify the proposed disclosures, and if so, how?
- In addition to the proposed disclosure requirements, should Form N-1A be amended to require certain funds to incorporate enhanced disclosure regarding liquidity risk into their summary prospectuses? If so, what funds should be subject to such enhanced disclosure requirements (*e.g.*, funds with certain investment strategies, whose three-day liquid asset minimums are below a certain threshold, or that hold above a certain percentage of their portfolio (for instance, 5%, 10%, 20%, 30%) in assets with extremely limited liquidity, such as assets that can only be converted to cash in over 7 days, over 15 days, over 30 days, or over 90 days at a price that does not materially affect the value of that asset immediately prior to sale)? What specific liquidity risk disclosure requirements should apply to these funds?
- Are there any challenges associated with funds disclosing when they expect to pay redemption proceeds? Should funds be required to disclose the expected period in normal and stressed market conditions?
- Are there any challenges associated with funds disclosing the methods that they use to meet redemption requests and whether those methods are used regularly or only in stressed market conditions? Would disclosure of this information overly complicate prospectus disclosures?

- In cases where the number of days in which a fund will pay redemption proceeds differs by distribution channel, are there any challenges associated with funds disclosing the number of days for each distribution channel? Do funds pay all redemption proceeds at the same time irrespective of distribution channel (although when the shareholder actually receives redemption proceeds may differ by distribution channel)?
- Would the proposed amendments provide useful information to shareholders about how funds plan to satisfy redemption requests? Is there any additional information about fund redemption policies that shareholders should be aware of that is not discussed above? If so, would such additional information already be covered under existing Form N-1A requirements, or would we need to make any amendments to the form or its instructions?
- Would the proposed amendment to Item 28 of Form N-1A that would require a fund to file as exhibits to its registration statement any agreements related to lines of credit for the benefit of the fund be useful to fund shareholders and market participants? Why or why not? Are there any issues associated with funds filing such credit agreements? For example, even if specific fees paid in connection with the credit agreements are redacted, do funds have confidentiality concerns regarding filing such credit agreements? Should funds be required to file credit agreements if we adopt the proposed amendments to proposed Form N-CEN that require a fund to disclose information regarding lines of credit available to the fund?
- Would the proposed amendments to Form N-1A regarding swing pricing be useful to fund shareholders? Should funds be required to disclose additional information regarding swing pricing, and if so, what information should be disclosed?

2. *Proposed Amendments to Proposed Form N-PORT*

The Commission, investors, and other market participants currently have limited information about the liquidity of portfolio investments of funds, and we believe that all would benefit from more detailed reporting and disclosure of the liquidity of a fund's portfolio investments. On May 20, 2015, we proposed requiring registered management investment companies and ETFs organized as unit investment trusts, other than registered money market funds or small business investment companies, to electronically file with the Commission monthly portfolio investment information on proposed Form N-PORT.[561] As we discussed in the Investment Company Reporting Modernization Release, the information that would be filed on proposed Form N-PORT would enhance the Commission's ability to effectively oversee and monitor the activities of investment companies in order to better carry out its regulatory functions. We also stated that we believe that many investors, particularly institutional investors, as well as academic researchers, financial analysts, and economic research firms, could use the information reported on proposed Form N-PORT to evaluate fund portfolios and assess the potential for returns and risks of a particular fund.[562]

We believe that requiring funds to report information about the liquidity of portfolio investments would assist the Commission in better assessing liquidity risk in the open-end fund industry, which can inform its policy and guidance, as well as in its monitoring for compliance with proposed rule 22e-4 and identifying potential outliers in fund liquidity classifications for further inquiry, as appropriate. Furthermore, we believe that this information would help

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561 Submissions on Form N-PORT would be required to be filed no later than 30 days after the close of each month. As proposed, only information reported for the third month of each fund's fiscal quarter on Form N-PORT would be publicly available, and such information would not be made public until 60 days after the end of the third month of the fund's fiscal quarter. *See* Investment Company Reporting Modernization Release, *supra* note 104.

562 *See* Investment Company Reporting Modernization Release, *supra* note 104.

investors and potential users better understand the liquidity risks in funds. Accordingly, the Commission seeks to enhance the reporting regarding the liquidity of fund holdings by proposing that each fund report on Form N-PORT the fund's three-day liquid asset minimum as well as the liquidity classification for each portfolio asset, as further described below.

a. Liquidity Classification of Portfolio Investments

Part C of proposed Form N-PORT would require a fund and its consolidated subsidiaries to disclose its schedule of investments and certain information about the fund's portfolio of investments. We propose to add Item C.13 to Part C of proposed Form N-PORT, which would require a fund to indicate the liquidity classification of each of the fund's positions in a portfolio asset. Funds would be required to indicate such liquidity classification using the following categories as specified in proposed rule 22e-4:

- Convertible to cash within 1 business day;
- Convertible to cash within 2-3 business days;
- Convertible to cash within 4-7 calendar days;
- Convertible to cash within 8-15 calendar days;
- Convertible to cash within 16-30 calendar days; and
- Convertible to cash in more than 30 calendar days.

For portfolio assets with multiple liquidity classifications, proposed Item C.13 would require funds to indicate the dollar amount attributable to each classification. For example, a fund could determine that it could convert half of a portfolio position to cash in 2-3 business days and the other half of the position in 4-7 calendar days in order to dispose of the position without creating a market impact and receive cash for the trade. In this case, half of the position would be reported in the 2-3 day category and the other half in the 4-7 day category.

We anticipate that the enhanced reporting proposed in these amendments would help our staff better monitor liquidity trends and various funds' liquidity risk profiles. We also believe that making this information available to the public quarterly, as with other information on proposed N-PORT, is appropriate. We received several comments to the Investment Company Reporting Modernization Release that addressed our proposal to require funds to identify on proposed Form N-PORT whether an investment is an illiquid asset. Specifically, several commenters noted concern that public dissemination of a fund's liquidity determinations could lead to misinterpretation and confusion among investors, particularly because of the subjective nature of such determinations.[563]

While we appreciate commenters' concerns and request further comment, we believe that the liquidity-related data reported on Form N-PORT that is made publicly available would inform investors and assist users in assessing funds' relative liquidity and the overall liquidity of the fund industry and of particular investment strategies and would not be confusing to investors.[564] For example, third-party data analyzers could use the reported information to produce useful metrics for investors about the relative liquidity of different funds with similar strategies. We also anticipate that this publicly available data would provide a resource for fund managers to compare the liquidity classifications assigned to various portfolio assets, which in turn could result in making the liquidity classifications assigned to certain positions more consistent across the fund industry, to the extent appropriate, and could provide greater market transparency as to the liquidity characteristics of certain assets.

563 *See, e.g.*, Comment Letter of Charles Schwab Investment Management on Investment Company Reporting Modernization Release (Aug. 11, 2015); Comment Letter of Invesco Advisers, Inc. on Investment Company Reporting Modernization Release (Aug. 11, 2015); Comment Letter of the Investment Company Institute on Investment Company Reporting Modernization Release (Aug. 11, 2015); Comment Letter of Pioneer Investments on Investment Company Reporting Modernization Release (Aug. 11, 2015).

564 *See supra* note 561 regarding public disclosure of information submitted on Form N-PORT.

We note that the liquidity classification of an asset may vary across funds depending on the facts and circumstances relating to the funds and their trading practices.[565] For example, one fund may hold a particular asset as a hedge against a risk in another portfolio asset. In this case, that asset's liquidity profile may be tied to the liquidity of the corresponding hedged asset. Another fund not using that asset as a hedge could report a quite different liquidity classification. Liquidity classifications also may vary based on the size of fund positions in a particular portfolio asset. We also recognize that liquidity classifications inherently involve some level of judgment by the fund and estimation as market conditions can change, and thus a fund may predict liquidity based on current information that it will take a certain time period to convert a particular asset to cash only to find that it takes longer to do so when the fund actually sells the asset. Nevertheless, for the reasons discussed above, we believe that the proposed reporting of liquidity classification information will provide very valuable information to us and market participants about current fund expectations regarding portfolio liquidity.

b. 15% Standard Assets

As currently proposed, Form N-PORT would require that each fund disclose whether each particular portfolio security is an "illiquid asset."[566] The proposed form defines illiquid assets in terms of current Commission guidelines (*i.e.*, assets that cannot be sold or disposed of by the fund within seven calendar days, at approximately the value ascribed to them by the

565 *See, e.g.*, Comment Letter of the Investment Company Institute on Investment Company Reporting Modernization Release (Aug. 11, 2015) ("These [liquidity] judgments may differ among personnel and certainly among fund complexes."); Comment Letter of Invesco Advisers, Inc. on Investment Company Reporting Modernization Release (Aug. 11, 2015) ("Invesco and other fund complexes could reasonably differ in their assessments of the liquidity of a particular security, even though both complexes have a sound method for determining liquidity and follow their own reasonable procedures.").

566 *See* Item C.7 of proposed Form N-PORT.

fund).[567] In connection with proposed rule 22e-4's requirement regarding 15% standard assets,[568] we propose to amend the General Instructions to proposed Form N-PORT to remove the term "Illiquid Asset" from the definitions section and replace it with the term "15% Standard Asset," as such term is defined in proposed rule 22e-4.[569]

This change would have the effect of requiring funds to report, for each portfolio asset, whether the asset is a 15% standard asset. This information would allow our staff and other interested parties to track the extent that funds are holding 15% standard assets and to discern the nature of those holdings. This information also would help these groups in tracking the fund's exposure to liquidity risk.

c. Three-Day Liquid Asset Minimum

We propose to add an Item B.7 to Part B of proposed Form N-PORT to require each fund to disclose its "three-day liquid asset minimum," as such term is defined in proposed rule 22e-4.[570] Requiring reporting of this information on Form N-PORT would allow our staff and other interested parties to easily assess the three-day liquid asset minimum across funds because of the interactive nature of how the information would be reported on proposed Form N-PORT.

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567 *See* General Instruction E of proposed Form N-PORT.

568 *See* proposed rule 22e-4(a)(4); *see also supra* section III.C.4.a.

569 *See* Item C.7 of proposed Form N-PORT; revised General Instructions to proposed Form N-PORT.

The Investment Company Reporting Modernization Release also proposed amendments to Article 12 of Regulation S-X in which funds would be required to identify illiquid securities. *See, e.g.*, proposed rule 12-12, n. 10 of Regulation S-X (requiring funds to indicate "by an appropriate symbol each issue of illiquid securities"). We propose to define "illiquid securities" in Regulation S-X (as well as "illiquid investment," which term also appears in Regulation S-X) by reference to the term "15% standard assets," as defined in proposed rule 22e-4(a)(4). *See* proposed 210.6-02(e), (f).

570 *See* proposed rule 22e-4(a)(9); *see also supra* section III.C.3. We also propose adding the term "Three-Day Liquid Asset Minimum" to General Instruction E of proposed Form N-PORT, referencing the definition of such term in proposed rule 22e-4.

This should facilitate comparisons between funds as well as the observation of trends over time in this indicator of fund liquidity.

d. Request for Comment

We seek comment on each of the Commission's proposed amendments to proposed Form N-PORT.

- Is there different or other information associated with liquidity that we should require funds to report on proposed Form N-PORT? If so, please describe the information.
- Would the proposed liquidity classification disclosure assist investors, fund boards, and other users in analyzing liquidity among portfolio assets within the fund and across the fund industry? What challenges, if any, may arise in reporting the liquidity classification information, and how could we address those challenges? What concerns are raised with public disclosure of liquidity classification information and how could we address those concerns?
- Should we require that the liquidity classification information on proposed Form N-PORT only be reported to the Commission and not be publicly disclosed? If so, how would we achieve our goal of allowing investors to become better informed, through information provided by third-party information providers or otherwise, about the liquidity of the funds in which they invest? Would public disclosure of liquidity classification information facilitate predatory trading practices or exacerbate first mover incentives? If so, how?
- Proposed Form N-PORT has a section in which a fund can provide explanatory notes with any information that it believes would be helpful in understanding the information

reported on Form N-PORT.[571] Would this allow funds to explain any methodologies, assumptions, or estimations used in determining liquidity classifications?

3. *Proposed Amendments to Proposed Form N-CEN*

As proposed, all registered investment companies, including money market funds but excluding face amount certificate companies, would be required to file Form N-CEN annually.[572] Form N-CEN would require these registered investment companies to provide census-type information that would assist our efforts to modernize the reporting and disclosure of information by registered investment companies and enhance the staff's ability to carry out its regulatory functions, including risk monitoring and analysis of the industry.[573]

a. Lines of Credit, Interfund Lending, Interfund Borrowing and Swing Pricing

We are proposing to amend proposed Form N-CEN to allow the Commission and other users to track certain liquidity risk management practices that we expect funds to use on a less frequent basis than the day-to-day portfolio construction techniques captured by proposed Form N-PORT. More specifically, we propose amending Part C of proposed Form N-CEN to add an item that would include certain questions regarding the use of lines of credit, interfund lending, interfund borrowing, and swing pricing.

The proposed amendments would add a new Item 44 to Part C of proposed Form N-CEN requiring a fund to disclose if it has available a committed line of credit, and, if so, the size of the line of credit in U.S. dollars, the name of the institution(s) with which the fund has the line of

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571 *See* Part E of proposed Form N-PORT.

572 *See* Investment Company Reporting Modernization Release, *supra* note 104.

573 *Id.*

credit, and whether the line of credit is for that fund alone or is shared among multiple funds.[574] If the line of credit is shared among multiple funds, the fund would be required to disclose the names and SEC File numbers of the other funds (including any series) that may use the line of credit.[575] If the fund responds affirmatively to having available a committed line of credit, the fund would be required to disclose whether it drew on the line of credit during the reporting period.[576] If the fund drew on that line of credit during the reporting period, Item 44 would require the fund to disclose the average dollar amount outstanding when the line of credit was in use and the number of days that line of credit was in use.[577] This information would allow our staff and other potential users to assess how often and to what extent funds rely on certain external sources of liquidity, rather than relying on the liquidity of fund portfolio assets alone, for liquidity risk management. It also would allow monitoring of whether such lines of credit are concentrated in particular financial institutions.

Proposed Item 44 also would require a fund to report whether it engaged in interfund lending or interfund borrowing during the reporting period, and, if so, the average amount of the interfund loan when the loan was outstanding and the number of days that the interfund loan was outstanding.[578] This information would provide some transparency regarding the extent to which funds use interfund lending or interfund borrowing. We understand that one reason that funds

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574 *See* proposed Item 44(a)(i)-(iii) of Part C of proposed Form N-CEN.

575 *See* proposed Item 44(a)(iii)(1) of Part C of proposed Form N-CEN. Under proposed Form N-CEN, "SEC File number" means the number assigned to an entity by the Commission when that entity registered with the Commission in the capacity in which it is named in Form N-CEN. *See* General Instruction F to proposed Form N-CEN.

576 *See* proposed Item 44(a)(iv) of Part C of proposed Form N-CEN.

577 *See* proposed Item 44(a)(v) and (vi) of Part C of proposed Form N-CEN.

578 *See* proposed Item 44(b) and (c) of Part C of proposed Form N-CEN.

have sought exemptive relief to engage in interfund lending and borrowing is to meet redemption obligations if necessary.

Finally, Item 44 would require a fund other than a money market fund to disclose whether it engaged in swing pricing during the reporting period. This disclosure would inform our staff and potential users about whether funds use swing pricing as a tool to mitigate dilution of the value of outstanding redeemable securities through shareholder purchase and redemption activity.[579]

b. Additional Information Concerning ETFs

Proposed Form N-CEN includes a section related specifically to ETFs.[580] Some of the proposed reporting requirements on Form N-CEN relate to an authorized participant's interaction with the ETF (or its service provider), as these entities play a significant role in the marketplace.[581] We believe collection of such information would allow us to better assess the size, capacity, and concentration of the authorized participant framework and may allow the Commission staff to monitor how ETF purchase and redemption activity is distributed across authorized participants and, for example, the extent to which a particular ETF—or ETFs as a group—may be reliant on one or more particular authorized participants.[582]

579 As part of the proposed revisions to proposed Form N-CEN, we propose renumbering previously proposed Items 44 through 79 to 45 through 80.

580 *See* Part E of proposed Form N-CEN. We note that the reporting requirements of proposed Form N-CEN that are tailored for ETFs also apply to UITs organized as ETFs, as well as exchange-traded managed funds. *See* General Instruction A to proposed Form N-CEN. The additional proposed reporting requirement discussed below would apply to the same group of entities.

581 Specifically, proposed Form N-CEN would require an ETF to provide identifying information about each of its authorized participants, as well as the dollar value of the ETF's shares that each authorized participant purchased or redeemed from the ETF during the reporting period. *See* proposed Item 60(g) of proposed Form N-CEN.

582 *See* Investment Company Reporting Modernization Release, *supra* note 104, at section II.E.4.

Specifically, we are proposing to add Item 60(g)[583] to Form N-CEN, which would require an ETF to report whether it required that an authorized participant post collateral to the ETF or any of its designated service providers in connection with the purchase or redemption of ETF shares during the reporting period.[584] We understand that some ETFs (or their custodians), particularly ETFs that invest in non-U.S. securities, require authorized participants transacting primarily on an in-kind basis to post collateral when purchasing or redeeming shares, most often for the duration of the settlement process. This can protect the ETF in the event, for example, that the authorized participant fails to deliver the basket securities.[585] The requirement to post collateral for creating or redeeming ETF shares impacts the authorized participant's operating capital, which could, in turn, affect the ability and willingness of authorized participants to serve such ETFs or serve other market makers on an agency basis. Accordingly, we believe that information about required posting of collateral by authorized participants when purchasing or redeeming shares—alongside the information we previously proposed to require in Form N-CEN—would be helpful in understanding whether, and to what extent, there may be concentration in the authorized participant framework for such ETFs.

c. Request for Comment

We seek comment on each of the Commission's proposed amendments to proposed Form N-CEN.

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583 In the Reporting Modernization Release, information requirements related to authorized participants for ETFs were in Item 59 of Proposed Form N-CEN; however, because this release proposes to add additional items to proposed Form N-CEN, Item 59 of proposed Form N-CEN would be renumbered to Item 60. *See infra* Text of Rules and Forms.

584 Proposed Item 60(g) of proposed Form N-CEN.

585 *See, e.g.*, Investment Company Institute, *The Role and Activities of Authorized Participants of Exchange-Traded Funds*, (Mar. 2015), *available at* https://www.ici.org/pdf/ppr_15_aps_etfs.pdf. In addition to ETFs that invest in non-U.S. securities, Commission staff understands that there are other ETFs that have collateral requirements for purchases and redemptions, such as ETFs that invest in debt securities.

- Would the proposed reporting on the availability and use of lines of credit, interfund lending, interfund borrowing and the use of swing pricing assist investors, Commission staff, and market participants in assessing liquidity and liquidity risks within a fund and across the fund industry? Would this information be readily available to funds? If not, please explain why.
- Do the proposed questions collect all sources of liquidity outside the liquidity of fund portfolio assets? If not, what are these other sources?
- Is the annual reporting time period under Form N-CEN appropriate for this requested information? Should it be collected more frequently? If so, should we require funds to disclose any or all of the requested information on Form N-PORT instead of Form N-CEN?
- Is there different or other information associated with liquidity that we should require funds to report on proposed Form N-CEN? If so, please describe the information.
- Should funds be required to report information on uncommitted lines of credit? Please explain why or why not.
- What types of ETFs tend to require posting of collateral for purchases or redemptions and why? Please provide data on the size of such collateral deposits, and how this deposit requirement can affect an authorized participant's operating capital? How common is it for an authorized participant or market maker to contract with another authorized participant to post such collateral on its behalf? Are there situations where one authorized participant contracts with another authorized participant to purchase or redeem ETF shares on an agency basis rather than purchase or redeem the shares directly with the

ETF because of the ETF's requirement that the purchase or redemption be collateralized for the duration of the settlement period?

H. Compliance Dates

1. Liquidity Risk Management Program

Proposed rule 22e-4 would require that each registered open-end management investment company, including open-end ETFs but not including money market funds, adopt and implement a written liquidity risk management program, approved by a fund's board of directors, that meets certain minimum requirements outlined in the rule. Given the nature of the liquidity risk management program, including the classification and ongoing review of the liquidity of each of a fund's positions in an asset (or portion thereof) required under proposed rule 22e-4(b)(2)(i) and the three-day liquid asset minimum determination required under proposed rule 22e-4(b)(2)(iv)(A), we expect to provide for a tiered set of compliance dates based on asset size for proposed rule 22e-4.

Specifically, for larger entities – namely, funds that together with other investment companies in the same "group of related investment companies"[586] have net assets of $1 billion or more as of the end of the most recent fiscal year – we are proposing a compliance date of 18 months after the effective date to comply with proposed rule 22e-4. For these larger entities, we expect that 18 months would provide an adequate period of time for funds to prepare internal

586 For these purposes, we expect that the threshold would be based on the definition of "group of related investment companies," as such term is defined in rule 0-10 under the Investment Company Act. Rule 0-10 defines the term in part as "two or more management companies (including series thereof) that: (i) Hold themselves out to investors as related companies for purposes of investment and investor services; and (ii) Either: (A) Have a common investment adviser or have investment advisers that are affiliated persons of each other; or (B) Have a common administrator…." We believe that this broad definition would encompass most types of fund complexes and therefore is an appropriate definition for compliance date purposes.

processes, policies and procedures and implement liquidity risk management programs that meet the requirements of the rule.

For smaller entities (*i.e.*, funds that together with other investment companies in the same "group of related investment companies" have net assets of less than $1 billion as of the end of the most recent fiscal year),[587] we are proposing to provide for an extra 12 months (or 30 months after the effective date) to comply with proposed rule 22e-4.[588] We believe that smaller entities would benefit from this extra time to establish and implement the requirements outlined in the rule.

On or before the applicable compliance date(s), a fund must have adopted and implemented compliance policies and procedures that satisfy the requirements of the new rule. These policies and procedures must have been approved by the board on or before the applicable compliance date(s).

2. *Swing Pricing*

Proposed rule 22c-1(a)(3), if adopted, would permit (but not require) a fund (with the exception of a money market fund or ETF) to adopt swing pricing policies and procedures. Related proposed amendments to rule 31a-2 (regarding the preservation of books and records evidencing and supporting adjustments to NAV based on swing pricing policies and procedures), Item 13 of Form N-1A and Regulation S-X (regarding financial reporting), and Item 11(c) of Form N-1A (regarding a fund's use of swing pricing) would apply only to funds that elect to use

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587 Based on staff analysis of data obtained from Morningstar Direct, as of June 30, 2015, we estimate that a $1 billion threshold would provide an extended compliance period to approximately 66% of the fund groups, but only 0.6% of all fund assets. We therefore believe that the $1 billion threshold would appropriately balance the need to provide smaller groups of investment companies with more time to prepare internal processes, policies and procedures and implement liquidity risk management programs that meet the requirements of proposed rule 22e-4, while still including the vast majority of fund assets in the initial compliance period.

588 *See* proposed rule 22e-4(b)(2)(i), (ii) and (iv)(A)-(C).

swing pricing. As reliance on rule 22c-1(a)(3) would be optional, we believe a compliance period would not be necessary. Therefore, we expect that a fund would be able to rely on the rule after the effective date as soon as the fund could comply with proposed rule 22c-1(a)(3) and related records, financial reporting and prospectus disclosure requirements.

3. *Amendments to Form N-1A*

Except with respect to the proposed amendments to Form N-1A related to swing pricing (discussed above), if the other proposed amendments to Form N-1A are adopted, we expect to require all initial registration statements on Form N-1A, and all post-effective amendments that are annual updates to effective registration statements on Form N-1A, filed six months or more after the effective date, to comply with the proposed amendments to Form N-1A. We do not expect that funds would require significant amounts of time to prepare additional disclosures in accordance with our proposed amendments regarding redemptions.

4. *Amendments to Form N-PORT*

Similar to the tiered compliance dates for the liquidity classification requirements for fund liquidity risk management programs under proposed rule 22e-4 (discussed above), we expect to provide for a tiered set of compliance dates based on asset size for the proposed amendments to proposed Form N-PORT. Specifically, for larger entities we are proposing a compliance date of 18 months after the effective date to comply with the new reporting requirements. For these larger entities, we expect that 18 months would provide an adequate period of time for funds, intermediaries, and other service providers to conduct the requisite operational changes to their systems and to establish internal processes to prepare, validate, and file reports containing the additional information requested by the proposed amendments to Form N-PORT. For smaller entities, we are proposing to provide for an extra 12 months (or 30 months after the effective date) to comply with the new reporting requirements. We believe that smaller groups would benefit from this extra time to comply with the filing requirements for Form N-PORT and would potentially benefit from the lessons learned by larger investment companies and groups of investment companies during the adoption period for Form N-PORT.

5. *Amendments to Form N-CEN*

If Form N-CEN and the amendments we propose to the form are adopted, we are proposing a compliance date of 18 months after the effective date to comply with the new reporting requirements.[589] We expect that 18 months would provide an adequate period of time for funds, intermediaries, and other service providers to conduct the requisite operational changes to their systems and to establish internal processes to prepare, validate, and file reports containing the additional information requested by the proposed amendments to Form N-CEN.

6. *Request for Comment*

We request comment on the compliance dates discussed above.

- How, if at all, should the proposed compliance dates be modified? What factors should we consider when setting the compliance dates for the proposed rule and amendments to the rules and forms? To the extent that a fund would decide to reallocate certain portions of its portfolio in order to correlate its portfolio holdings with its three-day liquid asset minimum, would the proposed compliance dates provide adequate time to do so in a way that would cause the fund to incur relatively few portfolio reallocation-related costs (*i.e.*,

[589] Unlike Form N-PORT, we do not expect to provide a tiered compliance date based on asset size because we believe that it is less likely that smaller fund complexes would need additional time to comply with the amendments we propose on Form N-CEN. This 18-month compliance period is consistent with the compliance period for proposed Form N-CEN. *See* Investment Company Reporting Modernization Release, *supra* note 104.

by permitting sufficient time to purchase and sell portfolio assets when it is relatively advantageous to do so)?

- We request comment on our proposed 18-month compliance date for proposed rule 22e-4. Is our 18-month compliance period appropriate? If not, what length of time (*e.g.*, 12 months or 24 months) would be appropriate for compliance with the new rule?
- We also request comment on our proposed tiered compliance dates for proposed rule 22e-4 and related reporting requirements under our proposed amendments to proposed Form N-PORT. Is a threshold of $1 billion based on the net assets of funds together with other investment companies in the same "group of related investment companies" as of the end of the most recent fiscal year appropriate? Should the threshold be higher or lower?[590] Should the threshold include aggregation of net assets with other investment companies in the same "group of related investment companies?" Why or why not? Is our 12-month extension of the compliance period for smaller entities appropriate? If not, what length of time (*e.g.*, 6 months or 18 months) would be adequate and why?
- With respect to our proposed amendments to Form N-PORT, is our compliance date of 18 months for larger filers appropriate? If not, what length of time would be appropriate for compliance with the proposed amendments? Would a shorter or longer compliance date be appropriate? Is our 12-month extension of the compliance period for smaller entities appropriate? If not, what length of time would be appropriate for compliance with the additional reporting requirements under the proposed amendments?

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590 Based on staff analysis of data obtained from Morningstar Direct, as of June 30, 2015, we estimate that a threshold of $100 million would include approximately 38% of fund firms and 0.1% of all fund assets. A threshold of $3 billion would include approximately 77% of fund firms and 1.6% of fund assets.

- Is our 18-month compliance period for our proposed amendments to Form N-CEN appropriate? If not, what length of time would be appropriate? Would a shorter or longer compliance date be appropriate?
- We are proposing to not have a compliance period for proposed amendments to rule 22c-1 regarding swing pricing policies procedures and related amendments to rule 31a-2, Form N-1A and Regulation S-X. Is this appropriate?
- Is our six-month compliance period for our proposed amendments to Form N-1A disclosure requirements regarding the redemption of fund shares adequate? If not, what length of time would be adequate and why?

IV. ECONOMIC ANALYSIS

A. Introduction and Primary Goals of Proposed Regulation

The Commission is sensitive to the economic effects that could result from the proposed liquidity risk management program requirement, the ability for funds to use swing pricing under proposed rule 22c-1(a)(3), and the proposed new disclosure and reporting requirements regarding liquidity risk and liquidity risk management (such proposed rule and proposed amendments to certain rules and forms, the "proposed liquidity regulations"). These economic effects include the benefits and costs of the proposed liquidity regulations, as well as the effects on efficiency, competition, and capital formation. The economic effects of the proposed liquidity regulations are discussed below in the context of the primary goals of the proposed regulation.

In summary, and as discussed in greater detail in section III above, the proposed liquidity regulations include the following:

- Proposed new rule 22e-4 would require that each fund establish a written liquidity risk management program. A fund's liquidity risk management program would be required to include the following elements: (i) classification and ongoing review of the classification of the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset), taking into account certain specified factors; (ii) assessment and periodic review of its liquidity risk; and (iii) management of the fund's liquidity risk, including limitations on the fund's acquisition of less liquid assets or 15% standard assets in certain circumstances.

- Under proposed rule 22c-1(a)(3), a fund (except a money market fund or ETF) would be permitted (but not required) to establish and implement swing pricing policies and procedures that would, under certain circumstances, require the fund to use swing pricing to adjust its current NAV to lessen potential dilution of the value of outstanding redeemable securities caused by shareholder purchase and redemption activity. A fund that engages in swing pricing would be subject to certain disclosure and reporting requirements.
- Proposed amendments to Form N-1A, Regulation S-X, proposed Form N-PORT, and proposed Form N-CEN would require enhanced fund disclosure and reporting regarding position liquidity, shareholder redemption practices, and swing pricing.

The proposed liquidity regulations are designed to promote effective liquidity risk management throughout the open-end fund industry and thereby reduce the risk that funds will be unable to meet redemption obligations and mitigate dilution of the interests of fund shareholders in accordance with, among other provisions, section 22(e) and rule 22c-1 under the Investment Company Act. The proposed liquidity regulations also seek to enhance disclosure regarding fund liquidity and redemption practices. In addition, these proposed reforms are intended to address the liquidity-related developments in the open-end fund industry discussed above and are a part of a broader set of initiatives to address the impact of open-end fund investment activities on financial markets and the risks associated with the increasingly complex portfolio composition and operations of the asset management industry. We provide an overview of these rulemaking goals in the following paragraphs, and the goals are discussed in more detail below as we describe the prospective benefits and costs of each aspect of the proposal.[591]

A primary goal of the proposed liquidity regulations is to promote investor protection by reducing the risk that funds will be unable to meet their redemption obligations, elevating the overall quality of liquidity risk management across the fund industry, increasing transparency of funds' liquidity risks and risk management practices, and mitigating potential dilution of existing shareholders' interests. Funds are not currently subject to requirements under the federal securities laws or Commission rules that specifically require them to maintain a minimum level of portfolio liquidity (with the exception of money market funds), and follow Commission guidelines (not rules) that generally limit their investment in illiquid assets.[592] Additionally, funds today are only subject to limited disclosure requirements concerning a fund's liquidity risk and risk management.[593] Staff outreach has shown that funds today engage in a variety of different practices—ranging from comprehensive and rigorous to minimal and basic—for classifying the liquidity of their portfolio assets, assessing and managing liquidity risk, and disclosing information about their liquidity risk, redemption practices, and liquidity risk management practices to investors.[594] We believe that the proposed enhanced requirements for

591 *See infra* sections IV.C.1, IV.C.2, and IV.C.3.

592 *See supra* section II.D; *infra* section IV.B.1.a.

593 *See supra* section II.D; *infra* section IV.B.1.c.

594 *See supra* section II.D; *infra* sections IV.B.1.a, IV.B.1.c.

funds' assessment, management, and disclosure of liquidity risk could decrease the chance that funds would be unable to meet their redemption obligations and mitigate potential dilution of non-redeeming shareholders' interests.

The proposed liquidity regulations are also intended to lessen the possibility of early redemption incentives (and investor dilution) created by insufficient liquidity risk management, as well as the possibility that investors' share value will be diluted by costs incurred by the fund as a result of other investors' purchase or redemption activity. When a fund experiences significant redemption requests, it may sell portfolio securities or borrow funds in order to obtain sufficient cash to meet redemptions.[595] However, sales of a fund's portfolio assets conducted in order to meet shareholder redemptions could result in significant adverse consequences to non-redeeming shareholders when a fund fails to adequately manage liquidity. For example, if a fund sells portfolio assets under unfavorable circumstances, this could create negative price pressure on those assets and decrease the value of any of those assets still held by the fund.[596] Funds also may borrow from a bank or use interfund lending facilities to meet redemption requests, but there are costs associated with such borrowings. Both selling of portfolio assets and borrowing to meet redemption requests could cause funds to incur costs that would be borne at least partially by non-redeeming shareholders.[597] These factors could result in dilution in the value of non-redeeming shareholders' interests in a fund,[598] and also could create incentives for early redemptions in times of liquidity stress, which could result in further dilution of

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595 *See supra* section II.B.2; *infra* sections IV.C.1, IV.C.2.

596 *See supra* notes 46-48 and accompanying text.

597 *See supra* notes 49-53 and accompanying text.

598 *See supra* notes 46-48 and accompanying text; *infra* sections IV.C.1, IV.C.2.

non-redeeming shareholders' interests.[599] There also is a potential for adverse effects on the markets when open-end funds fail to adequately manage liquidity. For example, the sale of less liquid portfolio assets at discounted or even fire sale prices can produce significant negative price pressure on those assets and correlated assets, which can impact other investors holding these assets and may transmit stress to other funds or portions of the markets.[600] For reasons discussed in detail below, we believe that the liquidity risk management program requirement and the ability for a fund to adopt swing pricing policies and procedures would mitigate the risk of potential shareholder dilution and decrease the incentive for early redemption in times of liquidity stress.

Finally, the proposed liquidity regulations are meant to address recent industry developments that have underscored the significance of funds' liquidity risk management practices. In recent years, there has been significant growth in the assets managed by funds with strategies that focus on holding relatively less liquid assets, such as fixed income funds (including emerging market debt funds), open-end funds with alternative strategies, and emerging market equity funds.[601] There also has been considerable growth in assets managed by funds that exhibit characteristics that could give rise to increased liquidity risk, such as relatively high investor flow volatility.[602] Additionally, as discussed in detail above, standard fund redemption and securities settlement periods have tended to become significantly shorter over the last several decades, which has caused funds to satisfy redemption requests within relatively

599 *See supra* notes 49-53 and accompanying text; *infra* sections IV.C.1, IV.C.2.

600 *See supra* note 54 and accompanying text.

601 *See supra* section II.C.1; *infra* section IV.B.3; *see also* DERA Study, *supra* note 39, at pp. 6-9.

602 *See infra* section IV.B.3.

short time periods (*e.g.*, within T+3, T+2, and next-day periods).[603] But while fund redemption periods have become shorter, certain funds have increased their holdings of portfolio securities with relatively long settlement periods, which could result in a liquidity mismatch between when a fund plans or is required to pay redeeming shareholders, and when any asset sales that the fund has executed in order to pay redemptions will settle.[604] Collectively, these industry trends have emphasized the importance of effective liquidity risk management among funds and enhanced disclosure regarding liquidity risk and risk management.

B. Economic Baseline

The proposed liquidity regulations would affect all funds and their investors, investment advisers and other service providers, all issuers of the portfolio securities in which funds invest, and other market participants potentially affected by fund and investor behavior. The effects of the proposed liquidity regulations on all of these parties are analyzed in detail below in the discussion of the costs and benefits of the proposed regulations. The economic baseline of the proposed liquidity regulations includes funds' current practices regarding liquidity risk management, swing pricing, and liquidity risk disclosure, as well as the economic attributes of funds that affect their portfolio liquidity and liquidity risk. These economic attributes include industry-wide trends regarding funds' liquidity and liquidity risk management, as well as industry developments highlighting the importance of robust liquidity risk management by funds.

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603 *See supra* notes 73-77 and accompanying text.

604 *See supra* notes 78-79 and accompanying text.

1. *Funds' Current Practices Regarding Liquidity Risk Management, Swing Pricing, and Liquidity Risk Disclosure*

a. Funds' Current Liquidity Risk Management Requirements and Practices

Under section 22(e) of the Investment Company Act, an open-end fund is required to make payment to shareholders for securities tendered for redemption within seven days of their tender.[605] In addition to the seven-day redemption requirement in section 22(e), open-end funds that are sold through broker-dealers are required as a practical matter to meet redemption requests within three business days because broker-dealers are subject to rule 15c6-1 under the Exchange Act, which establishes a three-day (T+3) settlement period for security trades effected by a broker or a dealer. Furthermore, rule 22c-1 under the Act, the "forward pricing" rule, requires funds, their principal underwriters, and dealers to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to purchase or redeem fund shares, even though cash proceeds from purchases may be invested or fund assets may be sold in subsequent days in order to satisfy purchase requests or meet redemption obligations.

With the exception of money market funds subject to rule 2a-7 under the Act, the Commission has not promulgated rules requiring open-end funds to invest in a minimum level of liquid assets.[606] The Commission historically has taken the position that open-end funds should maintain a high degree of portfolio liquidity to ensure that their portfolio securities and other assets can be sold and the proceeds used to satisfy redemptions in a timely manner in order to comply with section 22(e).[607] The Commission also has stated that open-end funds have a

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605 *See* section 22(e) of the Investment Company Act. Section 22(e) of the Act provides, in part, that no open-end fund shall suspend the right of redemption or postpone the date of payment upon redemption of any redeemable security in accordance with its terms for more than seven days after tender of the security absent specified unusual circumstances.

606 *See supra* note 85 and accompanying text.

607 *See* Restricted Securities Release, *supra* note 86.

"general responsibility to maintain a level of portfolio liquidity that is appropriate under the circumstances," and to engage in ongoing portfolio liquidity monitoring to determine whether an adequate level of portfolio liquidity is being maintained in light of the fund's redemption obligations.[608] Open-end funds also are required by rule 38a-1 under the Act to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the federal securities laws, and such policies and procedures should be appropriately tailored to reflect each fund's particular compliance risks.[609] An open-end fund holding a significant portion of its assets in securities with long settlement periods or with infrequent trading, for instance, may be subject to relatively greater liquidity risks than other open-end funds, and should have relatively more robust policies and procedures to comply with its redemption obligations.

Additionally, long-standing Commission guidelines generally limit an open-end fund's aggregate holdings of "illiquid assets" to 15% of the fund's net assets (the "15% guideline").[610] Under the 15% guideline, a portfolio security or other asset is considered illiquid if it cannot be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the fund has valued the investment.[611] The 15% guideline has generally limited funds' exposure to particular types of securities that cannot be sold within seven days and that the Commission and staff have indicated may be illiquid, depending on the facts and circumstances.

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608 *See supra* note 87 and accompanying text.

609 *See* Rule 38a-1 Adopting Release, *supra* note 90.

610 *See supra* note 92 and accompanying text.

611 *See supra* note 93 and accompanying text.

Staff outreach has shown that funds currently employ a diversity of practices with respect to classifying portfolio assets' liquidity, as well as managing liquidity risk. Section II.D.3 above provides an overview of these practices, which include, among others: assessing the ability to sell particular assets within various time periods, taking into account relevant market, trading, and other factors; monitoring initial liquidity determinations for portfolio assets (and modifying these determinations, as appropriate); holding certain amounts of the fund's portfolio in highly liquid assets or cash equivalents; establishing committed back-up lines of credit or interfund lending facilities; and conducting stress testing relating to the extent the fund has liquid assets to cover possible levels of redemptions.[612] We have observed that some of the funds with relatively more thorough liquidity risk management practices have appeared to be able to meet periods of high redemptions without significantly altering the risk profile of the fund or materially affecting the fund's performance, and thus with few dilutive impacts. It therefore appears that these funds have generally aligned their portfolio liquidity with their liquidity needs, and that their liquidity risk management permits them to efficiently meet redemption requests. Other funds, however, employ liquidity classification and liquidity risk management practices that are substantially less rigorous. As discussed above in section II.D.3, some funds do not take different market conditions into account when evaluating portfolio asset liquidity, and do not conduct ongoing liquidity monitoring. Likewise, some funds do not have independent oversight of their liquidity risk management outside of the portfolio management process. As a result, funds' procedures

[612] *See also e.g.*, Nuveen FSOC Notice Comment Letter, *supra* note 45 (discussing stress tests of a fund's ability to meet redemptions over certain periods); BlackRock FSOC Notice Comment Letter, *supra* note 50 (discussing several overarching principles that provide the foundation for a prudent market liquidity risk management framework for collective investment vehicles, including an independent risk management function, compliance checks to ensure portfolio holdings do not exceed regulatory limits, a risk management function that is independent from portfolio management, and measuring levels of liquid assets into "tiers of liquidity"); Invesco FSOC Notice Comment letter, *supra* note 35, at 11 (discussing liquidity analysis).

for classifying the liquidity of their portfolio securities, as well as the comprehensiveness and independence of their liquidity risk management, vary significantly.

b. Funds' Current Swing Pricing Practices

Commission rules and guidance do not currently address the ability of an open-end fund to use swing pricing to mitigate potential dilution of fund shareholders, and U.S. registered funds do not currently use swing pricing. However, as discussed above, certain foreign funds currently do use swing pricing.[613] We understand that some fund complexes that include U.S. registered funds also include foreign-domiciled funds that currently use swing pricing.

c. Funds' Current Liquidity Risk Disclosure Requirements and Practices

Items 4 and 9 of Form N-1A require a fund to disclose the principal risks of investing in the fund.[614] A fund currently must disclose the risks to which the fund's portfolio as a whole is expected to be subject and the circumstances reasonably likely to adversely affect the fund's NAV, yield, or total return.[615] Some funds currently disclose that liquidity risk is a principal risk of investing in the fund.

Item 11 of Form N-1A requires a fund to describe its procedure for redeeming fund shares, including restrictions on redemptions, any redemption charges, and whether the fund has reserved the right to redeem in kind.[616] Disclosure regarding other redemption information, such as the timing of payment of redemption proceeds to fund shareholders, varies across funds as there are currently no specific requirements for this disclosure. Some funds disclose that they will redeem shares within a specific number of days after receiving a redemption request, other

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613 *See supra* notes 417-420 and accompanying text.

614 Item 4(b)(1)(i) and Item 9(c) of Form N-1A.

615 *Id.*

616 Item 11(c) of Form N-1A.

funds disclose that they will honor such requests within seven days (as required by section 22(e) of the Act), and others provide no specific time periods. Additionally, some funds disclose differences in the timing of payment of redemption proceeds based on the distribution channel through which the fund shares are redeemed, while others do not.

Funds are not currently required to disclose information about the liquidity of their portfolio assets. However, Form N-PORT, as proposed earlier this year, would require that each fund disclose whether each particular portfolio security is an "illiquid asset" and defines illiquid assets in terms of current Commission guidelines (*i.e.*, assets that cannot be sold or disposed of by the fund within seven calendar days, at approximately the value ascribed to them by the fund).[617] Also, some funds voluntarily disclose in their registration statements any specific limitations applicable to the fund's investment in 15% guideline assets, as well as types of assets considered by the fund to be subject to the 15% guideline.

Form N-1A does not currently require funds to disclose information about liquidity risk management practices such as the establishment (or use) of committed back-up lines of credit. A fund is, however, required to disclose information regarding the amount and terms of unused lines of credit for short-term financing, as well as information regarding related party transactions in its financial statements or notes thereto.[618]

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617 *See* General Instruction E of proposed Form N-PORT.

618 *See* Regulation S-X 210.5-02.19 (b); 210.4-08(k).

2. *Economic Trends Regarding Funds' Liquidity and Liquidity Risk Management*

a. Overview

While the liquidity of a fund's portfolio assets, and the fund's overall liquidity risk, depend on a variety of factors and are unique to the particular circumstances facing the fund,[619] analysis by staff economists has revealed trends that are useful for providing an overview of the liquidity of funds exhibiting certain characteristics.[620] These trends are useful in estimating the relative level of liquidity of certain types of funds, and have thus helped to shape the scope and substance of the proposed liquidity regulations and to estimate the benefits and costs of the proposed liquidity regulations, as discussed below. Staff economists have also analyzed how fund portfolios change in response to decreases in market liquidity and large net outflows. These trends may be useful in examining how redemption requests could give rise to investor protection and potential market impact concerns.

b. Trends in the Relationship Between Liquidity of Portfolio Assets, Market Capitalization of Portfolio Assets, and Fund Assets

Staff economists have examined how the liquidity of U.S. equity funds' portfolios is influenced by both the market capitalization of a fund's portfolio assets, as well as the size of the fund in terms of assets. As described in more detail below, among U.S. equity funds, the average liquidity of a fund's equity positions is correlated with the market capitalization of a fund's portfolio assets, as well as the level of the fund's assets.[621] The staff's analysis with respect to

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619 *See supra* section III.B.2 (discussing factors relevant to an assessment of the liquidity of a fund's portfolio assets); *supra* section III.C.1 (discussing factors relevant to an assessment of a fund's liquidity risk).

620 The analysis discussed in this section reflects an evaluation of data on U.S. funds (primarily, U.S. equity funds and U.S. municipal bond funds) from the years 1999-2014, conducted by economists in the Commission's Division of Economic and Risk Analysis. DERA Study, *supra* note 39.

621 For these purposes, "average liquidity of a fund's equity positions" is defined as the asset-weighted average liquidity of the individual equity positions held by the fund. Liquidity for individual equity positions is calculated using the Amihud liquidity measure because it is a widely accepted liquidity measure. *See id.*,

these trends is, at this point, limited to an analysis of U.S. equity funds, on account of limitations in the availability of current data with respect to the holdings of funds that are not U.S. equity funds.[622] To the extent that Form N-PORT is adopted, we anticipate that the fund portfolio data filed on this form would significantly assist the staff in conducting similar liquidity-related analyses in the future.[623]

Fund liquidity tends to be highest for large cap U.S. equity funds and lowest for small cap U.S. equity funds.[624] As a U.S. equity fund's assets increase, fund liquidity also tends to increase. Among U.S. equity funds with less than $100 million in assets, the median price impact of ten million dollars in trading volume on the average portfolio asset is about 69 basis points; among U.S. equity funds with greater than $1 billion in assets, the same amount of trading volume has a median price impact of about 46 basis points.[625]

To the extent that a fund invests in portfolio assets that are relatively less liquid, the fund may experience greater liquidity risk than a fund that invests in portfolio assets that are highly liquid. Based in part on our empirical analysis, we have decided not to propose any modification of or exclusion from the proposed liquidity requirements for smaller funds, since smaller funds tend to demonstrate relatively high flow volatility (and thus possibly greater liquidity risk).[626] Also, based in part on staff analysis finding that different types of funds within the same broad investment strategy demonstrate different levels of liquidity (and thus, presumably, different

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section 4.1. *See also* Yakov Amihud, *Illiquidity and Stock Returns: Cross-Section and Time-Series Events*, 5 J. OF FIN. MARKETS (2002) 31 ("Amihud").

622 DERA Study, *supra* note 39, at pp. 31-32.

623 *See infra* section IV.C.3.b.

624 DERA Study, *supra* note 39, at pp. 29-30.

625 *Id.*

626 *See infra* section VI; *infra* note 727 and accompanying text.

levels of liquidity risk), we have decided not to propose to exclude certain investment strategies from the scope of the proposed rule.[627] Our cost estimates associated with the proposed liquidity risk management program requirement reflect staff analysis showing that certain types of funds tend to have relatively more liquid portfolios than others.[628]

We do note, however, that the staff's analysis discussed in the previous two paragraphs may overstate the difference in liquidity risk between funds with differing levels of asset liquidity for two reasons. First, the analysis performed by the staff does not reflect the fact that smaller funds will have smaller positions in the underlying equities, and sales of relatively small positions should result in less price impact than sales of larger positions (although the sale of smaller positions should have greater transaction costs as a percentage of sale proceeds). However, with respect to U.S. equity funds, staff analysis indicates that, on average, smaller funds hold assets that are relatively less liquid, which may at least partially offset that fact.[629] Second, the analysis does not reflect the fact that less liquid funds, regardless of style or size, may have larger cash and cash equivalent holdings or liquid asset buffers that may offset their less liquid holdings. Staff analysis does show that cash and cash equivalent holdings vary, on average, according to the funds' strategy, but cash and cash equivalent holdings also vary significantly among funds within a particular strategy.[630] That result implies that, even within a relatively less liquid strategy, certain funds within the strategy hold relatively little cash and cash equivalents.

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627 *See infra* notes 726-727 and accompanying text.

628 *See infra* section IV. C.1. and accompanying text.

629 DERA Study, *supra* note 39, at pp. 29-30.

630 DERA Study, *supra* note 39, at pp. 10-12. The DERA Study describes how cash and cash equivalents are defined for these purposes.

c. Trends in the Manner in Which Funds' Portfolio Management Responds to Changes in Flow Volatility and Decreases in Market Liquidity

While portfolio managers consider a variety of factors when constructing a fund's portfolio (including the fund's investment strategies, economic and market trends, portfolio asset credit quality, and tax considerations), meeting daily redemption obligations is fundamental for open-end funds, and funds need to manage liquidity in order to meet obligations. We understand, based on statements from members of the fund industry and staff outreach, that funds generally consider the portfolio management process to be of central importance in managing funds' liquidity risk.[631] Commission staff has analyzed whether the liquidity of funds' portfolio holdings, as well as funds' holdings of cash and cash equivalents, is correlated with certain events that could affect a fund's liquidity risk—that is, increased flow volatility, and decreased market liquidity. As described in more detail below, staff analysis shows empirical results indicating that funds' portfolio holdings tend to be less liquid, and their holdings of cash and cash equivalents tend to be lower, when funds encounter periods of decreased flow volatility. These results indicate that certain funds' portfolio construction takes liquidity risk management into account and, as discussed below, the details comprising these results have both reinforced our understanding of the benefits of the proposed regulations and have shaped certain of the provisions of the proposed regulations.

The results of the staff's analysis demonstrate that, with respect to U.S. equity funds, the liquidity of funds' holdings of equity securities is higher when flow volatility is higher.[632] As discussed above, staff's analysis with respect to trends that reflect the liquidity of funds'

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631 *See, e.g.*, ICI FSOC Notice Comment Letter, *supra* note 16, at 14 ("For mutual funds, the central importance of meeting redemptions means that liquidity management is a key element of regulatory compliance, investment risk management, and portfolio management—and a constant area of focus.").

632 DERA Study, *supra* note 39, at p. 37.

non-cash (or cash equivalent) holdings is limited to an analysis of U.S. equity funds, on account of limitations in the availability of current data with respect to the holdings of funds that are not U.S. equity funds.[633] However, the staff was able to conduct similar analyses regarding the relationship between flow volatility and portfolio liquidity with respect to U.S. municipal bond funds, which are unique in that their holdings typically consist only of U.S. municipal bonds and cash and cash equivalents. Because U.S. municipal bonds are less liquid than cash, any change in the relative holdings of municipal bonds and cash and cash equivalents indicates a change in the fund's portfolio liquidity. Unlike U.S. municipal bond funds, other types of funds tend to hold portfolio assets that are not as homogenous, and thus staff would not be able to assume that changes in relative holdings across asset classes could indicate a change in the fund's portfolio liquidity. With respect to U.S. municipal bond funds, the holdings of municipal bonds (as opposed to these funds' holdings of cash and cash equivalents) are relatively lower when flow volatility is higher; holdings of municipal bonds are higher and holdings of cash and cash equivalents are lower when flow volatility is lower.[634] Thus, like U.S. equity funds, U.S. municipal bond funds' portfolio liquidity tends to be higher when flow volatility is higher. Likewise, staff analysis of the cash and cash equivalent holdings of all funds (regardless of strategy) shows that funds with more volatile flows tend to hold more cash and cash equivalents.[635]

The results of staff's analysis on the relationship between portfolio liquidity and fund flow volatility are significant for several reasons. First, these results suggest that, as indicated by funds in the course of staff outreach and in funds' statements regarding their liquidity risk

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633 *See supra* notes 622-623 and accompanying text.

634 DERA Study, *supra* note 39, at pp. 39-40.

635 DERA Study, *supra* note 39, at pp. 41-42.

management, some funds actively manage their portfolio liquidity to respond to events that could challenge funds' ability to plan to meet redemption requests. These results also emphasize that flow volatility is a relevant factor that a fund should consider when assessing liquidity risk and managing the liquidity profile of its portfolio. Rule 22e-4 as proposed reflects this by requiring a fund to consider its cash flow projections in assessing its liquidity risk (and determining its three-day liquid asset minimum), including the volatility of historical purchases and redemptions of fund shares during normal and stressed periods.[636]

While increased flow volatility could make a fund less certain as to the extent of redemption requests it will be required to meet, changes in market liquidity (that is, the extent to which market factors affect the liquidity of a fund's portfolio holdings) could make a fund less certain that the assets its holds are sufficient to meet redemption requests, or meet such requests in a way that minimizes dilution of non-redeeming shareholders. Thus, both increased flow volatility and decreased market liquidity could increase a fund's liquidity risk. While staff analysis shows that U.S. equity fund liquidity decreased sharply during the 2007-2009 financial crisis, the cause of this decrease in liquidity is initially unclear.[637] Fund liquidity could have decreased because of a general decrease in the liquidity of all assets in the market, or fund liquidity could have decreased as a result trading activity—for instance, if the fund were to sell its most liquid assets to pay redeeming shareholders or if the fund were to buy less liquid assets because of perceived profit opportunities. Staff analysis, however, suggests that decreases in the liquidity of U.S. equity funds are generally driven by changes in market liquidity and that funds

636 *See* proposed rule 22e-4(b)(2)(iii)(A)*(1)*.

637 DERA Study, *supra* note 39, at pp. 30-31.

do limited trading to offset such decreases.[638] For the average U.S. equity fund, when market liquidity decreases by 1% from the previous quarter, fund liquidity decreases by 0.93% from the previous quarter. Conversely, when market liquidity increases by 1% from the previous quarter, fund liquidity increases by 0.82% from the previous quarter.[639] So, while the results are consistent with the view that U.S. equity funds actively manage their portfolio liquidity, funds appear to make only minor adjustment to their portfolio in response to changes in market liquidity.[640]

This analysis demonstrates that fund portfolio liquidity tends to be lower during periods of decreased market liquidity. Based on this analysis, if a shareholder were to redeem shares during a period of decreased market liquidity, funds would likely have a less liquid portfolio of assets available to sell to meet redemptions. To the extent that selling those relatively less liquid assets requires the fund to accept a discount from the assets' market value, the value of the fund's shares would be negatively affected. Our staff's analysis thus highlights a source of potential concern regarding investor protection, reinforcing our motivation to propose regulations to better protect investors by enhancing funds' liquidity risk management. A primary benefit of the proposed liquidity risk management program requirement, discussed below, is the potential for the requirement to improve investor protection by decreasing the likelihood that a

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638 DERA Study, *supra* note 39, at Section 6. As discussed above, staff's analysis with respect to trends that reflect the liquidity of funds' non-cash (or cash equivalent) holdings is limited to an analysis of U.S. equity funds, on account of limitations in the availability of current data with respect to the holdings of funds that are not U.S. equity funds. *See also supra* notes 622-623 and accompanying text.

639 DERA Study, *supra* note 39, at pp. 34-35.

640 Funds may be unable to fully offset decreases in market liquidity because of their investment mandate. A small cap mutual fund cannot simply begin buying only large cap stocks just because the liquidity of small cap stocks has decreased.

fund would be unable to meet its redemption obligations, or meet such obligations by materially affecting the fund's NAV.[641]

d. Trends in Fund Strategies to Meet Redemption Requests

A fund may meet redemption requests in a variety of ways, including by using available cash to pay all redemptions. If a fund were to sell portfolio assets in order to meet redemption requests, the fund's portfolio liquidity will be affected by the choice of which assets will be sold. Subsequent rebalancing of the fund's portfolio after redemptions are met will also affect portfolio liquidity. For example, a fund facing a large redemption request can lessen the price impact of selling assets by selling the most liquid portion of the portfolio.[642] That choice benefits non-redeeming investors by minimizing the loss in fund value due to the price impact of selling, but it also could increase the liquidity risk of the fund portfolio.[643] If the fund instead were to sell a "strip" of the portfolio (*i.e.*, a cross-section or representative selection of the fund's portfolio assets), the impact on fund value may be greater, but the liquidity of the fund portfolio would be unchanged as a result of the sale. Funds also could choose to meet redemptions by selling a range of assets in between its most liquid, on one end of the spectrum, and a perfect pro rata strip of assets, on the other end of the spectrum. Additionally, funds could choose to opportunistically pare back or eliminate holdings in a particular asset or sector to meet redemptions.

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641 *See infra* section IV.C.1.b.

642 We note that in some instances, selling only the most liquid assets to meet a large redemption could be inconsistent with the fund's investment mandate. For example, if a fund's investment mandate required it to hold a certain percentage of its portfolio in equities, the fund might not be able to sell a large portion of its equity holdings to meet redemption requests and still hold the required percentage of its portfolio in equities.

643 *See, e.g.*, *supra* note 37 (discussing recent circumstances in which, during a year of heavy redemptions that caused a high yield bond fund's assets to shrink 33% in this period, the fund's holdings of bonds rated triple-C or below grew to 47% of assets, from 35% before the redemptions).

Staff analysis of the impact of large redemptions on portfolio liquidity suggests that the typical U.S. equity fund does not sell a strip of its portfolio assets to meet redemptions, but instead appears—based on changes in funds' portfolio liquidity following net outflows—to disproportionately sell the more liquid portion of its portfolio for this purpose.[644] Similarly, staff analysis shows that when a U.S. municipal bond fund encounters net outflows, the typical U.S. municipal bond fund will experience an increase in its holdings of municipal bonds (and a decrease in its holdings of cash and cash equivalents), thus decreasing the fund's overall portfolio liquidity.[645] This suggests that U.S. municipal bond funds tend to satisfy redemption requests with cash, and not by selling a strip of the fund's portfolio assets.

Holding all else equal, as the liquidity of a U.S. equity fund portfolio decreases, the price impact of selling a strip of that portfolio increases.[646] As a result, we would expect less liquid U.S. equity funds to have greater incentive to meet redemption requests by selling their most liquid assets rather than a strip of their portfolio. Staff analysis suggests that, as initial liquidity decreases, U.S. equity funds do become more likely to disproportionately sell their relatively more liquid assets, rather than strips of their portfolio, to meet redemptions.[647] That choice has the effect of decreasing the liquidity of the portfolio, which could potentially disadvantage non-redeeming shareholders by increasing the fund's liquidity risk.[648] As discussed below, we

[644] DERA Study, *supra* note 39, at pp. 43-46.

[645] DERA Study, *supra* note 39, at pp. 47-49; *see also supra* notes 633-634 and accompanying text (discussing the staff's assumptions that a decrease in the holdings of municipal bonds by a U.S. municipal bond fund would increase the fund's liquidity, as well as the reasons that the staff does not make similar assumptions about funds other than U.S. municipal bond funds).

[646] DERA Study, *supra* note 39, at pp. 25-26. The Amihud liquidity measure used in this analysis measures price impact. When using this measure, price impact increases when liquidity decreases, by definition. However, using alternative measures of liquidity, this statement would not necessarily be true. *See supra* note 621.

[647] DERA Study, *supra* note 39, at pp. 45-46 and Table 19.

[648] While a holder of an illiquid asset receives compensation in the form of an illiquidity premium (*see, e.g.*,

believe that a significant benefit of the liquidity risk management program requirement is the decreased possibility that a fund's actions taken in order to pay redemptions would result in negative effects on the fund's liquidity profile that could ultimately harm non-redeeming shareholders.[649]

3. *Fund Industry Developments Highlighting the Importance of Funds' Liquidity Risk Management*

a. Overview

Along with staff analysis of economic relationships regarding funds' portfolio liquidity, evaluating recent fund industry developments also point to concerns about the need for funds to have liquidity risk management programs that will reduce the risk that funds will be unable to meet redemption obligations without materially affecting the fund's NAV or risk profile and mitigate dilution of interests of fund shareholders.[650] These developments include the growth in assets managed by funds with strategies that are generally viewed as concentrating in relatively less liquid asset holdings, as well as the growth in assets managed by funds with strategies that tend to exhibit relatively high portfolio flow volatility, which could give rise to increased liquidity risk. This section provides details about these industry trends.

Below we discuss the size and growth of the U.S. fund industry generally, as well as the growth of various investment strategies within the industry. We show that the fund industry has grown significantly in the past two decades, and during this period, funds with international strategies, fixed income funds, and funds with alternative strategies have grown particularly quickly. We also examine trends regarding the volatility and predictability of fund flows,

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Amihud, *supra* note 621, at 31), non-redeeming investors might not be aware of the change in portfolio liquidity and would therefore maintain an allocation that does not reflect their liquidity risk preference.

649 *See infra* section IV.C.1.b.

650 *See supra* section IV.A.

discussing in particular those types of funds that demonstrate notably volatile and unpredictable flows. Because volatility and predictability in a fund's flows can affect the extent to which the fund is able to meet expected and reasonably foreseeable redemption requests without materially affecting a fund's NAV or dilution of the interests of fund shareholders, assessing trends regarding these factors can provide information about sectors of the fund industry that could be particularly susceptible to liquidity risk.

While we believe that these trends are relevant from the perspective of addressing potential liquidity risk in the fund industry (and in funds' underlying portfolio assets), we emphasize that liquidity risk is not confined to certain types of funds or investment strategies. Although we recognize that certain fund characteristics could make a fund relatively more prone to liquidity risk, we believe that all types of funds entail liquidity risk to some extent.[651] Thus, while in this section we discuss certain types of funds and strategies that are generally considered to exhibit increased liquidity risk, we are not asserting that *only* these types of funds and strategies involve liquidity risk, or that a fund of the type and with the strategy discussed below necessarily demonstrates greater liquidity risk than a fund that does not have these same characteristics.

b. Size and Growth of the U.S. Fund Industry and Various Investment Strategies Within the Industry

Open-end funds and ETFs manage a significant and growing amount of assets in U.S. financial markets. As of the end of 2014, there were 8,734 open-end funds (excluding money market funds, but including ETFs), as compared to 5,279 at the end of 1996.[652] The assets of

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651 *See supra* section III.A.2.

652 *See* 2015 ICI Fact Book, *supra* note 3, at 177, 184.

these funds were $15.05 trillion in 2014, having grown from about $2.63 trillion in 1996.[653] Within these figures, the number of ETFs and ETFs' assets have increased notably in the past decade. There were 1,411 ETFs in 2014, as opposed to a mere 119 in 2003, and ETFs' assets have increased from $151 billion in 2003 to $1.9 trillion in 2014.[654]

U.S. equity funds represent the greatest percentage of U.S. open-end fund industry assets.[655] Excluding ETFs, money market funds and variable annuities, open-end U.S. equity funds held 44.5% of U.S. fund industry assets as of the end of 2014. The investment strategies with the next-highest percentages of U.S. fund industry assets are foreign equity funds (15.4%), mixed strategy funds (13.7%), and general bond funds (13.3%).[656] Funds with alternative strategies only represent a small percentage of the U.S. fund industry assets, but as discussed below, the number of alternative strategy funds and the assets of this sector have grown considerably in recent years.[657]

While the overall growth rate of funds' assets has been generally high (about 8.0% per year, between the years 2000 and 2014[658]), it has varied significantly by investment strategy.[659] U.S. equity funds' assets grew substantially in terms of dollars from the end of 2000 to 2014,[660] but this sector's assets as a percentage of total U.S. fund industry assets decreased from about

653 *See* 2015 ICI Fact Book, *supra* note 3, at 175, 183.

654 *See* 2015 ICI Fact Book, *supra* note 3, at 60.

655 DERA Study, *supra* note 39, at Table 1.

656 *Id.* The figure for general bond funds does not include assets attributable to foreign bond funds (2.0%), U.S. corporate bond funds (0.8%), U.S. government bond funds (1.3%), and U.S. municipal bond funds (4.5%).

657 DERA Study, *supra* note 39, at pp. 7-8.

658 DERA Study, *supra* note 39, at Table 2.

659 The figures in this paragraph and the following paragraph, discussing the variance in growth rate of funds' assets by investment strategy, exclude ETF assets.

660 U.S. equity funds held about $5.6 trillion as the end of 2014, compared to about $2.9 trillion at the end of 2000. DERA Study, *supra* note 39, at Table 2.

65% to about 45% during that same period.[661] Like U.S. equity funds, the assets of U.S. corporate bond funds, government bond funds, and municipal bond funds also increased in terms of dollars from 2000 to 2014, but each of these sectors' assets as a percentage of the fund industry decreased during this period.[662] On the other hand, the assets of foreign equity funds, general bond funds, and foreign bond funds increased steadily and substantially as a percentage of the fund industry over the same period.[663] For example, foreign equity funds increased steadily from 10.6% of total industry assets in 2000 to 15.4% in 2014. And within these three investment strategies, certain investment subclasses (emerging market debt and emerging market equity) have grown particularly quickly from 2000 to 2014.[664]

The assets of funds with alternative strategies[665] also have grown rapidly in recent years. From 2005 to 2014, the assets of alternative strategy funds grew from \$366 million to \$334 billion, and from the end of 2011 to the end of 2013, the assets of alternative strategy funds grew

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661 DERA Study, *supra* note 39, at Table 2.

662 *Id.* U.S. corporate bond funds held about \$99 billion at the end of 2014, as opposed to \$66 billion in 2000; these funds' assets as a percentage of the U.S. fund industry decreased from 1.5% in 2000 to 0.8% in 2014. U.S. government bond funds held about \$166 billion at the end of 2014, as opposed to \$91 billion in 2000; these funds' assets as a percentage of the U.S. fund industry decreased from 2.1% in 2000 to 1.3% in 2014. U.S. municipal bond funds held about \$565 billion at the end of 2014, as opposed to \$278 billion in 2000; these funds' assets as a percentage of the U.S. fund industry decreased from 6.3% in 2000 to 4.5% in 2014.

663 *Id.* Foreign equity funds held about \$1.9 trillion in 2014, as opposed to \$465 billion in 2000; these funds' assets as a percentage of the U.S. fund industry increased from 10.6% in 2000 to 15.4% in 2014. U.S. general bond funds held about \$1.7 trillion at the end of 2014, as opposed to \$240 billion in 2000; these funds' assets as a percentage of the U.S. fund industry increased from 5.4% in 2000 to 13.3% in 2014. Foreign bond funds held about \$259 billion at the end of 2014, as opposed to \$19 billion in 2000; these funds' assets as a percentage of the U.S. fund industry increased from 0.4% in 2000 to 2.0% in 2014.

664 DERA Study, *supra* note 39, at p. 9. Emerging market debt and emerging market equity funds held about \$334 billion at the end of 2014, as opposed to \$20 billion in 2000. The assets of emerging market debt funds and emerging market equity funds grew by an average of 20.8% and 22.7%, respectively, each year from 2000 through 2014.

These investment subclasses represent a small portion of the U.S. mutual fund industry (the combined assets of these investment subclasses as a percentage of the U.S. fund industry was 2.6% at the end of 2014).

665 *See supra* note 64 for a discussion of the primary investment strategies practiced by "alternative strategy" funds.

by almost 80% each year. However, as discussed above, funds with alternative strategies remain a relatively small portion of the U.S. fund industry as a percentage of total assets.[666] While growth in funds with alternative strategies has slowed over the past year, a rising interest rate environment could cause inflows to these funds to increase once again, as investors look to reduce their interest rate risk and/or increase income by investing in alternative strategies.[667]

c. Significance of Fund Industry Developments

The industry developments discussed above are notable for several reasons. The growth of funds generally over the past few decades demonstrates that investors have increasingly come to rely on investments in funds to meet their financial needs.[668] As investments in funds increase, the need for continued effective regulations to protect investors is paramount. Initiatives such as the proposed liquidity regulations, which aim to promote shareholder protection by enhancing funds' liquidity risk management, are important to decrease the risk that funds will be unable to meet redemption obligations and reduce potential dilution of the interests of fund shareholders.

These trends also demonstrate growth in particular types of funds that may entail increased liquidity risk. In particular, there has been significant growth in high-yield bond funds, emerging market debt funds, and funds with alternative strategies. Commissioners and Commission staff have previously spoken about the need to focus on potential liquidity risks relating to fixed income assets and fixed income funds,[669] and within this sector, funds that invest in high-yield bonds could be subject to greater liquidity risk as they invest in lower-rated bonds

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[666] *See supra* note 657 and accompanying text.

[667] *See supra* note 66.

[668] *See supra* note 6 and accompanying text.

[669] *See supra* note 62 and accompanying text.

that tend to be less liquid than investment grade fixed income securities.[670] Emerging market debt funds may invest in relatively illiquid securities with lengthy settlement periods.[671] Likewise, funds with alternative strategies may invest in portfolio assets that are relatively illiquid.[672] Moreover, Commission staff economists have found that both foreign bond funds (including emerging market debt funds) and alternative strategy funds have historically experienced relatively more volatile and unpredictable flows than the average mutual fund,[673] which could increase these funds' liquidity risk by making it more difficult to plan to meet fund redemptions (and thus, more likely that a fund may need to sell portfolio assets in a manner that creates a market impact in order to pay redeeming shareholders).[674] On account of these characteristics of high-yield bond funds, emerging market debt funds, and funds with alternative strategies, we are concerned that the growth in these strategies could give rise to increased concerns regarding these funds' liquidity risk.

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670 The Commission and Commission staff have cautioned that high yield securities may be considered to be illiquid, depending on the facts and circumstances. *See* Interval Fund Proposing Release, *supra* note 83; *see also* SEC Investor Bulletin, What Are High-Yield Corporate Bonds?, *available at* http://www.sec.gov/investor/alerts/ib_high-yield.pdf (noting that high-yield bonds may be subject to more liquidity risk than, for example, investment-grade bonds). *But see* BlackRock, Viewpoint, Who Owns the Assets?, *supra* note 79 (discussing the liquidity characteristics of high-yield bond funds in depth, and noting that these funds have weathered multiple market environments, and are generally managed with multiple sources of liquidity).

671 *See, e.g., supra* note 197 and accompanying text (discussing the settlement cycles associated with transactions in certain foreign securities); *see also* Reuters, "Fitch: Close Look at EM Corporate Bond Trading Reveals Liquidity Risks" (Apr. 16, 2015), *available at* http://www.reuters.com/article/2015/04/16/idUSFit91829620150416. *But see* BlackRock, Viewpoint, Who Owns the Assets?, *supra* note 79 (discussing the liquidity characteristics of emerging market debt funds in depth, and noting that these funds tend to hold a portion of their assets in developed market government bonds (providing further liquidity), generally establish limits on less liquid issuers, and generally maintain allocations to cash for liquidity and rebalancing purposes).

672 *See supra* notes 68-72 and accompanying text.

673 DERA Study, *supra* note 39, at pp. 16-24.

674 *See supra* notes 269-270 and accompanying text.

C. Benefits and Costs, and Effects on Efficiency, Competition, and Capital Formation

Taking into account the goals of the proposed liquidity regulations and the economic baseline, as discussed above, this section explores the benefits and costs of the proposed liquidity regulations, as well as the potential effects of the proposed liquidity regulations on efficiency, competition, and capital formation. This section also discusses reasonable alternatives to proposed rule 22e-4, proposed rule 22c-1(a)(3), and the proposed disclosure and reporting requirements regarding funds' liquidity risk and liquidity risk management and swing pricing.

1. Proposed Rule 22e-4

a. Requirements of Proposed Rule 22e-4

Proposed rule 22e-4 would require each fund to establish a written liquidity risk management program. The proposed rule specifies that a fund's liquidity risk management program shall include the following required program elements: (i) classification and ongoing review of the classification of the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset), taking into account certain specified factors set forth in the rule;[675] (ii) assessment and periodic review of the fund's liquidity risk taking into account certain specified factors set forth in the rule;[676] and (iii) management of the fund's liquidity risk.[677] A fund's policies and procedures for managing liquidity risk, in turn, must incorporate the determination and periodic review of the adequacy of a fund's three-day liquid asset minimum (that is, the percentage of the fund's net assets that must be invested in three-day liquid

675 Proposed rule 22e-4(b)(2)(i)-(ii).

676 Proposed rule 22e-4(b)(2)(iii).

677 Proposed rule 22e-4(b)(2)(iv).

assets).[678] Proposed rule 22e-4 would also prohibit a fund from acquiring any: (i) less liquid asset, if immediately after the acquisition, the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets;[679] or (ii) 15% standard asset, if immediately after the acquisition, the fund would have invested more than 15% of its net assets in 15% standard assets.[680] In addition, proposed rule 22e-4 would require a fund to establish policies and procedures regarding redemptions in kind, to the extent that the fund engages in or reserves the right to engage in redemptions in kind.[681]

A fund's board, including a majority of the fund's independent directors, would be required to approve the fund's liquidity risk management program (including the fund's three-day liquid asset minimum), as well as any material change to the program.[682] The fund would be required to designate the fund's adviser or officers responsible for administering the program, and such designation is required to be approved by the fund's board of directors.[683] The fund's board would also be required to review, at least annually, a written report prepared by the fund's investment adviser or officers administering the liquidity risk management program reviewing the adequacy of the fund's liquidity risk management program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation.[684]

Proposed rule 22e-4 also includes certain recordkeeping requirements. A fund would be required to keep a written copy of its liquidity risk management policies and procedures, as well

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678 Proposed rule 22e-4(b)(2)(iv)(A)-(B).

679 Proposed rule 22e-4(b)(2)(iv)(C).

680 Proposed rule 22e-4(b)(2)(iv)(D).

681 Proposed rule 22e-4(b)(2)(iv)(E).

682 Proposed rule 22e-4(b)(3)(i).

683 Proposed rule 22e-4(b)(3)(iii).

684 Proposed rule 22e-4(b)(3)(ii).

as copies of any materials provided to the fund's board in connection with the approval of the initial liquidity risk management program and any material changes to the program and annual board reporting requirement.[685] A fund also would be required to keep a written record of how its three-day liquid asset minimum, and any adjustments thereto, were determined.[686]

b. Benefits

We believe that proposed rule 22e-4 is likely to produce benefits for current and potential fund investors. Specifically, we believe that the proposed program requirement is likely to improve investor protection by decreasing the chance that a fund would be unable to meet its redemption obligations, would meet such obligations only by materially affecting the fund's NAV, or would meet such obligations through methods that would have other adverse impacts on non-redeeming investors (*e.g.*, increased risk exposure and decreased liquidity). Funds are not currently subject to specific requirements under the federal securities laws or Commission rules obliging them to manage their liquidity risk.[687] Also, with the exception of money market funds, funds are currently guided by Commission guidelines (not rules) that generally limit their investment in illiquid assets.[688] As discussed above, funds today employ notably different practices for assessing and classifying the liquidity of their portfolio assets, as well as for assessing and managing fund liquidity risk. Some of these practices take into account multiple aspects relating to portfolio assets' liquidity (including relevant market, trading, and asset-specific factors), involve comprehensive assessment and robust management of fund liquidity risk, and incorporate ongoing review of both portfolio liquidity and fund liquidity risk.

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685 Proposed rule 22e-4(c)(1) and (2).

686 Proposed rule 22e-4(c)(3).

687 *See supra* section IV.B.1.a.

688 *See id.*

Outreach by Commission staff has found that practices of some funds raise concerns regarding various funds' ability to meet their redemption obligations and lessen the effects of dilution. Also, while some funds have independent oversight of their liquidity risk outside of the portfolio management process, others do not. While a fund's portfolio management has access to a great deal of information relevant to the liquidity of the fund's portfolio assets, and thus pertinent to the fund's liquidity risk, a portfolio manager may have conflicts of interest that could impede effective liquidity risk management.[689] For example, because investments in relatively less liquid assets may result in higher total returns for a fund, fund managers may have incentive to increase their funds' investment in illiquid assets levels in a manner that is potentially inconsistent with the funds' expected and reasonably foreseeable redemptions. Consequently, to the extent that some funds do not currently meet the minimum baseline requirements for fund assessment and management of liquidity risk proposed in this rule, investor protection would be enhanced by reducing the risk that funds will be unable to meet redemption obligations and mitigating dilution of fund shareholders.

We believe that the proposed liquidity risk management program requirement would promote improved alignment of the liquidity of the fund's portfolio with the fund's expected (and reasonably foreseeable) levels of redemptions. As discussed above, proposed rule 22e-4 would require each fund to consider a standard set of factors, as applicable, in classifying the liquidity of its portfolio assets and in assessing its liquidity risk, and to determine a three-day liquid asset minimum to increase the likelihood that the fund will hold adequate liquid assets to meet redemption requests without materially affecting the fund's NAV. Each fund would have flexibility to determine the particular assets that it holds in connection with its three-day liquid

689 *See* text accompanying *supra* note 258.

asset minimum. Assets eligible for inclusion in a fund's three-day liquid asset minimum holdings could include a broad variety of securities, as well as cash and cash equivalents. While one fund may conclude that it is appropriate to hold a significant portion of its three-day liquid assets in cash and cash equivalents, another could decide it is appropriate to hold assets that are convertible to cash within longer periods (but not exceeding three business days) as the majority of its three-day liquid asset minimum holdings. We believe that the proposed three-day liquid asset minimum requirement would allow funds to continue to meet a wide variety of investors' investment needs by obliging funds to maintain appropriate liquidity in their portfolios, while permitting funds to remain substantially invested in portfolio assets that conform to their investment strategies. The limitation on acquisition of 15% standard assets would complement the three-day liquid asset minimum requirement to increase the likelihood that a fund's portfolio is not overly concentrated in assets whose liquidity is extraordinarily limited.

We believe that the proposed rule also would decrease the probability that a fund will be able to meet redemption requests only through activities that can materially affect the fund's NAV or risk profile or dilute the interests of fund shareholders. For example, when a fund does not effectively manage liquidity and is faced with significant redemptions, it may be forced to sell portfolio assets under unfavorable circumstances, which could create significant negative price pressure on those assets.[690] This, in turn, could disadvantage non-redeeming shareholders by decreasing the value of those shareholders' interests in the fund.[691] Even if a fund were to sell the most liquid portion of its portfolio to meet redemption requests, which would minimize the loss in fund value due to the price impact of selling, these asset sales could decrease the liquidity

690 *See* Coval & Stafford, *supra* note 51 (discussing how mutual fund fire sales impact asset prices).

691 While the impact of fire sales on asset prices may be short lived in some instances, Coval and Stafford show that the impact of fire sales can often take many months to dissipate. *Id.*

of the fund portfolio, potentially creating increased liquidity risk for non-redeeming shareholders. As discussed above, staff analysis suggests that U.S. equity funds may dispose of relatively more liquid assets first, as opposed to selling a pro rata "strip" of the fund's portfolio assets, which minimizes price impact on a fund in the short term, but ultimately decreases the liquidity of the fund's portfolio.[692] Short-term borrowings by a fund to meet redemption requests also could disadvantage non-redeeming shareholders by leveraging the fund and requiring the fund to pay interest on the borrowed funds (although, in some instances, the costs of borrowing may be less than the costs of selling assets to meet redemptions). For example, in a settled enforcement action, the Commission found that certain high-yield bond funds experienced liquidity problems and as a result, the funds borrowed heavily against a line of credit to meet fund redemption requests, which permitted shareholders to redeem fund shares at prices above the fair value of the fund's holdings. The result was a benefit to redeeming shareholders at the expense of remaining and new shareholders.[693] Moreover, the costs of borrowing (that is, the costs associated with maintaining a committed line of credit, as well as interest expenses associated with drawing on a credit line) could be passed on to fund shareholders in the form of fund operating expenses, which could adversely affect a fund's NAV. It is possible that such costs could exceed any price impact caused by asset sales conducted to generate liquidity, particularly since the costs of maintaining a committed line of credit are ongoing costs, whereas the price impact caused by asset sales could be only temporary. To the extent that the proposed program requirement results in liquidity risk assessment and management that enhance funds' ability to meet redemption obligations, it would be less likely that a fund takes actions to pay

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692 *See supra* note 39 and accompanying discussion.

693 Heartland Release, *supra* note 47.

redemptions that would materially affect the fund's NAV or have other adverse impacts on non-redeeming shareholders.

The potential negative consequences of asset sales effected to pay fund redemptions could create incentives in times of liquidity stress in the markets for early redemptions, or a "first-mover advantage."[694] For example, recent academic studies have suggested that an incentive exists for market participants to front-run trades conducted by a fund in response to significant changes in fund flows.[695] This suggests that sophisticated fund investors could anticipate that significant fund outflows could lead a fund to conduct trades that would disadvantage non-redeeming shareholders, which could create an incentive to redeem ahead of such trades. Among U.S. equity funds, staff analysis suggests that, as a fund's liquidity decreases, a fund will become more likely to sell its relatively more liquid assets to pay redemptions (thus resulting in decreased liquidity in the fund's portfolio).[696] Thus, if investors' redemptions are motivated by a first-mover advantage, this could lead to increasing levels of redemptions, and as the level of outflows from a fund increases, the incentive to redeem also increases. Any negative effects on non-redeeming shareholders thus could be magnified by a first-mover advantage to the extent that this dynamic produces growing redemptions and decreased portfolio liquidity. While we understand that fund investors may not have historically been motivated to redeem on account of a perceived (or actual) first-mover advantage during

694 *See supra* note 49 and accompanying text (discussing the possibility of a first-mover advantage with respect to the timing of shareholder redemption from funds). *But see supra* note 50 (discussing arguments that such a first-mover advantage does not exist in funds, as well as arguments that even if incentives to redeem ahead of other shareholders do exist, this does not necessarily imply that investors will in fact redeem *en masse* in times of market stress).

695 *See* Coval & Stafford, *supra* note 51; Dyakov & Verbeek, *supra* note 51.

696 *See supra* section II.B.2.

previous periods of stress,[697] we cannot predict how investors may behave in the future. The first-mover advantage is more commonly referenced with respect to money market funds, but the incentives that have been argued to create the first-mover advantage among those funds exist (in possibly weaker form) among other open-end funds. To the extent that economic incentives exist to redeem fund shares prematurely, this could lead to investor dilution as discussed above, and the possibility of protecting against this potential dilution is one motivating aspect (but not the only or key motivating aspect[698]) of the overall goal of investor protection that we believe the proposed rule 22e-4 would accomplish.

We recognize that certain funds already engage in fairly comprehensive liquidity risk management practices, and the proposed program requirement would likely benefit these funds' shareholders less than it would benefit the shareholders of funds that do not employ equally rigorous practices. The proposed program requirement aims to promote a minimum baseline in the fund industry, both in the assessment of portfolio assets' liquidity and the evaluation of factors relevant to liquidity risk management. This, in turn, we believe would promote investor protection by elevating the overall quality of liquidity risk management across the fund industry, reducing the likelihood that funds will meet redemption obligations only through activities that could materially affect fund NAVs or risk profiles, and mitigating dilution of shareholder interests. We cannot quantify the total benefits to fund operations and investor protection that we discuss above, but to the extent that staff outreach has noted that some funds currently have

697 *See, e.g.*, Comment Letter of Wellington Management Group LLP on the FSOC Notice (Mar. 25, 2015), at 4; ICI FSOC Notice Comment Letter, *supra* note 16, at 7; Nuveen FSOC Notice Comment Letter, *supra* note 45, at 10 (all arguing that evidence shows that fund shareholders' redemptions are largely driven by other concerns rather than a theoretical first-mover advantage).

698 *See supra* notes 690-693 and accompanying text.

no (or very limited) formal liquidity risk management programs in place, proposed rule 22e-4 would enhance current liquidity risk management practices.

We also believe that the liquidity risk management program requirement, as proposed, would not adversely impact fund diversity and investor choice. While the proposed liquidity risk management program requirement would include certain required elements, and would require a fund to consider certain specified factors in classifying the liquidity of its portfolio assets and assessing its liquidity risk, it would not produce a de facto prohibition against certain investment strategies. We anticipate that the proposed three-day liquid asset minimum requirement would be sufficiently flexible to permit funds with different investment strategies, and whose cash flow and liquidity needs vary notably from one fund to the next, to manage their individual levels of liquidity risk. This proposed requirement would not mandate a standard level of minimum liquid asset holdings across the fund industry. Proposed rule 22e-4 thus would allow a fund with a relatively less liquid investment strategy to continue operating under that strategy, so long as the fund determines a three-day liquid asset minimum that takes into account the factors required to be considered under the proposed rule, and invests its assets in compliance with its three-day liquid asset minimum. (We recognize, however, that the proposed rule could result in a fund modifying its portfolio composition if it determines that the three-day liquid asset minimum that it should hold, as a result of its consideration of the required factors specified in the proposed rule, does not correspond with the fund's current portfolio composition.[699]) The proposed requirement would not adversely impact the diversity of investment strategies within the fund

[699] *See infra* section IV.C.1.c.

industry and would permit a fund investor to choose appropriate investment options for his or her risk tolerance and risk preferences.[700]

Finally, to the extent that the proposed program requirement results in funds less frequently needing to sell portfolio assets in unfavorable market conditions in order to meet redemptions, the proposed requirement also could lower potential spillover risks that funds could pose to the financial markets generally. For example, the proposed approach could decrease the risk that all investors holding an asset would be affected if a fund facing heavy redemptions were forced to sell portfolio assets under unfavorable circumstances, which in turn could create significant negative price pressure on those assets. If, as a result of the proposed program requirement, a fund was prepared to meet redemption requests in other ways, the proposed rule could decrease the risk that the fund might indirectly transmit stress to other market sectors and participants. While there have been examples of funds' liquidity risk management preventing spillover market effects that could have arisen in the face of significant shareholder redemptions, this prevention of larger market effects has occurred because of funds' organic liquidity risk management practices, and not because of any specific liquidity risk management requirements. It is unclear whether such organic practices will be sufficient to prevent future spillover market events of similar or greater magnitude. The proposed rule should help all funds, not just funds with liquidity risk management practices currently in place, operate in a manner that lessens the chance of spillover risks. We are unable to quantify this potential benefit because we cannot predict the extent to which funds would enhance their current liquidity risk management

700 We also believe that investor choice would be facilitated by the proposed enhanced disclosure requirements, as discussed below at section IV.C.3.b.

practices as a result of proposed rule 22e-4, or predict the precise circumstances that could entail negative spillover effects in light of less-comprehensive liquidity risk management by funds.[701]

c. Costs

One-Time and Ongoing Costs Associated With Program Establishment and Implementation

Funds would incur one-time costs to establish and implement a liquidity risk management program in compliance with proposed rule 22e-4, as well as ongoing program-related costs. As discussed above, funds today employ a range of different practices, with varying levels of comprehensiveness, for assessing and classifying the liquidity of their portfolio assets, as well as for assessing and managing fund liquidity risk. Accordingly, funds whose practices regarding portfolio asset liquidity classification and liquidity risk assessment and management most closely align with the proposed liquidity risk management program requirements would incur relatively lower costs to comply with proposed rule 22e-4. Funds whose practices for classifying the liquidity of their portfolio assets and for assessing and managing liquidity risk are less comprehensive or not closely aligned with our proposals, on the other hand, may incur relatively higher initial compliance costs.

Our staff estimates that the one-time costs necessary to establish and implement a liquidity risk management program would range from $1.3 million to $2.25 million[702] per fund

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701 The ability of the Commission to perform such analysis is limited by difficulties in both gathering data about funds' liquidity risk management practices and quantifying such data.

702 These cost estimates are based in part on the staff's recent estimates of the one-time systems costs associated with implementing the fees and gates provisions of the 2014 amendments to rule 2a-7 under the 1940 Act. *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.5.b. Although the substance and content of systems associated with establishing and implementing a liquidity risk management program (including any systems changes associated with classifying the liquidity of funds' portfolio positions) would be different from the substance and content of systems associated with implementing the rule 2a-7 fees and gates provisions, the one-time costs associated with proposed rule 22e-4, like the one-time costs associated with the fees and gates provisions, would entail: drafting relevant procedures; planning, coding, testing, and installing relevant system modifications; integrating and

complex, depending on the particular facts and circumstances and current liquidity risk management practices of the funds comprising the fund complex.[703] These estimated costs are attributable to the following activities, as applicable to each of the funds within the complex: (i) developing policies and procedures relating to each of the required program elements,[704] and the related recordkeeping requirements of the proposed rule; (ii) planning, coding, testing, and installing any system modifications relating to each of the required program elements; (iii) integrating and implementing policies and procedures relating to each of the required program

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implementing relevant procedures; and preparing training materials and administering training sessions for staff in affected areas. *See id.* However, in estimating the one-time costs associated with proposed rule 22e-4, staff has adjusted the estimated one-time systems costs associated with implementing the fees and gates provisions to reflect that the estimated costs associated with implementing the fees and gates provisions include costs to be incurred by the fund and others in the distribution chain (including transfer agents, accountants, custodians, and intermediaries), whose services would be needed if a fund were to impose a fee or gate, whereas we anticipate that the proposed rule 22e-4 requirements would be borne primarily by a fund complex and not by others in the distribution chain.

We note that the estimated one-time systems costs associated with implementing the fees and gates provisions of the 2014 amendments to rule 2a-7 are generally similar to the proposed estimated one-time systems costs associated with implementing the floating NAV provisions of the 2014 rule 2a-7 amendments. *See id.* at section III.B.8.a. However, the proposed estimated one-time systems costs associated with implementing the floating NAV provisions were adjusted downward at adoption, to account for certain considerations specific to the floating NAV reforms. Thus, staff believes that the one-time costs associated with the fees and gates provisions would provide a closer analogue to the estimated costs associated with proposed rule 22e-4 than the one-time costs associated with the floating NAV provisions.

703 This estimate assumes that each fund would not bear all of the estimated costs (particularly, the costs of systems modification) on an individual basis, but instead that these costs would likely be allocated among the multiple users of the systems, that is, each of the members of a fund complex. Accordingly, we expect that, in general, funds within large fund complexes would incur fewer costs on a per fund basis than funds within smaller fund complexes, due to economies of scale in allocating costs among a group of users.

704 Specifically, a fund would be required to establish policies and procedures relating to: (i) classification and ongoing review of the classification of the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset) (proposed rule 22e-4(b)(2)(i)-(ii)); (ii) assessment and ongoing review of the fund's liquidity risk (proposed rule 22e-4(b)(2)(iii)); (iii) determination and periodic review of the adequacy of the fund's three-day liquid asset minimum (proposed rule 22e-4(b)(2)(iv)(A)-(B)); (iv) the requirement for the fund not to acquire any less liquid asset if, immediately after the acquisition, the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets (proposed rule 22e-4(b)(2)(iv)(C)); (v) the requirement for the fund not to acquire any 15% standard asset if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in 15% standard assets (proposed rule 22e-4(b)(2)(iv)(D)); and (vi) the requirement to establish policies and procedures regarding redemptions in kind, to the extent that the fund engages in or reserves the right to engage in redemptions in kind (proposed rule 22e-4(b)(2)(iv)(E)).

elements (including classifying the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset) in a portfolio asset pursuant to proposed rule 22e-4(b)(2)(i)), as well as the recordkeeping requirements of the proposed rule; (iv) preparing training materials and administering training sessions for staff in affected areas; and (v) board approval of the program. We anticipate that if there is demand to develop policies and procedures relating to each of the required program elements, third parties may develop programs that fund complexes could purchase for less than our estimated cost to develop the programs themselves. Indeed, we understand that third parties have already developed programs to classify the liquidity of portfolio assets, which are currently available for purchase.[705] Because the proposed requirement for a fund to limit acquisition of 15% standard assets under certain circumstances is similar to existing Commission guidelines, we assume that a fund complex would incur minimal costs associated with implementing the proposed requirement to limit acquisition of 15% standard assets with respect to each of its respective funds.[706]

We anticipate that, depending on the personnel (and/or third party service providers) involved with respect to the activities associated with establishing and implementing a liquidity risk management program, certain of the estimated one-time costs could be borne by the fund, and others could be borne by the fund's adviser. This cost allocation would be dependent on the facts and circumstances of a particular fund's liquidity risk management program, and thus we cannot specify the extent to which the estimated costs would typically be allocated to the fund as

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705 *See* text accompanying *supra* note 205 (discussing proposed Commission guidance on a fund's use of third-party service providers to obtain data to inform or supplement its consideration of the proposed liquidity classification factors).

We understand, based on staff outreach, that annual costs to subscribe to the liquidity classification services provided by third-party data and analytics providers currently range from $50,000 - $500,000.

706 *See supra* section III.C.4.a.

opposed to the adviser. Estimated costs that are allocated to the fund would be borne by fund shareholders in the form of fund operating expenses.

Staff estimates that each fund complex would incur ongoing program-related costs, as a result of proposed rule 22e-4, that range from 10% to 25% of the one-time costs necessary to establish and implement a liquidity risk management program.[707] Thus, staff estimates that a fund complex would incur ongoing annual costs associated with proposed rule 22e-4 that would range from $130,000 to $562,500.[708] These costs are attributable to the following activities, as applicable to each of the funds within the complex: (i) classification and ongoing review of the classification of the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset) (proposed rule 22e-4(b)(2)(i)-(ii)); (ii) ongoing review of the fund's liquidity risk (proposed rule 22e-4(b)(2)(iii)); (iii) periodic review of the adequacy of the fund's three-day liquid asset minimum (proposed rule 22e-4(b)(2)(iv)(B)); (iv) systems maintenance; (v) additional staff training; (vi) approval by the board of any material change to the fund's liquidity risk management program (including a change to the fund's three-day liquid asset minimum) (proposed rule 22e-4(b)(3)(i)); (vii) periodic reports to the board of directors reviewing the adequacy of the fund's three-day liquid asset minimum (proposed rule

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707 These cost estimates are based in part on the staff's recent estimates of the ongoing costs associated with implementing the fees and gates provisions of the 2014 amendments to rule 2a-7 under the 1940 Act. *See supra* note 702 (discussing why staff believes that the costs associated with the fees and gates provisions could be useful to estimate the costs associated with proposed rule 22e-4). In estimating the ongoing costs associated with proposed rule 22e-4, staff has adjusted the ongoing costs associated with implementing the fees and gates provisions to reflect that we anticipate that the costs associated with classifying the liquidity of a fund's portfolio positions would entail the majority of the ongoing costs associated with proposed rule 22e-4. Staff estimates that these costs, in conjunction with other ongoing costs, would exceed the estimated ongoing costs associated with the fees and gates provisions, and thus staff has adjusted these estimates upward (based in part on staff knowledge of costs associated with liquidity analyses prepared by third-party service providers, as well as knowledge of the costs associated with board approval to the extent that a fund's board were required to approve a modified three-day liquid asset minimum).

708 This estimate is based on the following calculations: 0.10 x $1,300,000 = $130,000; 0.25 x $2,250,000 = $562,500.

22e-4(b)(3)(ii)); and (viii) recordkeeping relating to the fund's liquidity risk management program (proposed rule 22e-4(c)).[709]

For purposes of this analysis, Commission staff estimates, based on outreach conducted with a variety of funds regarding funds' current liquidity risk management practices, that approximately 1/3 of currently-operational fund complexes (or 289 complexes[710]) would incur one-time and ongoing costs on the high end of the range of costs associated with establishing and implementing a liquidity risk management program, and 2/3 of currently-operational fund complexes (or 578 complexes[711]) would incur one-time and ongoing costs on the low end of the

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709 We anticipate that, depending on the personnel (and/or third party service providers) involved in the activities associated with administering a liquidity risk management program, certain of the estimated ongoing costs associated with these activities could be borne by the fund, and others could be borne by the adviser. *See* paragraph following *supra* note 706.

710 In developing the estimate that 289 fund complexes would incur one-time and ongoing costs on the high end of the range of costs associated with establishing and implementing a liquidity risk management program, the staff assumed that that fund complexes that include investment grade bond funds, high yield bond funds, world bond funds (including emerging market bond funds), multi-sector bond funds, state municipal funds, alternative strategy funds, and emerging market equity funds, as well as ETFs with any of these strategies, would incur costs on the high end of the range, and all other complexes would incur costs on the low end of the range. The staff assumed that the percentage of fund complexes that includes these selected investment strategies, as a fraction of all fund complexes, is the same as the percentage of all mutual funds (excluding money market funds) and ETFs that these strategies represent. The actual number of fund complexes that includes these selected strategies could be higher or lower than the number calculated using this assumption.

605 investment grade bond mutual funds + 241 high yield bond mutual funds + 347 world bond mutual funds + 139 multi-sector bond mutual funds + 322 state municipal mutual funds + 376 alternative strategy funds that are equity funds (alternative strategy funds that are bond funds are included in our estimates of the number of bond mutual funds) + 469 emerging market equity mutual funds + 264 bond ETFs + 165 emerging market ETFs = 2,928 funds. 2,928 funds ÷ 8,734 open-end funds (excluding money market funds, and including ETFs) = approximately 33% = approximately 1/3. 1/3 x 867 currently-operational fund complexes = 289 fund complexes. These estimates are based on figures included in the 2015 ICI Fact Book. See 2015 ICI Fact Book, supra note 3, at Fig. 1.8.

711 In developing the estimate that 578 fund complexes would incur one-time and ongoing costs on the high end of the range of costs associated with establishing and implementing a liquidity risk management program, the staff assumed that that fund complexes that include investment grade bond funds, high yield bond funds, world bond funds (including emerging market bond funds), multi-sector bond funds, state municipal funds, alternative strategy funds, and emerging market equity funds, as well as ETFs with any of these strategies, would incur costs on the high end of the range, and all other complexes would incur costs on the low end of the range. The staff assumed that the percentage of fund complexes that includes these selected investment strategies, as a fraction of all fund complexes, is the same as the percentage of all mutual funds (excluding money market funds) and ETFs that these strategies represent. The actual number of fund complexes that includes these selected strategies could be higher or lower than the number

range. Based on these estimates, staff further estimates that the total aggregate one-time costs for all funds to establish and implement a liquidity risk management program would be approximately $1.4 billion.[712] In addition, staff estimates that the aggregate annual costs associated with the liquidity risk management program requirement would be approximately $240 million.[713]

Certain elements of the program requirement may entail marked variability in related compliance costs, depending on a fund's particular circumstances and sources of potential liquidity risk. The process of classifying the liquidity of each of a fund's positions in a portfolio asset, taking into account the factors specified under proposed rule 22e-4(b)(2)(ii), could give rise to varying costs depending on the fund's particular investment strategy. For example, a U.S. large cap equity fund would likely incur relatively few costs to obtain the data necessary to consider the required factors. On the other hand, a fund that invests in assets for which relevant market, trading, and other liquidity-relevant data is less readily available would incur relatively greater costs associated with the classification, and ongoing review of the classification, of the funds' portfolio positions' liquidity. Certain of the factors that a fund would be required to consider in assessing its liquidity risk also could entail relatively greater costs, depending on the fund's circumstances. For instance, a fund with a relatively short operating history could incur

calculated using this assumption.

8,734 open-end funds (excluding money market funds, and including ETFs) - 2,928 funds (see supra note 710) = 5,806 funds. 5,806 funds ÷ 8,734 open-end funds (excluding money market funds, and including ETFs) = approximately 66% = approximately 2/3. 2/3 x 867 currently-operational fund complexes = 578 fund complexes. These estimates are based on figures included in the 2015 ICI Fact Book. See 2015 ICI Fact Book, supra note 3, at Fig. 1.8.

712 This estimate is based on the following calculation: (578 fund complexes x $1,300,000 = $751,400,000) + (289 fund complexes x $2,250,000 = $650,250,000) = $1,401,165,000.

713 This estimate is based on the following calculation: (578 fund complexes x $130,000 = $75,140,000) + (289 fund complexes x $562,500 = $162,562,500) = $237,702,500.

greater costs in assessing the fund's cash flow projections than a similarly situated fund with a relatively long operating history. This is because the newer fund could find it appropriate to assess redemption activity in similar funds during normal and stressed periods (to predict its future cash flow patterns), which could entail additional costs to gather and analyze relevant data about these comparison funds. Also, a fund whose shares are held largely through omnibus accounts may wish to periodically request shareholder information from financial intermediaries in order to determine how the fund's ownership concentration may affect its cash flow projections. These data requests, and related analyses, could cause a fund to incur costs that another fund, whose shares are largely held directly, would not. A fund that deems it appropriate to establish and implement additional liquidity risk management policies and procedures beyond those specifically required under the proposed rule also would incur additional related costs. While we recognize that, as described above, the costs to establish and implement a liquidity risk management program in compliance with proposed rule 22e-4 will depend to some degree on the level of liquidity risk facing the fund, we are unable to discuss in detail all of the ways in which a fund's individual risks and circumstances could affect the costs associated with establishing a liquidity risk management program.

A fund may incur costs if it decides to reallocate portfolio assets to correspond with its initial or subsequently modified three-day liquid asset minimum. While we are unable to anticipate how many funds may reallocate portfolio assets in this way, or the extent of such reallocation by any fund that does so, we anticipate that the transaction-related costs of any such reallocation will not be significant for most funds. This is because some funds may not need to reallocate portfolio assets at all to correspond with their three-day liquid asset minimum, and those that decide to do so would be able to gradually adjust their portfolios in order to buy and sell portfolio positions during times that are financially advantageous. We note that the three-day liquid asset minimum requirement would limit the *acquisition* of less liquid assets when such acquisition would result in a fund investing less than its three-day liquid asset minimum in three-day liquid assets, but would not require funds always to maintain a certain portion of their portfolio assets in three-day liquid assets.[714] Thus, while a fund may decide to reallocate its portfolio to correspond with its three-day liquid asset minimum by the time of the proposed compliance date or at any time the fund determined to modify the three-day liquid asset minimum, a fund would not be required to conduct transactions in portfolio assets in any particular timeframe, so long as it were to limit its acquisition of less liquid assets in compliance with its three-day liquid asset minimum. If a fund wishes to reallocate its portfolio by the proposed compliance date, we anticipate that the proposed compliance date would provide sufficient time to do so with relatively few associated transaction costs. We request comment on this point in section III.H above. Along with the transaction-related costs associated with any portfolio reallocation, we recognize that this reallocation in turn could affect the performance and/or risk profiles of funds that modify their composition, which in turn could result in costs associated with decreased investment options available to investors and any changes to the market for relatively less liquid assets; these costs are discussed below.[715]

Potential for Decreased Investment Options and Adverse Effects

Under the proposed rule, a fund would be required to determine its three-day liquid asset minimum based on a consideration of certain specified factors relating to the fund's liquidity

714 *See supra* notes 346-348 and accompanying text.

715 *See infra* paragraphs accompanying notes 716-717.

risk.[716] Because a fund is currently not required to consider any particular factors relating to its portfolio liquidity, we recognize that this requirement could result in a fund newly determining its existing portfolio liquidity profile given the fund's liquidity needs. This could lead a fund to modify its portfolio composition if it determines that the three-day liquid asset minimum that it should hold, as a result of its liquidity risk assessment, does not correspond with the fund's current portfolio composition. The proposed rule thus could result in certain funds increasing their investments in relatively more liquid assets, which in turn could affect the performance and/or risk profiles of funds that modify their portfolio composition in this way. This impact may be particularly strong for funds that plan to meet redemptions within seven days after receiving them (rather than a shorter period of time). Such modifications to funds' portfolio composition consequently could decrease certain investment options available to investors or reduce investor returns. However, because these portfolio composition shifts would occur only if a fund were to determine that it needs to adjust its existing liquidity level based on consideration of the factors in the proposed rule, we anticipate that the potential for decreased yield would likely only affect funds currently holding portfolios whose liquidity levels have the potential to create redemption-related liquidity risk for fund investors. Thus, the potential for decreased investment options for certain investors (and any related decrease in investment yield) has the corollary benefit of potential decreased liquidity risk in the funds in which these investors hold shares. Currently we are not able to quantify the number of funds that would need to significantly modify their portfolios' risk profile as a result of the proposed rule because of the lack of information necessary to provide a reasonable estimate. Such an estimate would depend on the number of funds that might need to modify their current portfolio composition as a result

716 Proposed rule 22e-4(b)(2)(iv)(A).

of the proposed rule, as well as the availability of relatively liquid assets that can act as adequate substitutes to existing assets for those affected funds. Because funds are not required to report or disclose information concerning the liquidity of their assets, because we cannot anticipate the three-day liquid asset minimum that each fund would determine to be appropriate based on its liquidity risk, and because we cannot determine what relatively more liquid assets funds would purchase as substitutes, we are unable to quantify the total potential costs discussed in this section. However, individual funds would only incur these costs if their current portfolio construction lacks sufficient liquidity to allow the offering of daily redemption without creating significant negative impact on investors.

Market for Relatively Less Liquid Assets

As discussed above, the proposed rule could result in certain funds increasing their investments in relatively more liquid assets, which would effectively mean that these funds would decrease their investments in relatively less liquid assets. If funds decrease their investments in relatively less liquid assets, the market for those assets could become even less liquid. This could discourage new issuances of similar assets and decrease the liquidity of relatively less liquid assets that are still outstanding. The impact of decreased activity from funds in less liquid markets will depend on how much current activity in those markets is driven by the funds, which varies between markets. Further, these market effects could be partially offset if other opportunistic investors with greater capacity to hold less liquid assets are attracted to the market by any lower prices for these assets that result if funds decrease their holdings of less liquid assets.[717] In addition, if the proposed rule leads funds to better assess the liquidity risk

[717] Relatively less liquid assets have a higher expected return compared to relatively more liquid assets, thereby compensating longer-term investors for holding relatively less liquid assets. *See* Yakov Amihud & Haim Mendelson, *Asset Pricing and the Bid-Ask Spread*, 17 J. FIN. ECON. 223 (1986).

associated with certain asset holdings, any decrease in the prices of these assets could reflect more efficient pricing of the assets (that is, risk would be better reflected in asset prices than it is currently). Because funds currently are not required to report or disclose information concerning the liquidity of their assets, and because we cannot anticipate the three-day liquid asset minimum that each fund would determine to be appropriate based on its liquidity risk, it is difficult to predict the extent to which the proposed rule could lead funds to modify their portfolio holdings, or whether such modifications would discourage the issuance of certain assets. As a result, we cannot quantify the potential costs discussed in this section. However, these costs will only exist to the extent that some funds lack sufficient liquidity in their current portfolio to allow the offering of daily redemption without creating significant negative impact on investors.

d. Effects on Efficiency, Competition, and Capital Formation

The proposed liquidity risk management program requirement would require a fund to assess its liquidity risk and to determine its three-day liquid asset minimum based on this risk assessment. We believe that the proposed requirements would improve the alignment between fund portfolio liquidity and fund liquidity needs. This improved alignment could enhance funds' ability to meet redemptions in a manner that mitigates potential dilution of shareholders' interests, and thus this improved alignment could be viewed as increasing efficiency to the extent that dilution is viewed as a drag on the ability of a fund's NAV to reflect the performance of its portfolio. Additionally, the requirement for a fund to classify the liquidity of its portfolio assets (along with the related reporting and disclosure requirements, discussed below) also could increase allocative efficiency by assisting investors in making investment choices that better match their risk tolerances.

By enhancing funds' liquidity risk assessment and risk management, the proposed program requirement also could promote pricing efficiency in the sense that it would decrease the likelihood that a fund would be forced to sell portfolio assets under unfavorable circumstances in order to meet redemptions (thus creating significant negative price pressure on those assets) without materially affecting the fund's NAV or risk profile. If a fund's asset sales were to temporarily move asset prices away from their market value, this could create a temporary pricing inefficiency. By decreasing the likelihood that these types of price movements would occur, the program requirement could decrease pricing inefficiency. However, the proposed program requirement could negatively affect the efficient pricing of relatively less liquid assets if it indirectly discourages funds from investing in them (for example, if a fund were to decrease its investments in less liquid assets if it determines that the three-day liquid asset minimum that it should hold, as a result of its liquidity risk assessment, does not correspond with the fund's current portfolio composition). But as discussed above, this market effect could be partially offset if other investors are incentivized to buy relatively less liquid assets on account of any lower prices for these assets that result if funds decrease their holdings of these assets.[718] Alternatively, any price decreases experienced as a result of decreased mutual fund investment could be considered efficient price adjustments given the reduction in liquidity of the assets.

If the proposed liquidity risk management program requirement results in a material decrease in funds' investment in relatively less liquid assets, competition for these assets would be negatively affected. Under this scenario, the relatively less liquid assets in which funds formerly would have invested may become even less liquid, since the number of current or potential market participants would be reduced. This decrease in competition may be partially offset if some other investors become willing to invest in relatively less liquid assets because of

[718] *See supra* section IV.C.1.c.

the larger illiquidity discount now associated with the price of those assets. As a corollary, if the proposed liquidity risk management program requirement results in a material increase in funds' investment in three-day liquid assets, competition for these assets would be positively affected. As funds increase their investment in relatively more liquid assets, the liquidity of those assets should increase. However, that increase may be partially offset if some other investors decrease their investment in relatively more liquid assets because of the larger liquidity premium now associated with the price of those assets.

The size of a fund, or the family of funds to which a fund belongs, could have certain competitive effects with respect to the fund's implementation of its liquidity risk management program. If there are economies of scale in creating and administrating multiple liquidity risk management programs, funds in large families would have a competitive advantage. For a fund in a smaller complex, however, a greater portion of the fund's (and/or adviser's[719]) resources may be needed to create and administer a liquidity risk management program, which may increase barriers to entry in the fund industry, and lead to an adverse effect on competition. The size of a fund family also could produce competitive advantages or disadvantages with respect to a fund's use of products developed by third parties to classify the liquidity of their portfolio assets, or to assess the fund's liquidity risk. Funds in a large complex also could receive relatively more favorable pricing for third-party liquidity risk management tools, if the fund complex were to purchase discounted bulk services from the developer or receive relationship-based pricing discounts. To the extent that they choose to use liquidity risk management tools such as committed lines of credit and interfund lending,[720] funds in larger complexes likewise could

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719 *See* paragraph following *supra* note 706.

720 *See supra* section III.C.5.a (discussing and providing guidance on the use of these tools).

receive more favorable rates on committed lines of credit than funds in smaller complexes, and could have opportunities to establish interfund lending agreements that may not be available to funds in smaller complexes.

Any changes in certain assets' or asset classes' liquidity that could indirectly result from the proposed liquidity risk management program requirement (for example, as discussed above, if the number of buyers and sellers for certain assets becomes significantly reduced as a result of the program requirement) could also affect capital formation among issuers of these assets. Some firms could be discouraged from issuing new securities in particular asset classes because of price discounts associated with lower liquidity. Or if changes in liquidity are not equal across all asset classes, firms may begin to shift their capital structure (*e.g.*, begin to issue equity instead of debt) or to change the terms of certain securities that they issue in order to increase their liquidity (*e.g.*, by standardizing the terms of certain debt securities, or modifying the securities' terms to promote electronic trading).

e. Reasonable Alternatives

In formulating our proposal, we have considered various alternatives to the individual elements of proposed rule 22e-4. Those alternatives are outlined above in the sections discussing the proposed rule elements, and we have requested comment on these alternatives.[721] The following discussion addresses significant alternatives to proposed rule 22e-4, which involve broader issues than the more granular alternatives to the individual rule elements discussed above.

721 *See supra* sections III.A.3, III.B.1.b, III.B.2.j, III.B.3.b, III.C.1.e, III.C.2.b, III.C.3.d, III.C.4.b, III.C.5.e, III.D.4, III.E.

Instead of proposing rule 22e-4, we could issue guidance surrounding the classification of portfolio assets' liquidity and the assessment and management of liquidity risk. However, on account of the significant diversity in liquidity risk management practices that we have observed in the fund industry, we believe that the need exists for an enhanced comprehensive baseline requirement instead of only guidance for fund liquidity risk management. Also, an approach that involves rulemaking, as opposed to merely guidance, would permit us to examine registrants' compliance with the requirements and bring enforcement actions relating to non-compliance and hence make it more likely that the benefits discussed above would be realized.

We considered proposing liquidity requirements similar to those imposed on money market funds—that is, the requirement to hold a minimum level of highly liquid asset holdings, and the ability to impose redemption fees and gates.[722] The requirements imposed on money market funds, and the tools available to these funds to manage heavy redemptions, are specifically tailored to the assets held by money market funds and the behavior of money market fund investors.[723] Imposing similar regulatory requirements on funds that are not money market funds would ignore significant differences between money market funds and other funds. We discuss below why we decided not to propose that funds hold a minimum level of highly liquid asset holdings (similar to the portfolio liquidity requirements applicable to money market funds). While funds are currently permitted under rule 22c-2 to impose redemption fees under certain circumstances, we understand based on fund outreach that funds are generally moving away from the use of fees to manage short-term trading risk, and we are not proposing that the use of fees be expanded in light of this, as well as the potential operational complexity that could

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722 *See supra* notes 154-155 and accompanying text.

723 *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section II.

accompany the use of fees.[724] We are not proposing that funds be permitted to impose redemption gates because funds that are not money market funds have not demonstrated the same risk of significant redemptions during times of market stress that money market funds may face, and which redemption gates are meant to prevent in money market funds. For example, while there is some evidence of a first-mover advantage among money market funds during the financial crisis, there is currently no matching evidence of first-mover advantage among funds that are not money market funds.[725]

The Commission considered, but ultimately decided against, proposing to exclude certain types of funds from proposed rule 22e-4. For example, the proposed rule could have carved out exemptions for funds with investment strategies that historically have entailed relatively little liquidity risk, or funds with relatively low assets. We are not proposing to exclude any subset of open-end funds, other than money market funds, from the scope of the proposed rule. As discussed above, even funds with investment strategies that historically have involved little liquidity risk could experience liquidity stresses in certain environments.[726] And investors in small funds could suffer from insufficient liquidity risk management just as investors in larger funds could. Indeed, staff analysis suggests that funds with relatively low total assets can experience greater flow volatility, including more volatility in unexpected flows, than funds with higher assets, which could indicate increased liquidity risk.[727] The proposed program requirement is meant to permit a fund to customize and calibrate its liquidity risk management

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724 *See infra* paragraph accompanying note 777 for a discussion of why we are proposing swing pricing, instead of a framework involving purchase fees or redemption fees, to address potential dilution of existing shareholder interests when a fund encounters significant net purchases or net redemptions and for a discussion of the operational differences between swing pricing and purchase and redemption fees.

725 *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.1.

726 *See supra* notes 123-125 and accompanying text.

727 DERA Study, *supra* note 39, at pp. 16-24.

program to reflect the liquidity risks that it typically faces (and that it could face in stressed market conditions). This flexibility is meant to result in programs whose scope, and related costs and burdens, are appropriate to manage the actual liquidity risks facing a particular fund.

We considered multiple alternatives to the proposed requirements regarding a fund's classification of the liquidity of its portfolio assets. Under proposed rule 22e-4, a fund would be required to classify and review the liquidity of each of the fund's positions in a portfolio asset (or a portion of a fund's position in a portfolio asset) based on the number of days within which a fund's position in a particular portfolio asset could be converted to cash at a price that does not materially affect the value of that asset assessed immediately prior to sale, and considering certain specified factors.[728] Instead of these proposed requirements, we could have codified a definition of illiquid asset that reflects the current 15% guideline. Because we believe most funds generally adhere to the 15% guideline, this approach would have had the benefit of already being accepted and understood by the industry, and would have entailed few additional implementation costs for funds. However, we understand, based on staff outreach, that the 15% guideline has generally caused funds to limit their exposures to particular types of securities that generally cannot be sold or sold quickly and that the Commission and staff have indicated are often illiquid, depending on the facts and circumstances. We also understand that it is not uncommon for a fund to consider very few (or none) of its portfolio assets to be 15% guideline assets. Given the parameters of the 15% guideline, we also do not believe that this approach would require the typical fund to consider the liquidity characteristics of a significant percentage of its portfolio.[729] Thus, this approach alone would not have provided as comprehensive a view

728 *See* rule 22e-4(b)(2)(i)-(ii).

729 *See supra* section III.C.4.

of the relative liquidity of portfolio assets as our proposed approach, or strengthen funds' ability to meet redemption obligations and mitigate dilution of the interests of shareholders.

Instead of proposing an approach whereby a fund would be required to assign each portfolio position to one of several liquidity categories, we could have proposed a classification framework under which a fund would simply be required to classify a portfolio position as "liquid" or "illiquid," based on a number of specified factors. As discussed above, Commission staff has found, based on outreach to a variety of funds, that funds with relatively comprehensive liquidity classification procedures tend to view the liquidity of their portfolio positions in terms of a liquidity spectrum rather than simply as wholly liquid or wholly illiquid. This "spectrum"-based approach to liquidity can greatly facilitate a fund's portfolio manager in engaging in portfolio construction that takes into account potential varying liquidity needs of the fund over time. Our proposed approach to liquidity classification reflects our understanding that funds commonly evaluate assets' liquidity across such a liquidity spectrum, as opposed to making a binary determination of whether an asset is liquid or illiquid. It also more accurately conveys to investors that liquidity tends to be a matter of degree.

We also considered several alternatives to the proposed requirement for each fund to determine its three-day liquid asset minimum and limit its acquisition of less liquid assets in contravention of that minimum. We instead could have proposed that each fund be required to determine a minimum buffer level of cash (or cash equivalents) that it would hold, or alternatively, to determine a minimum level of one-day liquid asset holdings. The cash buffer alternative would help ensure that a fund would be able to meet redemptions immediately, without the need to sell any portfolio assets. Likewise, a one-day liquid asset minimum requirement would help ensure that a fund would be able to meet redemptions within a very quick period, and could encourage a fund to hold a comparatively more liquid portfolio than the proposed three-day liquid asset minimum. But we believe that these options have a number of disadvantages. Namely, these options would not necessarily match a fund's liquidity needs with its redemption obligations, and could result in a fund being underinvested in assets that reflect the fund's investment strategy (and concurrent risks and performance potential).[730] We considered proposing a "seven-day liquid asset minimum" requirement—that is, requiring a fund to invest in a certain amount of assets that could be converted to cash within seven calendar days or less—which would correspond with a fund's redemption obligations under section 22(e) of the Act. However, we were concerned that a seven-day liquid asset minimum would not provide sufficient minimum liquidity given the regulatory requirements and disclosures that require most funds to meet redemptions obligations in shorter time periods and market practices that effectively require all funds to meet redemption requests within time periods shorter than seven calendar days.

We also considered proposing to require a standard level of three-day liquid asset minimum holdings for all funds. This alternative approach would have the advantage of being simple for investors to understand and our examination staff to verify. However, this alternative fails to account for notable differences between funds with respect to investment strategy, fund flow patterns, and other characteristics that contribute to funds' liquidity risk, which in turn would make it reasonable for funds' portfolios to have varying liquidity profiles. We believe that the proposed three-day liquid asset minimum requirement would promote consistency in funds' consideration of the factors relevant to their liquidity risk management, while also

[730] We note above that if a fund's redemption practices require it to pay redeeming shareholders within a period shorter than three business days, we expect the fund would consider whether a specified portion of its three-day liquid asset minimum should consist of portfolio positions that are convertible to cash within a period shorter than three business days.

permitting flexibility in implementation, which we believe is appropriate in light of the significant diversity within the fund industry. This approach includes elements that would help our staff to ascertain that funds are indeed considering the required factors: each fund would be required to maintain a written record of how its three-day liquid asset minimum was determined, as well as copies of materials submitted to the fund's board in connection with the board's approval of the three-day liquid asset minimum and reports provided to the board that review the adequacy of the fund's three-day liquid asset minimum.[731] And as discussed above, although a fund would be permitted to determine its own three-day liquid asset minimum under the proposed rule, we believe that the requirement for a fund to consider certain specified factors in determining its three-day liquid asset minimum would likely preclude a fund from concluding that zero holdings of three-day liquid assets would be appropriate.[732]

Instead of requiring funds to determine and invest their assets in compliance with a three-day liquid asset minimum, we could require funds to conduct stress tests of their own design relating to the extent the fund has liquid assets to cover possible levels of redemptions. This would have the benefit of permitting a fund flexibility in determining whether its portfolio liquidity profile is appropriate given its liquidity needs. Also, since the three-day liquid asset minimum requirement implicitly also involves the requirement for a fund to classify its portfolio assets' liquidity in a particular manner (since compliance with a fund's three-day liquid asset minimum would require knowing which assets are three-day liquid assets), not requiring funds to determine a three-day liquid asset minimum would permit a fund to not incur the costs associated with the proposed liquidity classification requirements. As discussed above, some funds already

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731 *See* proposed rule 22e-4(c)(2)-(3).

732 *See supra* section III.C.3.a.

conduct stress testing incorporating the factors that a fund would be required to consider in assessing their liquidity risk and determining their three-day liquid asset minimum based on this assessment.[733] But, because the quality and comprehensiveness of funds' liquidity risk management currently varies significantly, we believe that requiring a certain set of factors to be considered in assessing and managing liquidity risk (including determining the fund's three-day liquid asset minimum) is important in reducing the risk that funds will be unable to meet their redemption obligations under the Investment Company Act and elevating the overall quality of liquidity risk management across the fund industry. Also, we believe that it would be difficult to determine, depending on the level of discretion a fund would have in developing stress scenarios, whether these scenarios would accurately depict liquidity risk and lead funds to determine the appropriate level of portfolio liquidity they should hold. For example, if a fund's liquidity needs were generally high during normal periods, but were not correspondingly extreme during stress events, basing this fund's portfolio liquidity on the results of stress testing alone could cause a fund to hold too little liquidity during non-stressed periods. Therefore we do not believe that a general stress testing requirement would be an adequate substitute for the three-day liquid asset minimum requirement.[734]

Finally, we considered proposing a liquidity risk management program requirement that would not incorporate a three-day liquid asset minimum requirement (or one of the alternatives to this requirement discussed in the preceding paragraphs). Under this alternative, a fund would be required to adopt and implement a liquidity risk management program, which would include

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733 *See supra* note 257 and accompanying text.

734 We do note, however, that section 165(i)(2) of the Dodd-Frank Act obligates the Commission to specify certain stress testing requirements for certain large non-bank financial companies we regulate, including investment companies. *See supra note* 104 and accompanying text regarding initiatives to address the impact of open-end fund investment activities on investors and the financial markets.

the proposed requirements regarding a fund's classification of the liquidity of its portfolio assets (and related reporting and disclosure regarding its portfolio assets' liquidity) and the proposed requirements limiting investments in 15% standard assets, but a fund would not be required to establish a minimum level of three-day liquid assets. This alternative would have the benefit of permitting funds to have a large amount of flexibility in managing their liquidity risk. Although a fund would need to ensure that it is able to meet its redemption obligations and would be subject to the proposed limitations on investments in 15% standard assets, it would be subject to no other requirements regarding its portfolio liquidity. This would provide flexibility, for example, for a fund to adjust its liquidity profile very quickly in light of changing market conditions, whereas a fund subject to the three-day liquid asset minimum requirement might not be able to do so as quickly, to the extent the fund's board would be required to approve a change in the fund's three-day liquid asset minimum. It also would permit a fund to calibrate portfolio liquidity based on the factors the fund or its adviser considers appropriate, instead of the factors that the proposed rule would require a fund to consider in determining its three-day liquid asset minimum. To the extent that a fund's portfolio liquidity was not in line with investors' risk tolerances, investors could decide not to invest in the fund, based on information about the fund's portfolio liquidity reported on Form N-PORT.

We do not believe, however, that this alternative would adequately respond to primary goals of this rulemaking, that is, reducing the risks that funds will be unable to meet their redemption obligations and reducing potential dilution of non-redeeming shareholders. We believe that the three-day liquid asset minimum requirement is a critical element of the proposed liquidity risk management program requirement that is designed to provide investors with increased protections regarding how fund portfolio liquidity is managed. As discussed above, we believe that the proposed three-day liquid asset minimum requirement would result in a portfolio liquidity standard that fosters consistency in funds' consideration of the factors relevant to their liquidity risk management, while simultaneously permitting flexibility in implementation.[735] While the board approval requirement associated with the three-day liquid asset minimum could add a layer of process if a fund wished to change its liquidity profile, we believe that this requirement is necessary because it would add independent oversight over funds' liquidity risk management.[736] Although we believe that reporting and disclosure regarding a fund's portfolio liquidity are important, we do not believe that they would be sufficient to promote a high quality of liquidity risk management across the fund industry because they would not necessarily require a fund to consider its portfolio liquidity in relation to its liquidity needs.

2. *Swing Pricing*

a. Requirements of Proposed Rule 22c-1(a)(3)

Under proposed rule 22c-1(a)(3), a fund (with the exception of a money market fund or ETF) would be permitted to establish and implement swing pricing policies and procedures that would, under certain circumstances, require the fund to use swing pricing to adjust its current NAV as an additional tool to lessen potential dilution of the value of outstanding redeemable securities caused by shareholder purchase or redemption activity. In order to use swing pricing under the proposed rule, a fund would be required to establish and implement swing pricing policies and procedures.[737] These policies and procedures must: (i) provide that the fund will adjust its NAV by an amount designated as the "swing factor" once the level of net purchases or net redemptions from the fund has exceeded a specified percentage of the fund's net asset value

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735 *See supra* section III.C.3.

736 *See supra* section III.D.1.

737 Proposed rule 22c-1(a)(3)(i).

known as the "swing threshold";[738] (ii) specify the fund's swing threshold, considering certain specified factors;[739] (iii) provide for the periodic review (at least annually) of the fund's swing threshold, considering certain specified factors;[740] (iv) specify how a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached, which determination must take into account certain specified factors.[741]

A fund's board, including a majority of the fund's independent directors, would be required to approve the fund's swing pricing policies and procedures (including the fund's swing threshold, and any swing factor upper limit specified under the fund's swing pricing policies and procedures), and any material change to these policies and procedures.[742] However, the board would be required to designate the fund's investment adviser or officers responsible for administration of the fund's swing pricing policies and procedures and for determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached.[743]

A fund that adopts swing pricing policies and procedures also would be required to keep certain records, including a written copy of its swing pricing policies and procedures,[744] and records of support for each computation of an adjustment to the fund's NAV based on these

738 Proposed rule 22c-1(a)(3)(i)(A).

739 Proposed rule 22c-1(a)(3)(i)(B).

740 Proposed rule 22c-1(a)(3)(i)(C).

741 Proposed rule 22c-1(a)(3)(i)(D).

742 Proposed rule 22c-1(a)(3)(ii)(A).

743 Proposed rule 22c-1(a)(3)(ii)(B).

744 Proposed rule 22c-1(a)(3)(iii).

policies and procedures.[745] A fund that engages in swing pricing would be required to make certain disclosures and reflect its use of swing pricing in its financial statements.[746]

b. Benefits

We believe proposed rule 22c-1(a)(3) would promote investor protection by providing funds with a tool to reduce the potentially dilutive effects of shareholder purchase or redemption activity. Rule 22c-1 under the Investment Company Act, the "forward pricing" rule, requires a fund to price its shares based on the current market prices of its portfolio assets next computed after receipt of an order to buy or redeem shares.[747] When a fund trades portfolio assets in order to meet purchases or redemptions, the fund's current NAV on the trade date would reflect any changes to the value of the fund's assets that occurs as a result of trading on that day. But as discussed above, when a fund trades portfolio assets in order to satisfy purchase or redemption requests, certain costs associated with this trading activity currently may not be taken into account in the price that the purchasing or redeeming shareholder receives for his or her fund shares.[748] The NAV of the fund shares held by existing shareholders, however, will eventually reflect all of these costs, including those that were not passed on to the purchasing or redeeming shareholders.[749] Swing pricing provides funds with an additional tool—as a supplement to the pricing conventions required by the forward pricing rule—to pass estimated near-term costs stemming from shareholder purchase or redemption activity on to the shareholders associated

745 Proposed amendment to rule 31a-2(a)(2).

746 *See* proposed amendments to Items 11, 13 and 26 of Form N-1A and proposed amendments to Regulation S-X.

747 *See* rule 22c-1(a).

748 *See supra* notes 410-413 and accompanying text.

749 *See id.*

with that activity.[750] Swing pricing thus could lessen dilution of existing shareholders and limit redemptions motivated by a potential first-mover advantage.

We recognize that swing pricing may involve potential disadvantages to funds as well as potential advantages, and the provisions of proposed rule 22c-1(a)(3) are designed to maximize the relative advantages and respond to potential concerns associated with swing pricing. While swing pricing may reduce dilution at the fund level and could act as a deterrent against redemptions motivated by any first-mover advantage, the potential disadvantages to swing pricing (described in more detail below) include increased performance volatility and the fact that the precise impact of swing pricing on particular purchase or redemption requests would not be known in advance and thus may not be fully transparent to investors. In addition, the swing factor used by a fund on a particular day may not capture all costs incurred by the fund resulting from purchases or redemptions that day.

Commission rules and guidance do not currently address the ability of a fund to use swing pricing to mitigate potential dilution of fund shareholders, and the Commission's current valuation guidance could raise questions about making such NAV adjustment.[751] The proposed swing pricing rule would provide the regulatory framework that a fund would apply to adjust its NAV in order to effectively pass on estimated trading costs to purchasing or redeeming shareholders. The proposed rule would require a fund that conducts swing pricing to do so in accordance with policies and procedures and other restrictions designed to promote all shareholders' interests.[752] Because we cannot prospectively measure the extent to which the swing pricing policies and procedures that a fund may adopt would mitigate potential dilution,

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750 *See supra* paragraph accompanying note 424.

751 *See supra* note 423 and accompanying text.

752 *See supra* note 424 and accompanying text.

we are unable to quantify the total potential benefits discussed in this section.[753] However, analysis by fund groups of their funds domiciled in regions that allow swing pricing indicates that investor dilution is significantly reduced through swing pricing for some funds.[754]

c. Costs

A primary cost of implementing swing pricing is an increase in fund return volatility. The implementation of swing pricing also could increase tracking error relative to a fund's benchmark. However, the impact of swing pricing on volatility and tracking error would decrease as a function of time: for example, the impact of swing pricing on daily return volatility and tracking error would likely be much greater than the impact on monthly volatility and tracking error. The use of "partial" swing pricing also lessens the impact on volatility and tracking error. When deciding whether or not to implement swing pricing, a fund would have to weigh the cost of increased volatility and tracking error (along with the other costs discussed below) against the previously-discussed benefits of swing pricing.

In addition, a swing pricing regime that uses a fund's daily net purchases or net redemptions to determine when the fund will adjust its NAV could create costs for fund investors. For example, an investor who purchases fund shares on a day when a fund adjusts its NAV downward will pay less to enter the fund than if the fund had not adjusted its NAV on that day. However, investors would not be able to purposefully take advantage of this lower purchase price without knowledge of contemporaneous intraday flows, which funds do not publicly disclose. Further, we believe that investors who purchase shares on a day that a fund adjusts its NAV downward would not create dilution for non-redeeming shareholders.

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753 There is no database currently available that identifies whether a foreign-domiciled fund uses swing pricing or the structure of a fund's swing pricing program (*e.g.*, full swing pricing versus partial swing pricing).

754 *See* BlackRock Swing Pricing Paper, *supra* note 412.

Shareholders' purchase activity would provide liquidity to the fund, which could reduce the fund's liquidity costs and thereby could also decrease the swing factor. This could potentially help redeeming shareholders to receive a more favorable redemption price than they otherwise would have if there had been less purchase activity on that day, but would not affect the interests of non-redeeming investors. Similarly, adjusting a fund's NAV when the fund's daily net redemptions cross a certain threshold, regardless of the size of the component shareholder redemptions that comprise the daily net redemptions, could produce costs to individual redeeming shareholders whose redemptions alone would not result in redemption-related costs to the fund. For instance, a small investor's redemption request would not create any significant liquidity costs for the fund on its own, but if this investor were to redeem on the same day that the fund's net redemptions are high, his or her redemption proceeds would be reduced by the NAV adjustment.

We are not proposing to exempt certain investors from the NAV adjustments permitted under proposed rule 22c-1(a)(3). We believe that the costs of exempting certain investors from the NAV adjustment could be significant, particularly the operational costs that we believe could result from the relatively complex process of applying the NAV adjustment only to some investors and not to others. Exempting small investors from the NAV adjustment also may not be beneficial to a fund because such exemption could lead to large investors engaging in gaming behavior—that is, structuring their investments in funds using multiple small accounts—in order to use the exemption. This could contravene the purpose of the exemption and be costly for funds to detect.

Each fund that chooses to adopt swing pricing policies and procedures pursuant to proposed rule 22c-1(a)(3) would incur one-time costs to develop and implement the policies and procedures, as well as ongoing costs relating to administration of the policies and procedures. Those costs will directly impact the fund and may indirectly impact fund investors if the fund passes along its costs to investors through increased fees. As discussed above, while U.S. registered funds do not currently use swing pricing to mitigate potential dilution, certain foreign funds affiliated with U.S. fund families currently do use swing pricing.[755] U.S. registered funds in fund complexes that also include foreign-domiciled funds that use swing pricing may incur relatively lower costs to implement swing pricing policies and procedures pursuant to the proposed rule. These funds may only need to modify current swing pricing policies, procedures, and systems used for foreign-domiciled funds to comply with proposed rule 22c-1(a)(3), instead of developing them from scratch.

Just as the costs associated with proposed rule 22e-4 could depend largely on the level of liquidity risk facing the fund, as well as the sources of the fund's liquidity risk, the costs of implementing swing pricing policies and procedures likewise could vary depending on these factors. As discussed above, there are multiple ways in which the costs associated with classifying portfolio positions' liquidity and assessing a fund's liquidity risk could vary based on a fund's individual risks and circumstances.[756] To determine a fund's swing threshold, proposed rule 22c-1(a)(3) would require a fund to consider certain of the factors required to be considered as part of the liquidity risk assessment required under proposed rule 22e-4.[757] Therefore, the

755 *See supra* notes 417-420 and accompanying text.

756 *See supra* section IV.C.1.c.

757 *See* proposed rule 22c-1(a)(3)(i)(B). Specifically, the requirement for a fund to consider: (i) the size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods, (ii) the fund's investment strategy and the liquidity of the fund's portfolio assets, and (ii) the fund's holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources overlap with certain of the proposed liquidity risk assessment factors. *See* proposed rule 22e-4(b)(iii)(A), (B), and (D).

costs associated with developing policies and procedures for determining the swing threshold could also vary according to similar factors that could cause differences in the costs to funds associated with proposed rule 22e-4.[758]

Our staff estimates that the one-time costs necessary to establish and implement swing pricing policies and procedures pursuant to proposed rule 22c-1(a)(3) would range from $1.3 million to $2.25 million[759] per fund complex, depending on the particular facts and circumstances applicable to the funds comprising the fund complex.[760] These estimated costs are attributable to the following activities, as applicable to each of the funds within the complex that adopts swing

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758 *See supra* section IV.C.1.c.

759 These cost estimates are based in part on the staff's recent estimates of the one-time systems costs associated with implementing the fees and gates provisions of the 2014 amendments to rule 2a-7 under the 1940 Act. *See* 2014 Money Market Fund Reform Adopting Release, *supra* note 85, at section III.A.5.b. Although the substance and content of systems associated with establishing and implementing swing pricing policies and procedures would be different from the substance and content of systems associated with implementing the rule 2a-7 fees and gates provisions, the one-time costs associated with establishing and implementing swing pricing policies and procedures, like the one-time costs associated with the fees and gates provisions, would entail: drafting relevant procedures; planning, coding, testing, and installing relevant system modifications; integrating and implementing relevant procedures; and preparing training materials and administering training sessions for staff in affected areas. *See id.* However, in estimating the one-time costs associated with establishing and implementing swing pricing policies and procedures, staff has adjusted the estimated one-time systems costs associated with implementing the fees and gates provisions to reflect that the estimated costs associated with implementing the fees and gates provisions include costs to be incurred by the fund and others in the distribution chain (including transfer agents, accountants, custodians, and intermediaries), whose services would be needed if a fund were to impose a fee or gate, whereas we anticipate that the requirements associated with establishing and implementing swing pricing policies and procedures would be borne primarily by a fund complex and not by others in the distribution chain.

We note that the estimated one-time systems costs associated with implementing the fees and gates provisions of the 2014 amendments to rule 2a-7 are generally similar to the proposed estimated one-time systems costs associated with implementing the floating NAV provisions of the 2014 rule 2a-7 amendments. *See id.* at section III.B.8.a. However, the proposed estimated one-time systems costs associated with implementing the floating NAV provisions were adjusted downward at adoption, to account for certain tax considerations specific to the floating NAV reforms. Thus, staff believes that the one-time costs associated with the fees and gates provisions would provide a closer analogue to the estimated costs associated with establishing and implementing swing pricing policies and procedures than the one-time costs associated with the floating NAV provisions.

760 This estimate assumes that each fund would not bear all of the estimated costs (particularly, the costs of systems modification) on an individual basis, but instead that these costs would likely be allocated among the multiple users of the systems, that is, each of the members of a fund complex that adopts swing pricing policies and procedures.

pricing policies and procedures: (i) developing swing pricing policies and procedures that include all of the elements required under the proposed rule,[761] as well as policies and procedures relating to the recordkeeping requirements associated with swing pricing;[762] (ii) planning, coding, testing, and installing any system modifications for adjusting the fund's NAV pursuant to the fund's swing pricing policies and procedures; (iii) integrating and implementing the fund's swing pricing policies and procedures, as well as policies and procedures relating to the financial reporting and recordkeeping requirements associated with swing pricing; (iv) preparing training materials and administering training sessions for staff in affected areas; and (v) board approval of the fund's swing pricing policies and procedures.

We anticipate that, depending on the personnel (and/or third party service providers) involved in the activities associated with establishing and implementing swing pricing policies and procedures, certain of the estimated one-time costs associated with these activities could be borne by the fund, and others could be borne by the adviser. This cost allocation would depend on the facts and circumstances of a particular fund's swing pricing policies and procedures, and thus we cannot specify the extent to which the estimated costs would typically be allocated to the fund as opposed to the adviser. Estimated costs that are allocated to the fund would be borne by fund shareholders in the form of fund operating expenses.

Staff estimates that, on average, a fund complex that includes funds that adopt swing pricing policies and procedures pursuant to proposed rule 22c-1(a)(3) would incur ongoing annual costs that range from 5% to 15% of the one-time costs necessary to establish and

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[761] Proposed rule 22c-1(a)(3)(i).

[762] Proposed rule 22c-1(a)(3)(iii); proposed amendment to rule 31a-2(a)(2).

implement swing pricing policies and procedures pursuant to proposed rule 22c-1(a)(3).[763] Thus, staff estimates that a fund complex that includes funds that adopt swing pricing policies and procedures would incur ongoing annual costs associated with proposed rule 22c-1(a)(3) that would range from $65,000 to $337,500.[764] These estimated costs are attributable to the following activities, as applicable to each of the funds within the complex that adopts swing pricing policies and procedures: (i) costs associated with monitoring whether the fund's net purchases or net redemptions cross the swing threshold (which could include, to the extent a fund determines appropriate, costs associated with obtaining interim feeds of flows from its transfer agent or distributor in order to reasonably estimate its daily net flows) (implicated by proposed rule 22c-1(a)(3)(i)(A)); (ii) adjusting the fund's NAV when the fund's net purchases or net redemptions cross the swing threshold, including costs associated with determining a swing factor that would be used to adjust the fund's NAV when the fund's swing threshold is breached (proposed rule 22c-1(a)(3)(i)(A), proposed rule 22c-1(a)(3)(i)(D)); (iii) periodic review of the fund's swing threshold (proposed rule 22c-1(a)(3)(i)(C)); (iv) systems maintenance; (iv) additional staff training; (v) board approval of any material changes to the program (proposed rule 22c-1(a)(3)(ii)(A)); and (vi) recordkeeping (proposed rule 22c-1(a)(3)(iii), proposed amendments to rule 31a-2(a)(2)).[765]

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[763] These cost estimates are based in part on the staff's recent estimates of the ongoing costs associated with implementing the fees and gates provisions of the 2014 amendments to rule 2a-7 under the 1940 Act. *See supra* note 759 (discussing why staff believes that the costs associated with the fees and gates provisions could be useful to estimate the costs associated with establishing and implementing swing pricing policies and procedures).

[764] This estimate is based on the following calculations: 0.05 x $1,300,000 = $65,000; 0.15 x $2,250,000 = $337,500.

[765] We anticipate that, depending on the personnel (and/or third party service providers) involved in the activities associated with administering a fund's swing pricing policies and procedures, certain of the estimated ongoing costs associated with these activities could be borne by the fund, and others could be borne by the adviser. *See* paragraph following *supra* note 762.

A fund would be permitted, but not required, to establish and implement swing pricing policies and procedures under proposed rule 22c-1(a)(3), and for purposes of this cost analysis, staff estimates that 167 fund complexes would adopt swing pricing policies and procedures. In developing this estimate, staff assumed that complexes including certain mutual fund strategies (high-yield bond funds, world bond funds (including emerging market debt funds), multi-sector bond funds, state municipal funds, alternative strategy funds, and emerging market equity funds) would be relatively more likely to adopt swing pricing policies and procedures, and of complexes with funds following these strategies, 75% would actually adopt swing pricing policies and procedures.[766] Staff estimates that the aggregate one-time costs for fund complexes to establish and implement swing pricing policies and procedures, and to comply with the recordkeeping requirements of the proposed amendments to rule 31a-2(a)(2) and the financial reporting requirements in Form N-1A and Regulation S-X, would be approximately $296

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766 In developing the estimate that 167 fund complexes would adopt swing pricing policies and procedures, the staff assumed that the percentage of fund complexes that includes high-yield bond funds, world bond funds (including emerging market debt funds), multi-sector bond funds, state municipal funds, alternative strategy funds, and emerging market equity funds, as a fraction of all fund complexes, is the same as the percentage of all mutual funds (excluding money market funds) that these strategies represent. The actual number of fund complexes that includes these selected strategies could be higher or lower than the number calculated using this assumption. 241 high yield bond mutual funds + 347 world bond mutual funds (estimate includes emerging market bond funds) + 139 multi-sector bond mutual funds + 322 state municipal mutual funds + 376 alternative strategy funds that are equity funds (alternative strategy funds that are bond funds are included in our estimates of the number of bond mutual funds) + 469 emerging market equity mutual funds = 1,894 funds with strategies that staff assumed would be relatively more likely to adopt swing pricing policies and procedures. 1,894 funds with selected strategies ÷ 7,395 mutual funds (excluding money market funds) = approximately 25.6%. 0.256 x 867 fund complexes = approximately 222 fund complexes. Assuming that 75% of these fund complexes would actually adopt swing pricing policies and procedures, 0.75 x 222 fund complexes = approximately 167 fund complexes. These estimates are based on figures included in the 2015 ICI Fact Book. *See* 2015 ICI Fact Book, *supra* note 3.

million.[767] In addition, staff estimates that the annual aggregate costs associated with the proposed regulations relating to swing pricing would be approximately $34 million.[768]

d. Effects on Efficiency, Competition, and Capital Formation

Proposed rule 22c-1(a)(3) would permit a fund, under certain circumstances, to adjust its NAV to effectively pass on costs stemming from shareholder purchase or redemption activity to the shareholders associated with that activity. Adjusting a fund's NAV in this way could reduce dilution to existing shareholders arising from trading costs. We therefore believe that the proposed rule could increase the efficiency of cost allocation among shareholders of funds that adopt swing pricing policies and procedures, provided that a fund's swing threshold and swing factor are appropriately calculated.[769] If investors believe swing pricing to be valuable, funds that decide to implement swing pricing will be at a competitive advantage. Fund complexes currently using swing pricing in other domiciles may be able to implement swing pricing more quickly and more effectively.

We anticipate that proposed rule 22c-1(a)(3) could indirectly foster capital formation by bolstering investor confidence. Investors may be more inclined to invest in funds if they understand that funds will be able to use swing pricing to prevent the purchase or redemption activity of certain investors from diluting the interests of other investors (particularly long-term

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767 Because staff is unable to estimate how many fund complexes would incur one-time costs on the low end of the estimated range versus the high end of the estimated range, this estimate is based on the assumption that each fund complex would incur one-time costs of $1,775,000, which represents the middle of the range of estimated one-time costs ($1,300,000 + $2,250,000 = $3,550,000; $3,550,000 ÷ 2 = $1,775,000). 167 fund complexes x $1,775,000 = $296,425,000.

768 Because staff is unable to estimate how many fund complexes would incur ongoing costs on the low end of the estimated range versus the high end of the estimated range, this estimate is based on the assumption that each fund complex would incur ongoing costs of $201,250, which represents the middle of the range of estimated ongoing costs ($65,000 + $337,500 = $402,500; $402,500 ÷ 2 = $201,250). 167 fund complexes x $201,250 = $33,608,750.

769 *See supra* notes 748-749 (discussing cost allocation among shareholders with respect to funds that do not use swing pricing).

investors, who represent the majority of fund shareholders). To the extent that swing pricing preserves investment returns to investors, particularly long-term investors,[770] this could incentivize investment in funds that use swing pricing. If proposed rule 22c-1(a)(3) enhances investor confidence in funds, investors are more likely to invest in funds, thus making additional assets available for investment in the capital markets. On the other hand, investors could be discouraged from investing in funds that use swing pricing if swing pricing produces increased performance volatility, which could increase tracking error, and could make a fund's short-term performance appear relatively poor compared to other funds and the fund's benchmark. Because we do not have the information necessary to determine how investors will perceive swing pricing, or how they will evaluate the relative benefits or detriments of investing in funds that use swing pricing, we are unable to draw conclusions about the precise effects of proposed rule 22c-1(a)(3) on capital formation. However, to the extent that investors perceive swing pricing improves fund performance by decreasing investor dilution, capital formation could be encouraged.

e. Reasonable Alternatives

The following discussion addresses significant alternatives to proposed rule 22c-1(a)(3). More detailed alternatives to the individual elements of the proposed rule are discussed in detail above, and we have requested comment on these alternatives.[771]

Instead of permitting, but not requiring, funds to adopt swing pricing policies and procedures under proposed rule 22c-1(a)(3), we could have proposed a rule that would require all funds to adopt swing pricing policies and procedures. This alternative approach would have the

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770 *See supra* notes 440-441 and accompanying text.

771 See *supra* Requests for Comment in sections III.F.1.a, III.F.1.b, III.F.1.c, III.F.1.d, III.F.1.e, III.F.1.f, III.F.1.g, III.F.2.d, and III.F.3.

benefit of establishing a uniform regulatory framework to prevent potential shareholder dilution. But because funds differ notably in terms of their particular circumstances and risks, as well as with respect to the tools funds use to manage risks relating to liquidity and shareholder purchases and redemptions, we decided to propose a rule that would permit swing pricing as a voluntary tool for funds. Our chosen approach would allow funds to weigh the advantages of swing pricing (*e.g.*, improved allocation of trading costs[772]) against potential disadvantages (*e.g.*, the potential for swing pricing to increase the volatility of a fund's NAV in the short term[773]).

While proposed rule 22c-1(a)(3) envisions partial swing pricing (that is, a NAV adjustment would not be permitted unless net purchases or redemptions exceed a threshold set by the fund), the Commission instead could have proposed a rule that would permit full swing pricing (that is, a NAV adjustment would be permitted any time the fund experiences net purchases or net redemptions). Full swing pricing would result in *any* costs associated with purchases or redemptions being passed along to the shareholders whose actions created those costs, whereas the partial swing pricing contemplated by the proposed rule would only allocate trading costs to purchasing or redeeming shareholders when net purchases or net redemptions exceed the fund's swing threshold. Nevertheless, we believe that the partial swing pricing alternative is, on balance, preferable to the full swing pricing option. We expect that partial swing pricing, as opposed to full swing pricing, would reduce any performance volatility potentially associated with swing pricing.[774] Also, the use of partial swing pricing recognizes that purchases or redemptions below a certain threshold might not require a fund to trade portfolio assets, and therefore a NAV adjustment might not be appropriate if purchases or

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772 *See supra* sections III.F.1.a, III.F.1.c, III.F.1.e.

773 *See supra* paragraphs accompanying note 446.

774 *See supra* paragraph accompanying notes 447-449.

redemptions would not result in costs associated with asset purchases or sales (in which case, a NAV adjustment could unfairly penalize purchasing or redeeming shareholders).[775]

We considered permitting funds to use swing pricing only to adjust their NAV downward in the event that net redemptions exceeded a particular threshold, as there may be more significant issues regarding potential dilution for non-redeeming shareholders in connection with shareholder redemptions, because funds are obligated to satisfy redemption requests pursuant to section 22(e) of the Act. In this regard, we note that unlike redemptions, funds may reserve the right to decline purchase requests. For example, a fund may decline purchase requests from shareholders who engaged in frequent trading, and it also may decline large purchase requests that would negatively impact the fund. However, we are proposing to permit funds to use swing pricing to adjust their NAV upward or downward because we believe that swing pricing could be a useful tool in mitigating dilution associated with shareholder purchase activity as well.

We also considered limiting the swing factor, but we recognize that there could be circumstances in which limiting the swing factor would prevent a fund from capturing the costs associated with purchase or redemption activity in a fund.[776] We believe it is appropriate to provide flexibility to funds to determine the appropriate swing factor that takes into account estimated trading costs. As part of their swing pricing policies and procedures, funds may decide to limit the swing factor.

Lastly, instead of proposing to permit funds to use swing pricing, we considered clarifying that a fund (other than a money market fund) could impose a purchase fee or

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[775] *See supra* note 449 and accompanying text.

[776] *See supra* paragraph accompanying notes 502-504.

redemption fee to address potential dilution.[777] Swing pricing and purchase and redemption fees could pass on transaction-related costs to transacting shareholders. Purchase fees and redemption fees, as opposed to swing pricing, would have the benefit of being simple for investors to understand, and they would not produce the same volatility and tracking error concerns as swing pricing. However, on balance we believe that the operational costs and difficulty of imposing a fee would be significantly higher than those associated with swing pricing. Implementing a fee requires coordination with the fund's service providers, which could entail operational complexity. On the other hand, we anticipate that swing pricing would be simpler to implement than a fee because the NAV adjustment would occur pursuant to the fund's own procedures and would be factored into the process by which a fund strikes its NAV.

3. *Disclosure and Reporting Requirements Regarding Liquidity Risk and Liquidity Risk Management*

a. Proposed Disclosure and Reporting Requirements

We are proposing amendments to Form N-1A, Regulation S-X, proposed Form N-PORT, and proposed Form N-CEN to enhance fund disclosure and reporting regarding liquidity and redemption practices. Specifically, proposed amendments to Form N-1A would require a fund to disclose: (i) the number of days in which the fund will pay redemption proceeds to redeeming shareholders[778] and (ii) the methods the fund uses to meet redemption requests in stressed and non-stressed market conditions.[779] A fund also would be required to file as an exhibit to its

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777 As discussed above, funds are currently permitted under rule 22c-2 to impose redemption fees under certain circumstances. *See supra* notes 421-422 and accompanying text; *see also* Rule 22c-2 Adopting Release, *supra* note 421 (noting that the redemption fee permitted under rule 22c-2 "is intended to allow funds to recoup some of the direct and indirect costs incurred as a result of short-term trading strategies, such as market timing").

778 Proposed Item 11(c)(7) of Form N-1A.

779 Proposed Item 11(c)(8) of Form N-1A.

registration statement any credit agreements for the benefit of the fund.[780] Regarding swing pricing, a fund would be required to disclose in Form N-1A a statement as to whether the fund uses swing pricing, and an explanation of the circumstances under which it will use swing pricing and the effects of using swing pricing.[781] The NAV reported on a fund's financial statements would reflect swing pricing, if applicable. Proposed amendments to proposed Form N-PORT would require a fund to disclose: (i) for each portfolio asset, whether that security is a 15% standard asset;[782] (ii) the fund's three-day liquid asset minimum;[783] and (iii) for each of the fund's positions in a portfolio asset, the liquidity classification of that position as determined pursuant to proposed rule 22e-4(b)(2)(i).[784] Finally, proposed amendments to proposed Form N-CEN would require a fund to disclose certain information regarding the use of lines of credit, interfund borrowing and lending, and swing pricing.[785] We have also proposed amendments to Form N-CEN that would require an ETF to report whether it required that an authorized participant post collateral to the ETF or any of its designated service providers in connection with the purchase or redemption of ETF shares.[786]

b. Benefits

The proposed disclosure and reporting requirements would promote investor protection by improving the availability of information regarding funds' liquidity risks and risk

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780 Proposed Item 28(h) of Form N-1A.

781 Proposed Item 6(d) of Form N-1A.

782 Proposed Item C.7 of proposed Form N-PORT.

783 Proposed Item B.7 of proposed Form N-PORT.

784 Proposed Item C.13 of proposed Form N-PORT. If a fund were to determine that different portions of a position in a particular asset would receive different liquidity classifications pursuant to proposed rule 22e-4(b)(2)(i) (*see supra* paragraph accompanying note 172), the fund would be required to indicate the dollar amount of that position attributable to each classification.

785 Proposed Item 44 of proposed Form N-CEN.

786 Proposed Item 60g of proposed Form N-CEN.

management practices, as well as funds' redemption practices. As discussed above, funds' disclosures to shareholders regarding their redemption practices are currently quite varied in content and comprehensiveness.[787] While some funds voluntarily include disclosure regarding fund limitations on illiquid asset holdings that track the 15% guideline, a fund is not currently required to disclose information about the liquidity of its portfolio assets. A fund is also not currently required to disclose information about liquidity risk management practices such as the use of lines of credit. In light of the relatively few disclosure requirements regarding funds' liquidity risks, liquidity risk management practices, and redemption practices, as well as the current inconsistency in funds' liquidity-related disclosures, we believe that the proposed disclosure and reporting requirements would increase shareholder understanding of particular funds' liquidity-related risks and redemption policies. This in turn would assist investors in making investment choices that better match their risk tolerances.

We note that, while proposed Form N-PORT and proposed Form N-CEN are designed primarily to assist the Commission and its staff, we believe that the information in these proposed forms (including the liquidity-related information proposed to be included in these forms) also would be valuable to investors.[788] In particular, we believe that both sophisticated institutional investors and third-party users that provide services to investors may find the proposed liquidity-related information to be useful. And we believe that individual investors would benefit indirectly from the information collected on reports on Form N-PORT, through analyses prepared by third-party service providers, and through enhanced Commission monitoring and oversight of the fund industry.

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787 *See supra* section III.G.1.a.

788 *See* Investment Company Reporting Modernization Release, *supra* note 104, at sections IV.B.b, IV.E.b.

The liquidity-related information that funds would be required to provide on proposed Form N-PORT and proposed Form N-CEN would enhance investor protection by improving the Commission's ability to monitor funds' liquidity using relevant and targeted data. This monitoring would permit us to analyze liquidity trends in individual funds, and among certain types of funds and the fund industry as a whole, as well as to better understand funds' liquidity risk management practices. As discussed in our recent proposal to modernize investment company reporting, the information we receive on these reports would facilitate the oversight of funds and would assist the Commission, as the primary regulatory of such funds, to better effectuate its mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[789]

Because we cannot predict the extent to which the proposed requirements would enhance investors' awareness of funds' portfolio liquidity and liquidity risk, or that this enhanced awareness would influence investors' investments in certain funds, we are unable to quantify the potential benefits discussed in this section.

c. Costs

Funds would incur one-time and ongoing annual costs to comply with the proposed disclosure and reporting requirements regarding liquidity and shareholder redemption practices.

We estimate that the one-time costs to comply with the proposed amendments to Form N-1A would be approximately $637 per fund (plus printing costs).[790] We estimate that each fund

789 *See id.*

790 This estimate is based on the following calculation: 2 hours (1 hour to update registration statement to include swing pricing-related disclosure statements + 1 hour to update registration statement disclosure about redemption procedures and file credit agreements as exhibits, if applicable) x $318.50 (blended rate for a compliance attorney ($334) and a senior programmer ($303)) = $637. This figure incorporates the costs we estimated for each fund to update its registration statement to include the required disclosure about: (i) the number of days in which the fund will pay redemption proceeds to redeeming shareholders;

would incur an ongoing cost associated with compliance with the proposed amendments to Form N-1A of approximately $80[791] each year to review and update the proposed disclosure regarding swing pricing and redemptions.

The proposed amendments to proposed Form N-PORT would require funds to report on Form N-PORT the liquidity classification of each portfolio asset position (or portion of a position in a particular asset), and we estimate that the average one-time compliance costs associated with this reporting would be $15,330 per fund.[792] Furthermore, we estimate that 8,734 funds would be required to file, on a monthly basis, additional information on Form N-PORT as a result of the proposed amendments.[793] Assuming that 35% of funds (3,057 funds) would choose to license a software solution to file reports on Form N-PORT in house,[794] we estimate an upper bound on the initial annual costs to file the additional information associated with the

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(ii) the methods the fund uses to meet redemption requests in stressed and non-stressed market conditions; and (iii) if the fund uses swing pricing, an explanation of the circumstances under which it will use swing pricing and the effects of using swing pricing. This figure also includes the costs we estimate for each fund to file any applicable credit agreements as exhibits to the fund's registration statement. The costs associated with these activities are all paperwork-related costs and are discussed in more detail *infra* at section V.G.

791 This estimate is based on the following calculations: 0.25 hours (1/8 hour to update swing pricing-related disclosure statements + 1/8 hour to update disclosures about redemption procedures) x $318.50 (blended hourly rate for a compliance attorney ($334) and a senior programmer ($303)) = $79.63.

792 This estimate is based on the following calculation: (i) project planning and systems design (24 hours x $260 (hourly rate for a senior systems analyst) = $6,240) and (ii) systems modification integration, testing, installation and deployment (30 hours x $303 (hourly rate for a senior programmer) = $9,090). $6,240 + $9,090 = $15,330. Estimates for drafting, integrating, implementing policies and procedures are addressed in the discussion of proposed rule 22e-4. This figure incorporates the costs that we estimated associated with preparing the section of the fund's report on Form N-PORT that would incorporate the information that would be required under proposed Item C.13. The costs associated with these activities are all paperwork-related costs and are discussed in more detail *infra* at section V.E. As discussed in section V.E *infra*, we believe that any external annual costs associated with filing Form N-PORT would be only incrementally affected by compliance with proposed Item C.13 to proposed Form N-PORT, and thus proposed Item C.13 does not affect our previous estimates of these costs.

793 There were 8,734 open-end funds (excluding money market funds, and including ETFs) as of the end of 2014. *See* 2015 ICI Fact Book, *supra* note 3, at 177, 184.

794 This assumption tracks the assumption made in the Investment Company Reporting Modernization Release that 35% of funds would choose to license a software solution to file reports on Form N-PORT. *See* Investment Company Reporting Modernization Release, *supra* note 104, at nn.658-659 and accompanying text.

proposed amendments for funds choosing this option of $780 per fund[795] with annual ongoing costs of $260 per fund.[796] We further assume that 65% of funds (5,677 funds) would choose to retain a third-party service provider to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-PORT,[797] and we estimate an upper bound on the initial costs to file the additional information associated with the proposed amendments for funds choosing this option of $1,040 per fund[798] with annual ongoing costs of $130 per fund.[799]

Likewise, compliance with the proposed amendments to proposed Form N-CEN would involve ongoing costs as well as one-time costs. We estimate that 8,734 funds would be required to file responses on Form N-CEN as a result of the proposed amendments to the form. We estimate that the one-time and ongoing annual compliance costs associated with providing

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795 This estimate is based upon the following calculations: $780 in internal costs = ($780 = 3 hours x $260 (blended hourly rate for senior programmer ($303), senior database administrator ($312), financial reporting manager ($266), senior accountant ($198), intermediate accountant ($157), senior portfolio manager ($301), and compliance manager ($283)). We do not anticipate any change to external annual costs as a result of the proposed amendments. *See infra* at section V.E. The hourly wage figures in this and subsequent footnotes are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

796 This estimate is based upon the following calculations: $260 in internal costs ($260 = 1 hour x $260 (blended hourly rate for senior programmer ($303), senior database administrator ($312), financial reporting manager ($266), senior accountant ($198), intermediate accountant ($157), senior portfolio manager ($301), and compliance manager ($283)). We do not anticipate any change to external annual costs as a result of the proposed amendments. *See infra* at section V.E.

797 This assumption tracks the assumptions made in the Investment Company Reporting Modernization Release that 65% of funds would choose to retain a third-party service provider to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-PORT. *See* Investment Company Reporting Modernization Release, *supra* note 104, at nn.660-661 and accompanying text.

798 This estimate is based upon the following calculations: $1,040 in internal costs ($1,040 = 4 hours x $260 (blended hourly rate for senior programmer ($303), senior database administrator ($312), financial reporting manager ($266), senior accountant ($198), intermediate accountant ($157), senior portfolio manager ($301), and compliance manager ($283)). We do not anticipate any change to external annual costs as a result of the proposed amendments.

799 This estimate is based upon the following calculations: $130 in internal costs ($130 = (0.5 hours x $260 (blended hourly rate for senior programmer ($303), senior database administrator ($312), financial reporting manager ($266), senior accountant ($198), intermediate accountant ($157), senior portfolio manager ($301), and compliance manager ($283)). We do not anticipate any change to external annual costs as a result of the proposed amendments.

additional responses to Form N-CEN as a result of the proposed amendments would be approximately $160 per fund.[800]

Based on these estimates, staff further estimates that the total one-time costs to comply with the proposed disclosure and reporting requirements would be approximately $51 million for all funds that would file reports on proposed Form N-PORT in house[801] and approximately $96 million for all funds that would use a third-party service provider to prepare and file reports on proposed Form N-PORT.[802] In addition, staff estimates that the total ongoing annual costs associated with the proposed disclosure and reporting requirements would be approximately $1.5 million for all funds that would file reports on proposed Form N-PORT in house[803] and approximately $2.1 million for all funds that would use a third-party service provider to prepare and file reports on proposed Form N-PORT.[804]

We appreciate that the proposed amendments to proposed Form N-PORT would increase the amount and availability of public information about investment companies' portfolio positions and that more frequent portfolio disclosure could potentially harm fund shareholders by

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800 This estimate is based on the following calculation: 0.5 hour x $318.50 (blended hourly rate for a compliance attorney ($334) and a senior programmer ($303)) = $159.25. This figure incorporates the costs that we estimated associated with preparing the section of the fund's report on Form N-CEN that would incorporate the information that would be required under proposed Item 44. We do not estimate any additional costs in connection with proposed Item 60(g) of Form N-CEN because the proposed new item only requires a yes or no response. We do not estimate any change to the external costs associated with Form N-CEN. The costs associated with these activities are all paperwork-related costs and are discussed in more detail *infra* at section V.F.

801 This estimate assumes that 35% of funds (3,057 funds) would choose to file reports on proposed Form N-PORT in house (*see infra* section V.E) and is based on the following calculation: 3,057 funds x $16,587.75 ($318.50 + $15,330 + $780 + $159.25) = $50,708,751.75.

802 This estimate assumes that 65% of funds (5,677) would choose to file reports on proposed Form N-PORT with the assistance of third-party service providers (*see infra* section V.E) and is based on the following calculation: 5,677 funds x $16,847.75 ($318.50 + $15,330 + $1,040 + $159.25) = $95,644,676.75.

803 This estimate is based on the following calculation: 3,057 funds x $498.88 ($79.63 + $260 + $159.25) = $1,525,076.16.

804 This estimate is based on the following calculation: 5,677 funds x $368.88 ($79.63 + $130 + $159.25) = $2,094,131.76.

expanding the opportunities for professional traders to exploit this information by engaging in predatory trading practices, such as "front-running" and "copycatting."[805] Both front-running and copycatting can reduce the returns of shareholders who invest in actively managed funds.[806] Thus, the proposed amendments to proposed Form N-PORT could entail costs to funds and market participants associated with any reduced profitability of funds that could result from the increase in publicly available information.[807] We believe that these costs cannot be separated from the overall costs to funds and market participants that could result from the increased disclosure of currently non-public information associated with Form N-PORT in its entirety.[808] The effects of the proposed liquidity-related disclosures are intertwined with the effects of the other proposed Form N-PORT disclosures. For example, any analyses of the liquidity-related disclosure proposed to be required could be affected by the enhanced reporting of information concerning the pricing of funds' investments, information on fund flows, and disclosure of additional information that could more clearly reveal the investment strategy and risk exposures of reporting funds (*e.g.*, information pertaining to derivatives and securities lending activities). The potential costs associated with the increased disclosure of currently non-public information on Form N-PORT are discussed in detail in our recent proposal to modernize investment company reporting.[809] This proposal also discusses the ways in which we have endeavored to mitigate these costs, including by proposing to maintain the status quo for the frequency and

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805 *See* Investment Company Reporting Modernization Release, *supra* note 104, at n.170 and accompanying and following text.

806 *See* Russ Wermers, *The Potential Effects of More Frequent Portfolio Disclosure on Mutual Fund Performance*, 7 Investment Company Institute Perspective No. 3 (June 2001), *available at* http://www.ici.org/pdf/per07-03.pdf.

807 *See* Investment Company Reporting Modernization Release, *supra* note 104, at nn.663-667 and accompanying text.

808 *See id.* at paragraphs accompanying nn.663-673.

809 *See id.*

timing of disclosure of publicly available portfolio information.[810] While proposed Form N-PORT would be required to be filed monthly, it would be required to be disclosed quarterly and would not be made public until 60 days after the close of the period at issue. Because funds are currently required to disclose their portfolio investments quarterly (and this disclosure is made public with a 60-day lag), we believe that maintaining the status quo with regard to the frequency and the time lag of publicly available portfolio reporting would permit the Commission (as well as the fund industry generally) to assess the impact of the Form N-PORT filing requirement on the mix of information available to the public, and the extent to which these changes might affect the potential for predatory trading, before determining whether more frequent or more timely public disclosure would be beneficial to investors in funds.[811] We cannot currently predict the extent to which the proposed enhancements to funds' disclosures on Form N-PORT would give rise to front-running, predatory trading, and other activities that could be detrimental to a fund and its investors, and thus we are unable to quantify potential costs related to these activities.

d. Effects on Efficiency, Competition, and Capital Formation

We believe the proposed requirements could increase informational efficiency by providing additional information about the liquidity of funds' portfolio positions to investors, third-party service providers, and the Commission. This in turn could assist investors in evaluating the risks associated with certain funds, which could increase allocative efficiency by assisting investors in making investment choices that better match their risk tolerances. Enhanced disclosure regarding funds' liquidity and liquidity risk management practices could

810 *See id.* at section II.A.4 and paragraph accompanying n. 670.

811 *See id.*

positively affect competition by permitting investors to choose whether to invest in certain funds based on this information. However, if investors were to move their assets among funds as a result of the disclosure requirements (for example, if the disclosure made clear that a certain fund was able to generate higher returns than its peers through high exposure to relatively less liquid positions, which then led investors with limited risk tolerance to move assets out of this fund), this could negatively affect the competitive stance of certain funds.

Increased investor awareness of funds' portfolio liquidity and liquidity risk management practices also could promote capital formation if investors find certain funds' liquidity profiles and/or risk management practices attractive, and this awareness promotes increased investment in these funds and in turn in the assets in which the funds invest. For example, disclosure that reveals liquidity risk in funds' portfolios could negatively impact capital formation if this disclosure leads investors to decide that such funds pose too great of an investment risk, and consequently decide not to invest in these funds or to decrease their investment in these funds. Conversely, to the extent that investors assume that funds investing in relatively less liquid assets could obtain a liquidity risk premium in the form of higher returns over some period of time, the potential for higher returns could draw certain investors to funds investing in relatively less liquid asset classes, which could positively affect capital formation for these funds. If investors shift their invested assets between funds based on liquidity, there could be capital formation effects stemming from increased (or decreased) investment in the funds' portfolio assets, even if the total capital invested in funds remains constant. For example, if fund investors move assets from an investment strategy that entails relatively high liquidity risk to one whose investment strategy involves relatively low liquidity risk, less liquid portfolio asset classes could experience an adverse impact on capital formation while the more liquid portfolio asset classes could experience a positive impact on capital formation, although the total capital invested in funds would remain constant.

e. Reasonable Alternatives

The following discussion addresses significant alternatives to proposed disclosure and reporting requirements. More detailed alternatives to the individual elements of the proposed requirements are discussed in detail above, and we have requested comment on these alternatives.[812]

The Commission considered proposing to require each fund to disclose information about the liquidity of its portfolio positions in the fund's prospectus or on the fund's website, in addition to in reports filed on Form N-PORT. For example, we could have proposed to require a fund to disclose its three-day liquid asset minimum, or the percentage of the fund's portfolio invested in each of the liquidity categories specified under proposed rule 22e-4(b)(2)(i), in its prospectus or on its website. This additional disclosure could further increase transparency with respect to funds' portfolio liquidity and liquidity-related risks. But we had concerns that this additional disclosure could create investor confusion; for example, an investor could mistakenly understand statements about the liquidity of the fund's *portfolio* to implicate the redeemability of the fund's *shares*. We also had concerns that this additional disclosure could inappropriately emphasize risks relating to a fund's portfolio liquidity over other significant risks associated with an investment in the fund. We therefore determined that this alternative could lead to poor investor allocation and that its costs would likely outweigh its potential benefits.

Conversely, the Commission also considered limiting the proposed enhancements to funds' liquidity-related disclosures on proposed Form N-PORT. As discussed above, we are

812 *See supra* sections III.G.1.a, III.G.1.b, III.G.2.d, and III.G.3.c.

sensitive to the possibility that the proposed amendments to the proposed form could facilitate front-running, predatory trading, and other activities that could be detrimental to a fund and its investors. Limiting the required disclosure about information concerning the liquidity of funds' portfolio positions could allow funds to shelter certain information that they may consider a source of competitive advantage. As discussed in our recent proposal to modernize investment company reporting, the items included on proposed Form N-PORT reflect our careful consideration of what information we believe to be important for our oversight activities and to the public, and the costs to investment companies to provide the information.[813] We likewise carefully weighed costs and benefits with respect to the new liquidity-related disclosures proposed to be required under proposed Form N-PORT and concluded that these disclosures appropriately balance related costs with the benefits that could arise from the ability of the Commission, and members of the public, to monitor and analyze the liquidity of individual funds, as well as liquidity trends within the fund industry.

D. Request for Comment

The Commission requests comment on all aspects of this initial economic analysis, including whether the analysis has: (i) identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (ii) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (iii) identified and considered reasonable alternatives to the proposed new rule and rule amendments. We request and encourage any interested person to submit comments regarding the proposed rule and proposed amendments, our analysis of the potential effects of the proposed rule and proposed amendments, and other matters that may have an effect on the proposed rule and

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813 *See* Investment Company Reporting Modernization Release, *supra* note 104, at section IV.B.

proposed amendments. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed rule and proposed amendments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. We also request comments on all data and empirical analyses used in support of the proposed rule and proposed amendments.

In addition to our general request for comment on the economic analysis associated with the proposed rule and proposed amendments, we request specific comment on certain aspects of the proposal:

- To what extent do funds' current practices regarding portfolio asset liquidity classification and liquidity risk assessment and management currently align with the proposed liquidity risk management program requirements, and what operational and other costs would funds incur in modifying their current practices to comply with the proposed requirements?
- What factors, with respect to a fund's particular risks and circumstances, would cause particular variance in funds' compliance costs related to the liquidity risk management program requirement?
- We note that rule 22e-4 as proposed is meant to provide flexibility in permitting a fund to customize its liquidity risk management program, and thus we anticipate that the costs and burdens relating to the program requirement will vary based on the fund's risks and circumstances. Does this flexibility (and the attendant requirement for each fund to adopt liquidity risk management policies and procedures based on an assessment of the fund's individual liquidity risk) affect the extent to which a fund family could lower costs by

developing procedures, or implementing systems modifications, that could be used by all funds within the fund family? Does this flexibility enhance the potential effectiveness of the proposed liquidity risk management program?

- We request comment on our estimates of the one-time and ongoing costs associated with the proposed program requirement. Do commenters agree with our cost estimates? If not, how should our estimates be revised, and what changes, if any, should be made to the assumptions forming the basis for our estimates? Are there any significant costs that have not been identified within our estimates that warrant consideration? To what degree would economies of scale affect compliance costs for larger entities, and is the longer proposed compliance period for small entities[814] appropriate in light of any relatively larger burden that would be borne by smaller entities that are not able to take advantage of economies of scale? How do commenters anticipate that these estimated costs might be allocated between a fund and its adviser?
- To what extent do commenters anticipate that the proposed liquidity risk management program requirement could lead funds to modify their investment strategies or increase their investments in relatively more liquid assets? Do commenters believe that the proposed program requirement could significantly affect the market for relatively more liquid assets (or, conversely, the market for relatively less liquid assets) and if so, to what extent would these markets be affected?
- We request comment on our estimate of the number of funds that would adopt swing pricing policies and procedures under proposed rule 22c-1(a)(3). For what reasons would a fund decide not to adopt swing pricing policies and procedures, and would funds with

814 *See supra* section III.H.1.

certain investment strategies be relatively more likely to adopt swing pricing policies and procedures?

- What operational and other costs would a fund incur in adopting swing pricing policies and procedures, and would these costs be significantly lower if a fund is a member of a fund complex that also includes foreign-domiciled funds that currently use swing pricing? Do commenters agree with our cost estimates associated with proposed rule 22c-1(a)(3)? If not, how should our estimates be revised, and what changes, if any, should be made to the assumptions forming the basis for our estimates? Are there any significant costs that have not been identified within our estimates that warrant consideration? How do commenters anticipate that these estimated costs might be allocated between a fund and its adviser?
- Would fund shareholders be more inclined or less inclined to invest in a fund that has adopted swing pricing policies and procedures as contemplated by proposed rule 22c-1(a)(3)? Do commenters believe that swing pricing could preserve investment returns to fund investors? If so, please provide any available data regarding the relationship between the use of swing pricing and the preservation of investment returns.
- Do commenters agree with our statement that swing pricing would be simpler and less costly to implement than purchase fees or redemption fees?
- Do the proposed disclosure and reporting requirements raise any concerns about confidentiality relating to a fund's portfolio holdings, investor confusion, the potential misallocation of invested funds, or other concerns? To what extent would the proposed portfolio liquidity-related enhancements to funds' disclosures on Form N-PORT give rise

to front-running, predatory trading, and other activities that could be detrimental to a fund and its investors?

- Would additional prospectus disclosure about funds' portfolio liquidity, beyond that which would be required under the proposed Form N-1A amendments, be useful to investors? If so, what additional disclosure would be most useful, and what disclosure methods would permit funds to appropriately balance disclosure about liquidity-related risks with disclosure regarding other risks facing the fund?

V. Paperwork Reduction Act Analysis

A. Introduction

Proposed rule 22e-4 and the proposed amendments to rule 22c-1 contain "collections of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[815] In addition, the proposed amendments to rule 31a-2, Form N-1A and Regulation S-X would impact the collections of information burden under those rules and form.[816] The proposed amendments to proposed Form N-CEN and proposed Form N-PORT would impact the collections of information burdens associated with these proposed forms described in the Investment Company Reporting Modernization Release.[817]

The title for the existing collections of information are: "Rule 31a-2 Records to be preserved by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies" (OMB Control No.

815 44 U.S.C. 3501 through 3521.

816 The paperwork burden from Regulation S-X is imposed by the rules and forms that relate to Regulation S-X and, thus, is reflected in the analysis of those rules and forms. To avoid a PRA inventory reflecting duplicative burdens and for administrative convenience, we have previously assigned a one-hour burden to Regulation S-X.

817 *See* Investment Company Reporting Modernization Release, *supra* note 104, at section V.

3235-0179); and "Form N-1A under the Securities Act of 1933 and under the Investment Company Act of 1940, Registration Statement of Open-End Management Investment Companies" (OMB Control No. 3235-0307). In the Investment Company Reporting Modernization Release, we submitted new collections of information for proposed Form N-CEN and proposed Form N-PORT.[818] The titles for these new collections of information are: "Form N-CEN Under the Investment Company Act, Annual Report for Registered Investment Companies" and "Form N-PORT Under the Investment Company Act, Monthly Portfolio Investments Report." We are submitting new collections of information for proposed new rule 22e-4 and the proposed amendments to rule 22c-1 under the Investment Company Act of 1940. The titles for these new collections of information would be: "Rule 22e-4 Under the Investment Company Act of 1940, Liquidity risk management programs," and "Rule 22c-1 Under the Investment Company Act of 1940, Pricing of redeemable securities for distribution, redemption and repurchase." The Commission is submitting these collections of information to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

The Commission is proposing new rule 22e-4 and amendments to rule 22c-1, rule 31a-2, Regulation S-X and Form N-1A. The Commission also is proposing to amend proposed Form N-CEN and proposed Form N-PORT. The new rule and proposed amendments are designed to promote effective liquidity risk management throughout the open-end fund industry, prevent potential dilution of interests of fund shareholders in light of redemption activity, and enhance

818 *See id.*

disclosure regarding fund liquidity and shareholder redemption practices. We discuss below the collection of information burdens associated with these reforms.

B. Rule 22e-4

Proposed rule 22e-4 would require funds to establish a written liquidity risk management program that is reasonably designed to assess and manage the fund's liquidity risk. This program would include policies and procedures adopted by the fund that incorporate certain program elements, including: (i) classification, and ongoing review of the classification, of the liquidity of a fund's portfolio positions; (ii) assessment and periodic review of a fund's liquidity risk; and (iii) management of the fund's liquidity risk, including determination and periodic review of the fund's three-day liquidity asset minimum and establishment of policies and procedures regarding redemptions in kind, to the extent that the fund engages in or reserves the right to engage in redemptions in kind. The rule also would require board approval and oversight of the program and recordkeeping. The proposed requirements that funds adopt a written liquidity risk management program, report to the board, maintain a written record of how the three-day liquid asset minimum and any adjustments were determined, and retain certain records are collections of information under the PRA. The respondents to proposed rule 22e-4 would be open-end management investment companies (other than money market funds), and we estimate that funds within 867 fund complexes would be subject to proposed rule 22e-4.[819] Compliance with proposed rule 22e-4 would be mandatory for all such funds. Information regarding the fund's three-day liquid asset minimum would be confidential until publicly reported on Form N-PORT, as described below. Other information provided to the Commission

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819 *See* 2015 ICI Fact Book, *supra* note 3, at Fig. 1.8.

in connection with staff examinations or investigations would be kept confidential subject to the provisions of applicable law.

1. Preparation of Written Liquidity Risk Management Program

We believe that most funds regularly monitor the liquidity of their portfolios as part of the portfolio management function, but they may not have written policies and procedures regarding liquidity management. Proposed rule 22e-4 would require funds to have a written liquidity risk management program. We believe such a program would promote efficient liquidity risk management, reduce the probability that a fund will be able to meet redemption requests only through activities that could materially affect the fund's NAV or risk profile or dilute the interests of fund shareholders, and respond to risks associated with increasingly complex portfolio investments and operations.

For purposes of this PRA analysis, we estimate that a fund complex would incur a one-time average burden of 40 hours associated with documenting the liquidity risk management programs adopted by each fund within the complex. Proposed rule 22e-4 requires fund boards to approve the liquidity risk management program and any material changes to the program (including the three-day liquid asset minimum), and we estimate a one-time burden of nine hours per fund complex associated with fund boards' review and approval of the funds' liquidity risk management programs and preparation of board materials. Amortized over a 3 year period, this would be an annual burden per fund complex of about 16 hours. Accordingly, we estimate that the total burden for initial documentation and review of funds' written liquidity risk management program would be 42,483 hours.[820] We also estimate that it would cost a fund complex

820 This estimate is based on the following calculation: (40 + 9) hours x 867 fund complexes = 42,483 hours.

approximately $38,466 to document, review and initially approve these policies and procedures, for a total cost of approximately $33,350,022.[821]

2. Reporting Regarding the Three-Day Liquid Assets Minimum

Under proposed rule 22e-4(b)(2)(iv), each fund would be required as part of its liquidity risk management program to determine and periodically review its three-day liquid asset minimum. The fund's investment adviser or officer that administers the liquidity risk management program must provide a written report to the fund's board at least annually that reviews the adequacy of the fund's liquidity risk management program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation.

For purposes of this PRA analysis, we estimate that, for each fund complex, compliance with the reporting requirement would entail: (i) five hours of portfolio management time, (ii) five hours of compliance time, (iii) five hours of professional legal time and (iv) 2.5 hours of support staff time, requiring an additional 17.5 burden hours at a time cost of approximately $5,193 per fund complex to draft the required report to the board.[822] We estimate that the total

821 These estimates are based on the following calculations: 20 hours x $301 (hourly rate for a senior portfolio manager) = $6,020; 20 hours x $455.5 (blended hourly rate for assistant general counsel ($426) and chief compliance officer ($485) = $9,110; 5 hours x $4,400 (hourly rate for a board of 8 directors) = $22,000; 4 hours (for a fund attorney's time to prepare materials for the board's determinations) x $334 (hourly rate for a compliance attorney) = $1,336. $6,020 + $9,110 + $22,000 + $1,336 = $38,466; $38,466 x 867 fund complexes = $33,350,022. The hourly wages used are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. The staff previously estimated in 2009 that the average cost of board of director time was $4,000 per hour for the board as a whole, based on information received from funds and their counsel. Adjusting for inflation, the staff estimates that the current average cost of board of director time is approximately $4,400.

822 This estimate is based on the following calculation: 5 hours x $301 (hourly rate for a senior portfolio manager) = $1,505; 5 hours x $283 (hourly rate for compliance manager) = $1,415; 5 hours x $426 (hourly rate for assistant general counsel) = $2,130; and 2.5 hours x $57 (hourly rate for general clerk) = $143. $1,505 + $1,415 + $2,130 + $143 = $5,193. The hourly wages used are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. The hourly wage used for the general clerk is from SIFMA's Office Salaries in the Securities Industry 2013, modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee

burden for preparation of the board report would be 15,173 hours, at an aggregate cost of $4,502,331.[823]

3. *Recordkeeping*

Proposed rule 22e-4(c) would require a fund to maintain a written copy of policies and procedures adopted pursuant to its liquidity risk management program for five years in an easily accessible place. The proposed rule also would require a fund to maintain copies of materials provided to the board, as well as a written record of how the three-day liquid asset minimum and any adjustments to the minimum were determined, for five years, the first two years in an easily accessible place. The retention of these records would be necessary to allow the staff during examinations of funds to determine whether a fund is in compliance with the required liquidity risk management program. We estimate that the burden would be five hours per fund complex to retain these records, with 2.5 hours spent by a general clerk and 2.5 hours spent by a senior computer operator. We estimate a time cost per fund complex of $361.[824] We estimate that the total burden for recordkeeping related to the liquidity risk management program would be 4,335 hours, at an aggregate cost of $312,987.[825]

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benefits, and overhead.

Because each fund within a fund complex would be required to determine its own three-day liquid asset minimum, this estimate assumes that the report at issue would incorporate an assessment of the three-day liquid asset minimum for each fund within the fund complex.

823 These estimates are based on the following calculations: 867 fund complexes x 17.5 hours = 15,173 hours; and $5,193 x 867 fund complexes = $4,502,331.

824 This estimate is based on the following calculations: 2.5 hours x $57 (hourly rate for a general clerk) = $143; 2.5 hours x $87 (hour rate for a senior computer operator) = $218. $143 + $218 = $361.

825 This estimate is based on the following calculations: 867 fund complexes x 5 hours = 4,335 hours. 867 fund complexes x $361 = $312,987.

4. Estimated Total Burden

Amortized over a three-year period, the hour burdens and time costs associated with proposed rule 22e-4, including the burden associated with (a) funds' initial documentation and review of the required written liquidity risk management program, (b) reporting to a fund's board regarding the fund's three-day liquid asset minimum, and (c) recordkeeping requirements, would result in an average aggregate annual burden of 28,611 hours and average aggregate time costs of $14,431,215.[826] We estimate that there are no external costs associated with this collection of information.

C. Rule 22c-1

We are proposing to amend rule 22c-1 and establish new collection of information burdens under the rule. The proposed amendments would permit a fund (with the exception of a money market fund or ETF) to establish and implement policies and procedures that would require the fund, under certain circumstances, to use swing pricing to mitigate dilution of the value of outstanding redeemable securities stemming from shareholder purchase or redemption activity. We believe the proposed amendments to rule 22c-1 would promote investor protection by providing funds with an additional tool to mitigate the potentially dilutive effects of shareholder purchase or redemption activity and provide a set of operational standards that would allow funds to gain comfort using swing pricing as a new means of mitigating potential dilution.[827]

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826 These estimates are based on the following calculations: 42,483 hours (year 1) + (2 x 15,173 hours) (years 2 and 3) + (3 x 4,335 hours) (years 1, 2 and 3) ÷ 3 = 28,611 hours; $33,350,022 (year 1) + (2 x $4,502,331) (years 2 and 3) + (3 x $312,987) (years 1, 2 and 3) ÷ 3 = $14,431,215.

827 *See supra* section IV.C.2.b.

In order to use swing pricing under the proposed amendments, a fund would be required to establish and implement swing pricing policies and procedures that meet certain requirements.[828] The proposed amendments also would require a fund's board of directors to approve the fund's swing pricing policies and procedures, including any material change to these policies and procedures,[829] and funds would be required to maintain a written copy of the fund's swing pricing policies and procedures.[830] The requirements that funds adopt policies and procedures, obtain board approval and retain certain records related to swing pricing are collections of information under the PRA. The respondents to the proposed amendments to rule 22c-1 would be open-end management investment companies (other than money market funds or ETFs) that engage in swing pricing. We estimate that 167 fund complexes include funds that would adopt swing pricing policies and procedures pursuant to the rule.[831] Compliance with rule 22c-1 would be mandatory for any fund that chose to use swing pricing to adjust its NAV in reliance on the proposed amendments. The information when provided to the Commission in connection with staff examinations or investigations would be kept confidential subject to the provisions of applicable law.

For purposes of this PRA analysis, we estimate that each fund complex would incur a one-time average burden of 24 hours to document swing pricing policies and procedures. The proposed amendments to rule 22c-1 would require fund boards initially to approve the swing pricing policies and procedures (including the swing threshold) and any material changes to them, and we estimate a one-time burden of five hours per fund complex associated with the

828 *See* proposed rule 22c-1(a)(3)(i).

829 *See* proposed rule 22c-1(a)(3)(ii).

830 *See* proposed rule 22c-1(a)(3)(iii).

831 *See supra* section IV.C.2.c.

fund board's review and approval of swing pricing policies and procedures. Amortized over a 3 year period, this would be an annual burden per fund complex of about 10 hours. Accordingly, we estimate that the total burden associated with the preparation and approval of swing pricing policies and procedures by those fund complexes that we believe would use swing pricing would be 4,843 hours.[832] We also estimate that it would cost a fund complex $21,710 to document, review and initially approve these policies and procedures, for a total cost of $3,625,570.[833]

The proposed amendments to rule 22c-1 also would require a fund that uses swing pricing to retain a written copy of the fund's swing policies and procedures that are in effect, or at any time within the past six years were in effect, in an easily accessible place.[834] The retention of these records would be necessary to allow the staff during examinations of funds to determine whether a fund is in compliance with its swing pricing policies and procedures, and whether the policies and procedures comply with the proposed amendments to rule 22c-1. We estimate that the burden would be three hours per fund complex to retain these records, with 1.5 hours spent by a general clerk and 1.5 hours spent by a senior computer operator. We estimate a time cost per fund complex of $216.[835] We estimate that the total for recordkeeping related to swing

832 This estimate is based on the following calculation: (24 +5) hours x 167 fund complexes = 4,843 hours.

833 These estimates are based on the following calculations: 12 hours x $198 (hourly rate for a senior accountant) = $2,376; 12 hours x $455.5 (blended hourly rate for assistant general counsel ($426) and chief compliance officer ($485) = $5,466; 3 hours x $4,400 (hourly rate for a board of 8 directors) = $13,200; 2 hours (for a fund attorney's time to prepare materials for the board's determinations) x $334 (hourly rate for a compliance attorney) = $668; ($2,376 + $5,466 +$13,200 + $668) = $21,710; $21,710 x 167 fund complexes = $3,625,570. The hourly wages used are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. *See also supra* note 821 (discussing basis for estimated hourly rate for a board of directors).

834 Proposed rule 22c-1(a)(3)(iii).

835 This estimate is based on the following calculations: 1.5 hours x $57 (hourly rate for a general clerk) = $85.5; 1.5 hours x $87 (hour rate for a senior computer operator) = $130.5. $85.5 + $130.5 = $216.

pricing would be 501 hours, at an aggregate cost of $36,072 for all fund complexes that we believe include funds that would adopt swing pricing policies and procedures.[836]

Amortized over a three-year period, the hour burdens and time costs associated with the proposed amendments to rule 22c-1, including the burden associated with the requirements that funds adopt policies and procedures, obtain board approval and retain certain records related to swing pricing, would result in an average aggregate annual burden of 2,115 hours and average aggregate time costs of $1,244,595.[837] We estimate that there are no external costs associated with this collection of information.

D. Rule 31a-2

Section 31(a)(1) of the Investment Company Act requires registered investment companies and certain of their majority-owned subsidiaries to maintain and preserve records as prescribed by Commission rules. Rule 31a-1 under the Act specifies the books and records that must be maintained. Rule 31a-2 under the Act specifies the time periods that entities must retain certain books and records, including those required to be maintained under rule 31a-1. The retention of records, as required by rule 31a-2, is necessary to ensure access by Commission staff to material business and financial information about funds and certain related entities. This information is used by the staff to evaluate fund compliance with the Investment Company Act and regulations thereunder. The Commission currently estimates that the annual burden associated with rule 31a-2 is 220 hours per fund, with 110 hours spent by a general clerk at a rate

836 These estimates are based on the following calculation: 3 hours x 167 fund complexes = 501 hours. 167 fund complexes x $216 = $36,072.

837 These estimates are based on the following calculations: 4,843 hours (year 1) + (3 x 501 hours) (years 1, 2 and 3) ÷ 3 = 2,115 hours; $3,625,570 (year 1) + (3 x $36,072) (years 1, 2 and 3) ÷ 3 = $1,244,595.

of $52 per hour and 110 hours spent by a senior computer operator at a rate of $81 per hour.[838] The current estimate of the total annual burden for all funds to comply with rule 31a-2 is approximately 766,480 hours at an estimated cost of $50,970.920.[839]

We are proposing to amend rule 31a-2 to require a fund that chooses to use swing pricing to create and maintain a record of support for each computation of an adjustment to the NAV of the fund's shares based on the fund's swing policies and procedures.[840] This collection of information requirement would be mandatory for any fund that chooses to use swing pricing to adjust its NAV in reliance on the proposed amendments to rule 22c-1. To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential, subject to the provisions of applicable law.

We estimate that approximately 947 funds would use swing pricing pursuant to the proposed amendments to rule 22c-1. We also estimate that each fund that uses swing pricing generally would incur an additional burden of 1 hour per year in order to comply with the proposed amendments to rule 31a-2. Accordingly, we estimate that the total average annual hour burden associated with the proposed amendments to rule 31a-2 would be an additional 947 hours at a cost of $68,169.[841]

838 The estimated salary rates were derived from SIFMA's Office Salaries in the Securities Industry 2011, modified to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead.

839 These estimates were based on the following calculations: 220 hours x 3,484 funds (the estimated number of funds the last time the rule's information collections were submitted for PRA renewal in 2012) = 766,480 total hours; 776,480 hours ÷ 2 = 383,240 hours; 383,240 x $52/hour for a clerk = $19,928,480; 383,240 x $81 rate per hour for a computer operator = $31,042,440; $19,928,480 + $31,042,440 = $50,970,920 total cost.

840 Proposed amendment to rule 31a-2(a)(2).

841 These estimates are based on the following calculations: 1 hour x 947 funds = 947 total hours; 474 hours x $57 rate per hour for a general clerk = $27,018; 473 hours x $87 rate per hour for a senior computer operator = $41,151; $27,018 + $41,151 = $68,169 total cost.

The Commission currently estimates that the average external cost of preserving books and records required by rule 31a-2 is approximately $70,000 per fund at a total cost of approximately $243,880,000 per year,[842] but that funds would already spend approximately half this amount to preserve these same books and records, as they are also necessary to prepare financial statements, meet various state reporting requirements, and prepare their annual federal and state income tax returns. Therefore, the Commission estimated that the total annual cost burden for all funds as a result of compliance with rule 31a-2 is approximately $121,940,000.[843] We estimate that the annual external cost burden of compliance with the information collection requirements of rule 31a-2 would increase by $300 per fund that engages in swing pricing, for an increase in the total annual cost burden of $284,100.[844]

E. Form N-PORT

On May 20, 2015, the Commission proposed Form N-PORT, which would require funds to report information within thirty days after the end of each month about their monthly portfolio holdings to the Commission in a structured data format. Preparing a report on Form N-PORT is mandatory and a collection of information under the PRA, and the information required by Form N-PORT would be data-tagged in XML format. Responses to the reporting requirements would be kept confidential for reports filed with respect to the first two months of each quarter; the third month of the quarter would not be kept confidential, but made public sixty days after the quarter end.

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842 This estimate is based on the following calculation: 3,484 funds (the estimated number of funds the last time the rule's information collections were submitted for PRA renewal in 2012) x $70,000 = $243,880,000.

843 *See Submission of OMB Review; Comment Request, Extension: Rule 31a-2, OMB Control No. 3235-0179,* Securities and Exchange Commission 77 FR 66885 (Nov. 7, 2012).

844 This estimate is based on the following calculation: 947 funds x $300 = $284,100.

In the Investment Company Reporting Modernization Release, we estimated that, for the 35% of funds that would file reports on proposed Form N-PORT in house, the per fund average aggregate annual hour burden was estimated to be 178 hours per fund, and the average cost to license a third-party software solution would be $4,805 per fund per year.[845] For the remaining 65% of funds that would retain the services of a third party to prepare and file reports on proposed Form N-PORT on the fund's behalf, we estimated the average aggregate annual hour burden to be 125 hours per fund, and each fund would pay an average fee of $11,440 per fund per year for the services of third-party service provider. In sum, we estimated that filing reports on proposed Form N-PORT would impose an average total annual hour burden of 1,537,572 hours on applicable funds, and all applicable funds would incur on average, in the aggregate, external annual costs of $97,674, 221.[846]

We are proposing amendments to Form N-PORT that would require each fund to report its three-day liquid asset minimum,[847] the liquidity classification for each portfolio asset position (or portion thereof),[848] and whether an asset is a 15% standard asset.[849] For portfolio assets with multiple liquidity classifications, the proposed amendments would require funds to indicate the dollar amount attributable to each classification. We believe that requiring funds to report information about the liquidity of portfolio investments would assist the Commission in better assessing liquidity risk in the open-end fund industry. Moreover, we believe that this

845 *See* Investment Company Reporting Modernization Release, *supra* note 104, at nn.736-741, 749 and accompanying text.

846 *See* Investment Company Reporting Modernization Release, *supra* note 104, at nn.748 and 751 and accompanying text.

847 *See* proposed Item B.7 of proposed Form N-PORT.

848 *See* proposed Item C.13 of proposed Form N-PORT.

849 *See* proposed Item C.7 of proposed Form N-PORT.

information would help investors and potential users better understand the liquidity risks in funds.

1. Liquidity Classification

Under proposed rule 22e-4(b)(2)(i), an open-end management investment company (other than a money market fund) would be required as part of its liquidity risk management program to classify the liquidity of each of its positions in a portfolio asset (or portions of a position in a particular asset) based the number of days that the fund's position in the asset (or portion thereof) would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale. We estimate that 8,734 funds would be required to file, on a monthly basis, additional information on Form N-PORT as a result of the proposed amendments.[850] Funds also would be required to conduct an ongoing review of the liquidity of their assets. Proposed rule 22e-4(b)(2)(ii) includes factors that funds must take into account when classifying the liquidity of their assets. The liquidity classifications of each portfolio asset position would be reported on Item C. 13 of proposed Form N-PORT.

Based on staff outreach, we understand that many funds currently categorize assets based on their liquidity, but this proposal would require a specific type of classification and the determination of a three-day liquid asset minimum. We expect that funds would incur a one-time internal burden to initially classify a fund's portfolio securities and program existing systems to conduct the ongoing classifications and reviews required by the proposed rule for reporting purposes. We estimate that each fund would incur an average one-time burden of 54

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[850] There were 8,734 open-end funds (excluding money market funds, and including ETFs (for purposes of these calculations, we exclude non-1940 Act ETFs)) as of the end of 2014. *See* 2015 ICI Fact Book, *supra* note 3, at 177, 184.

hours at a time cost of $15,330.[851] Amortized over a three year period, this would result in an average annual hour burden of approximately 18 burden hours and a time cost of $5,110.[852]

2. *Reporting on Proposed Form N-PORT*

In addition to the classification and review of securities, we estimate that 8,734[853] funds would be required to file, on a monthly basis, additional information on Form N-PORT as a result of the proposed amendments. We estimate that each fund that files reports on Form N-PORT in house (35%, or 3,057 funds) would require an average of approximately 3 burden hours to compile (including review of the information), tag, and electronically file the additional information in light of the proposed amendments for the first time and an average of approximately 1 burden hours for subsequent filings. Therefore, we estimate the per fund average annual hour burden associated with the incremental changes to Form N-PORT as a result of the proposed amendments for these funds would be an additional 14 hours for the first year[854] and an additional 12 hours for each subsequent year.[855] Amortized over three years, the average annual hour burden would be an additional 12.67 hours per fund.[856]

We estimate that 65% of funds (5,677) would retain the services of a third party to provide data aggregation, validation and/or filing services as part of the preparation and filing of

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851 We estimate that these systems modifications would include the following costs: (i) project planning and systems design (24 hours x $260 (hourly rate for a senior systems analyst) = $6,240) and (ii) systems modification integration, testing, installation and deployment (30 hours x $303 (hourly rate for a senior programmer) = $9,090. $6,240 + $9,090 = $15,330.

852 $15,330 ÷ 3 = $5,110.

853 There were 8,734 open-end funds (excluding money market funds, and including ETFs) as of the end of 2014. *See* 2015 ICI Fact Book, *supra* note 3, at 177, 184.

854 The estimate is based on the following calculation: (1 filing x 3 hours) + (11 filings x 1 hour) = 14 burden hours in the first year.

855 This estimate is based on the following calculation: 12 filings x 1 hour = 12 burden hours in each subsequent year.

856 The estimate is based on the following calculation: (14 + (12 x 2)) ÷ 3 = 12.67.

reports on proposed Form N-PORT on the fund's behalf. For these funds, we estimate that each fund would require an average of approximately 4 hours to compile and review the information with the service provider prior to electronically filing the report for the first time and an average of 0.5 burden hours for subsequent filings. Therefore, we estimate the per fund average annual hour burden associated with the incremental changes to proposed Form N-PORT as a result of the proposed amendments for these funds would be an additional 9.5 hours for the first year[857] and an additional 6 hours for each subsequent year.[858] Amortized over three years, the average aggregate annual hour burden would be an additional 7.17 hours per fund.[859] In sum, we estimate that the proposed amendments to Form N-PORT would impose an average total annual hour burden of an additional 79,436.28 hours on applicable funds.[860] We do not anticipate any change to the total external annual costs of $97,674,221.[861]

F. Form N-CEN

On May 20, 2015, we proposed to amend rule 30a-1 to require all funds to file reports with certain census-type information on proposed Form N-CEN with the Commission on an annual basis. Proposed Form N-CEN would be a collection of information under the PRA, and is designed to facilitate the Commission's oversight of funds and its ability to monitor trends and risks. The collection of information under Form N-CEN would be mandatory for all funds, and responses would not be kept confidential.

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857 The estimate is based on the following calculation: (1 filing x 4 hours) + (11 filings x 0.5 hour) = 9.5 burden hours in the first year.

858 This estimate is based on the following calculation: 12 filings x 0.5 hour = 6 burden hours in each subsequent year.

859 The estimate is based on the following calculation: (9.5 + (6 x 2)) ÷ 3 = 7.17.

860 The estimate is based on the following calculation: (3,057 funds x 12.67 hours) + (5,677 funds x 7.17 hours) = 79,436.28 hours.

861 *See* Investment Company Reporting Modernization Release, *supra* note 104, at n. 751 and accompanying text.

In the Investment Company Reporting Modernization Release, we estimated that the average annual hour burden per response for proposed Form N-CEN for the first year would be 32.37 hours and 12.37 hours in subsequent years.[862] Amortizing the burden over three years, we estimated that the average annual hour burden per fund per year would be 19.04 and the total average annual hour burden would be 59,900 hours.[863] We also estimated that all applicable funds would incur, in the aggregate, external annual costs of $1,748,637, which would include the costs of registering and maintaining LEIs for funds.

We are proposing amendments to Form N-CEN to enhance the reporting of a fund's liquidity risk management practices. Specifically, the proposed amendments to Form N-CEN would require a fund to disclose information about committed lines of credit, including the size of the line of credit, the number of days that the line of credit was used, and the identity of the institution with whom the line of credit is held. The proposed amendments to Form N-CEN also would require a fund to report whether it engaged in interfund lending or interfund borrowing. Funds other than money market funds and ETFs would be required to report whether they used swing pricing during the reporting period. In addition, proposed amendments to Form N-CEN would require an ETF to report whether it required that an authorized participant post collateral to the ETF or any of its designated service providers in connection with the purchase or redemption of ETF shares during the reporting period.[864]

We estimate that 8,734 funds would be required to file responses on Form N-CEN as a result of the proposed amendments to the form. We estimate that the average annual hour

862 *Id.* at n. 762 and accompanying text.

863 *Id.* at n. 765 and accompanying text.

864 We do not estimate any change in burden as a result of proposed Item 60(g) of Form N-CEN because the proposed new item only requires a yes or no response.

burden per additional response to Form N-CEN as a result of the proposed amendments would be 0.5 hour per fund per year for a total average annual hour burden of 4,367 hours.[865] We do not estimate any change to the external costs associated with proposed Form N-CEN.

G. Form N-1A

Form N-1A is the registration form used by open-end investment companies. The respondents to the proposed amendments to Form N-1A are open-end management investment companies registered or registering with the Commission. Compliance with the disclosure requirements of Form N-1A is mandatory, and the responses to the disclosure requirements are not confidential. We currently estimate for Form N-1A a total hour burden of 1,579,974 hours, and the total annual external cost burden is $124,820,197.[866]

We are proposing amendments to Form N-1A that would require funds that use swing pricing to disclose that they use swing pricing, and, if applicable, an explanation of the circumstances under which swing pricing is used, and the effects of using swing pricing.[867] We also are proposing amendments to Form N-1A that would require funds to disclose on their balance sheet the NAV as adjusted pursuant to swing pricing policies and procedures. The proposed amendments to Form N-1A also would require funds to disclose additional information concerning the procedures for redeeming a fund's shares. Funds would be required to describe the number of days following receipt of shareholder redemption requests in which the fund will pay redemption proceeds to redeeming shareholders.[868] Funds also would be required to describe

865 This estimate is based on the following calculation: 8,734 funds x 0.5 hours = 4,367 hours.

866 These estimates are based on the last time the rule's information collections were submitted for PRA renewal in 2014.

867 *See* proposed Item 6(d) of Form N-1A.

868 *See* proposed Item 11(c)(7) of Form N-1A.

the methods used to meet redemption requests in stressed and non-stressed market conditions.[869] Finally, funds would be required to file as exhibits to their registration statements credit agreements for the benefit of the funds. Overall, we believe that requiring funds to provide this additional disclosure regarding swing pricing and redemption procedures, and requiring the filing of credit agreements would provide Commission staff, investors, and market participants with improved information about the procedures funds use to meet their redemption obligations and the conditions under which swing pricing procedures will be used to mitigate the effects of dilution as a result of shareholder purchase or redemption activity.

Form N-1A generally imposes two types of reporting burdens on investment companies: (i) the burden of preparing and filing the initial registration statement; and (ii) the burden of preparing and filing post-effective amendments to a previously effective registration statement (including post-effective amendments filed pursuant to rule 485(a) or 485(b) under the Securities Act, as applicable). We estimate that each fund would incur a one-time burden of an additional 2 hours,[870] at a time cost of an additional $637,[871] to draft and finalize the required disclosure and amend its registration statement. In aggregate, we estimate that funds would incur a one-time burden of an additional 17,468 hours,[872] at a time cost of an additional $5,563,558,[873] to comply with the proposed Form N-1A disclosure requirements. Amortizing the one-time burden over a

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869 *See* proposed Item 11(c)(8) of Form N-1A.

870 This estimate is based on the following calculation: 1 hour to update registration statement to include swing pricing-related disclosure statements + 1 hour to update registration statement disclosure about redemption procedures = 2 hours.

871 This estimate is based on the following calculation: 2 hours x $318.5 (blended rate for a compliance attorney ($334) and a senior programmer ($303)) = $637.

872 This estimate is based on the following calculations: 2 hours x 8,734 funds = 17,468 hours.

873 This estimate is based on the following calculation: 17,468 hours x $318.50 (blended rate for a compliance attorney ($334) and a senior programmer ($303)) = $5,563,558.

three-year period results in an average annual burden of an additional 5,823 hours at a time cost of an additional $1,854,519.[874]

We estimate that each fund would incur an ongoing burden of an additional 0.25 hours, at a time cost of an additional $80,[875] each year to review and update the proposed disclosure in response to Item 11 and Item 28 of Form N-1A regarding the pricing and redemption of fund shares and the inclusion of credit agreements as exhibits, respectively. In aggregate, we estimate that funds would incur an annual burden of an additional 2,184 hours,[876] at a time cost of an additional $695,604,[877] to comply with the proposed Form N-1A disclosure requirements.

Amortizing these one-time and ongoing hour and cost burdens over three years results in an average annual increased burden of approximately 0.50 hours per fund,[878] at a time cost of $265.42 per fund.[879]

In total, we estimate that funds would incur an average annual increased burden of approximately 8,007 hours,[880] at a time cost of approximately $2,550,123,[881] to comply with the proposed Form N-1A disclosure requirements. We do not estimate any change to the external costs associated with the proposed amendments to Form N-1A.

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874 This estimate is based on the following calculation: 17,468 hours ÷ 3 = 5,823 average annual burden hours; $5,563,558 burden costs ÷ 3 = $1,854,519 average annual burden cost.

875 This estimate is based on the following calculations: 0.25 hours x $318.50 (blended hourly rate for a compliance attorney ($334) and a senior programmer ($303)) = $79.63.

876 This estimate is based on the following calculation: 0.25 hours x 8,734 funds = 2,183.5 hours.

877 This estimate is based on the following calculation: 2,184 hours x $318.50 (blended hourly rate for a compliance attorney ($334) and a senior programmer ($303)) = $695,604.

878 This estimate is based on the following calculation: 1 burden hour (year 1) + 0.25 burden hour (year 2) + 0.25 burden hour (year 3) ÷ 3 = 0.50 hours.

879 This estimate is based on the following calculation: $637 (year 1 monetized burden hours) + $79.63 (year 2 monetized burden hours) + $79.63 (year 3 monetized burden hours) ÷ 3 = $265.42.

880 This estimate is based on the following calculation: 5,823 hours + 2,184 hours = 8,007 hours.

881 This estimate is based on the following calculation: $1,854,519 + $695,604 = $2,550,123.

H. Request for Comments

We request comment on whether our estimates for burden hours and any external costs as described above are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The agency has submitted the proposed collection of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments 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 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. S7-16-15. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release; therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-16-15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE., Washington, DC 20549-2736.

VI. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

This Initial Regulatory Flexibility Analysis has been prepared in accordance with section 3 of the Regulatory Flexibility Act ("RFA").[882] It relates to: proposed rule 22e-4; proposed amendments to rule 22c-1(a)(3) and rule 31a-2; and proposed amendments to Form N-1A, Regulation S-X, proposed Form N-PORT, and proposed Form N-CEN.

A. Reasons for and Objectives of the Proposed Actions

Funds are not currently subject to requirements under the federal securities laws or Commission rules that specifically require them to manage their liquidity risk.[883] Also, with the exception of money market funds, there are guidelines (not rules) stating that an open-end fund should limit its investments in illiquid assets.[884] Moreover, funds are only subject to limited disclosure and reporting requirements concerning a fund's liquidity risk and risk management.[885] We understand that funds today engage in a variety of different practices, with varying levels of comprehensiveness, for classifying the liquidity of their portfolio assets, assessing and managing liquidity risk, and disclosing information about their liquidity risk, redemption practices, and liquidity risk management practices to investors.[886]

The Commission is proposing a new rule, amendments to current rules, and amendments to current and proposed forms that are designed to promote effective liquidity risk management

882 5 U.S.C. 603.

883 *See supra* sections II.D, IV.B.1.a.

884 *See id.*

885 *See supra* sections II.D, IV.B.1.c.

886 *See supra* sections II.D, IV.B.1.a, IV.B.1.c.

throughout the open-end fund industry and thereby reduce the risk that funds will be unable to meet redemption obligations and mitigate dilution of the interests of fund shareholders. The proposed amendments also seek to enhance disclosure regarding fund liquidity and redemption practices. Specifically, a primary objective of these proposed liquidity regulations is to promote shareholder protection by elevating the overall quality of liquidity risk management across the fund industry, as well as by increasing transparency of funds' liquidity risks and risk management. The proposed liquidity regulations are also intended to lessen the possibility of early redemption incentives (and investor dilution) created by insufficient liquidity risk management, as well as the possibility that investors' share value will be diluted by costs incurred by the fund as a result of other investors' purchase and redemption activity. Finally, the proposed liquidity regulations are meant to address recent industry developments that have underscored the significance of funds' liquidity risk management practices. Each of these objectives is discussed in detail in section IV above.

B. Legal Basis

The Commission is proposing new rule 22e-4 under the authority set forth in sections 22(c), 22(e) and 38(a) of the Investment Company Act [15 U.S.C. 80a-37(a)]. The Commission is proposing amendments to rule 22c-1 under the authority set forth in sections 22(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a-22(c) and 80a-37(a)]. The Commission is proposing amendments to rule 31a-2 under the authority set forth in section 31(a) of the Investment Company Act [15 U.S.C. 80a-31(a)]. The Commission is proposing amendments to Form N-1A, Regulation S-X, proposed Form N-PORT, and proposed Form N-CEN under the authority set forth in the Securities Act, particularly section 19 thereof [15 U.S.C. 77a *et seq.*], the Trust Indenture Act, particularly, section 19 thereof [15 U.S.C. 77aaa *et seq.*], the Exchange

Act, particularly sections 10, 13, 15, and 23, and 35A thereof [15 U.S.C. 78a *et seq.*], and the Investment Company Act, particularly, sections 8, 30, and 38 thereof [15 U.S.C. 80a *et seq.*].

C. Small Entities Subject to the Proposed Liquidity Regulations

An investment company is a small entity if, together with other investment companies in the same group of related investment companies, it has net assets of $50 million or less as of the end of its most recent fiscal year.[887] Commission staff estimates that, as of December 2014, there were 134 small open-end investment companies (comprising 85 fund complexes) that would be considered small entities; this number includes open-end ETFs.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

1. Proposed Rule 22e-4

Proposed new rule 22e-4 would require each fund, including each small entity, to establish a written liquidity risk management program.[888] A fund's liquidity risk management program would be required to include the following elements: (i) a fund must classify, and review the classification on an ongoing basis, the liquidity of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset), taking into account certain specified factors;[889] (ii) a fund must assess and periodically review its liquidity risk, taking into account certain specified factors;[890] and (iii) a fund must manage its liquidity risk, including by maintaining a prescribed minimum portion of net assets in three-day liquid assets.[891] A fund's board, including a majority of the fund's independent directors, would be required to approve the

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887 *See* rule 0-10(a) under the Investment Company Act.

888 Proposed rule 22e-4(b)(1).

889 Proposed rule 22e-4(b)(2)(i)-(ii).

890 Proposed rule 22e-4(b)(2)(iii).

891 Proposed rule 22e-4(b)(2)(iv).

fund's liquidity risk management program, as well as any material change to the program.[892] Proposed rule 22e-4 also includes certain recordkeeping requirements.[893] All of these requirements are discussed in detail above in sections III.A. and III.E. For smaller funds and fund groups (*i.e.*, funds that together with other investment companies in the same "group of related investment companies" have net assets of less than $1 billion as of the end of the most recent fiscal year), which would include small entities, we have proposed an extra 12 months (or 30 months after the effective date) to comply with the proposed liquidity risk management program requirement.[894]

We estimate that 85 fund complexes are small fund groups that have funds that would be required to comply with the proposed liquidity risk management program requirement.[895] As discussed above, we estimate that, on average, a fund complex would incur one-time costs ranging from $1,300,000 to $2,250,000, depending on the fund's particular circumstances and current liquidity risk management practices, to establish and implement a liquidity risk management program.[896] We further estimate that a fund complex would incur ongoing annual costs associated with proposed rule 22e-4 that would range from $130,000 to $562,500.[897] For purposes of this analysis, Commission staff estimates, based on outreach conducted with a variety of funds regarding funds' current liquidity risk management practices, that approximately two-thirds of small fund groups would incur one-time and ongoing costs on the low end of the range of costs associated with establishing and implementing a liquidity risk management

892 Proposed rule 22e-4(b)(3).

893 Proposed rule 22e-4(c).

894 *See supra* section III.H.

895 *See supra* section VI.C.

896 *See supra* section IV.C.1.c.

897 *See id.*

program,[898] and one-third of small fund groups would incur one-time and ongoing costs on the high end of the range.[899]

2. *Swing Pricing*

Under proposed rule 22c-1(a)(3), all funds (except money market funds and ETFs), including small entities, would be permitted (but not required) to use swing pricing to adjust the fund's current NAV to prevent potential dilution of the value of outstanding redeemable securities caused by shareholder purchase or redemption activity. In order to use swing pricing, a fund would be required to adopt swing pricing policies and procedures that must: (i) provide that the fund will adjust its NAV by an amount designated as the "swing factor" once the level of net purchases or net redemptions from the fund has exceeded a specified percentage of the fund's net asset value known as the "swing threshold";[900] (ii) specify the fund's swing threshold, considering certain specified factors;[901] (iii) provide for the periodic review (at least annually) of the fund's swing threshold considering certain specified factors;[902] (iv) specify how the swing factor to be used to adjust the fund's NAV when the fund's swing threshold is breached will be determined, which determination must take into account certain specified factors.[903] A fund's board, including a majority of the fund's independent directors, would be required to approve the fund's swing pricing policies and procedures.[904] A fund that adopts swing pricing policies and procedures also would be subject to certain recordkeeping requirements under proposed rule

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898 *See id.*

899 *See id.*

900 Proposed rule 22c-1(a)(3)(i)(A).

901 Proposed rule 22c-1(a)(3)(i)(B).

902 Proposed rule 22c-1(a)(3)(i)(C).

903 Proposed rule 22c-1(a)(3)(i)(D).

904 Proposed rule 22c-1(a)(3)(ii).

22c-1(a)(3) and proposed amendments to rule 31a-2(a)(2).[905] Because proposed rule 22c-1(a)(3) would permit, but not require, a fund to adopt swing pricing policies and procedures, there is no compliance date associated with this proposed rule. Thus, while we anticipate that the compliance dates for proposed rule 22e-4 and the proposed disclosure and reporting requirements regarding liquidity risk and liquidity risk management would be tiered to permit a longer compliance period for smaller funds and fund groups, there would be no need for tiered compliance with respect to proposed rule 22c-1(a)(3) and the proposed amendments to rule 31a-2(a)(2), because a fund would be permitted to adopt swing pricing policies and procedures within whatever period the fund chooses.[906]

As discussed above, we estimate that, on average, a fund complex would incur one-time costs ranging from $1,300,000 to $2,250,000, depending on the fund complex's particular circumstances, to adopt swing pricing policies and procedures and comply with related record retention requirements, as well as ongoing annual costs ranging from $65,000 to $337,500 per year associated with the proposed swing pricing (and related recordkeeping) regulations.[907] We estimate that 24 fund complexes that are small complexes would adopt swing pricing policies and procedures under proposed rule 22c-1(a)(3).[908] Because staff is unable to estimate how many small fund complexes would incur one-time and ongoing costs on the low end of the estimated range versus the high end of the estimated range, staff estimates that each small fund complex

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905 Proposed rule 22c-1(a)(3)(iii); proposed amendments to rule 31a-2(a)(2).

906 *See supra* section III.H.

907 *See supra* section IV.C.2.c.

908 We assume that certain types of mutual fund strategies (high-yield bond funds, world bond funds (including emerging market debt funds), multi-sector bond funds, state municipal funds, alternative strategy funds, and emerging market equity funds would be relatively more likely to adopt swing pricing policies and procedures, and of the fund complexes with funds comprising these strategies, 75% would actually adopt swing pricing policies and procedures. Staff estimates that there are 32 fund complexes that are small fund groups with funds that use these stated strategies. 0.75 x 32 funds = 24 funds.

would incur one-time costs of $1,775,000 (which represents the middle of the range of estimated one-time costs)[909] and ongoing costs of $201,250 (which represents the middle of the range of estimated ongoing costs).[910]

3. *Disclosure and Reporting Requirements Regarding Liquidity Risk and Liquidity Risk Management*

We are proposing amendments to Form N-1A, proposed Form N-PORT, and proposed Form N-CEN to enhance fund disclosure and reporting regarding the fund's redemption practices, portfolio liquidity, and certain liquidity risk management practices. Specifically, proposed amendments to Form N-1A would require new disclosure regarding a fund's redemption practices and its use of swing pricing (as applicable);[911] and proposed amendments to proposed Form N-PORT would require a fund to report certain information about the liquidity of the fund's portfolio assets.[912] Proposed amendments to proposed Form N-CEN would require a fund to report certain information about the fund's use of lines of credit, interfund lending and borrowing, and swing pricing, and also would require an ETF to report whether it requires authorized participants to post collateral in connection with the purchase or redemption of ETF shares.[913]

All funds would be subject to the proposed disclosure and reporting requirements, including funds that are small entities. For smaller funds and fund groups (*i.e.*, funds that together with other investment companies in the same "group of related investment companies"

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909 This estimate is based on the following calculations: $1,300,000 + $2,250,000 = $3,550,000; $3,550,000 ÷ 2 = $1,775,000.

910 This estimate is based on the following calculations: $65,000 + $337,500 = $402,500; $402,500 ÷ 2 = $201,250.

911 Proposed Items 6(d), 11(c)(8), 11(c)(9) of Form N-1A.

912 Proposed Items B.7, C.7, and C.13 of proposed Form N-PORT.

913 Proposed Items 44 and 60(g) of proposed Form N-CEN.

have net assets of less than $1 billion as of the end of the most recent fiscal year), which would include small entities, we proposed an extra 12 months (or 30 months after the effective date) to comply with the proposed Form N-PORT reporting requirements.[914] We estimate that 134 funds are small entities that would be required to comply with the proposed disclosure and reporting requirements.[915]

As discussed above, we estimate that each fund, including funds that are small entities, would incur a one-time burden of an additional 2 hours, at a time cost of an additional $637 (plus printing costs), to comply with the proposed amendments to Form N-1A.[916] We also estimate that each fund, including small entities, would incur an ongoing burden of an additional 0.25 hours, at a time cost of approximately an additional $80 each year associated with compliance with the proposed amendments to Form N-1A.[917] We do not estimate any change to the external costs associated with the proposed amendments to Form N-1A.[918]

We also estimate that the one-time disclosure- and reporting-related compliance costs for a fund that files reports in compliance with the proposed amendments to Form N-PORT in house would be approximately $780, and the one-time costs for a fund that uses a third-party service provider to prepare and file reports on proposed Form N-PORT would be approximately $1,040.[919] We estimate that the ongoing disclosure- and reporting-related compliance costs for a fund that files reports to comply with the proposed amendments to Form N-PORT in house would be approximately $260, and the ongoing costs for a fund that uses a third-party service

914 *See supra* section III.H.

915 *See supra* section VI.C.

916 *See supra* notes 790, 870-871 and accompanying text.

917 *See supra* notes 791, 875 and accompanying text.

918 *See supra* section V.G.

919 *See supra* notes 801-802 and accompanying text.

provider to prepare and file reports on proposed Form N-PORT would be approximately $130.[920] These compliance cost estimates would not vary based on the fund's size. We assume that 35% of funds that are small entities, or approximately 47 funds, would file reports on proposed Form N-PORT in house, and 65% of funds that are small entities, or approximately 87 funds, would use a third-party service provider to prepare and file reports on proposed Form N-PORT.[921]

As discussed above, we also estimate that the average annual burden per additional response to Form N-CEN as a result of the proposed amendments would be 0.5 hour per year per fund, including funds that are small entities.[922] Furthermore, we estimate that the one-time and ongoing annual compliance costs associated with providing additional responses to Form N-CEN as a result of the proposed amendments would be approximately $160 per fund, including funds that are small entities.[923] We do not estimate any change to the external costs associated with proposed Form N-CEN.[924]

E. Duplicative, Overlapping, or Conflicting Federal Rules

Commission staff has not identified any federal rules that duplicate, overlap, or conflict with the proposed liquidity regulations.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant economic impact on small entities. We considered the following alternatives for small entities in relation to the proposed

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920 *See supra* notes 803-804 and accompanying text.

921 *See supra* notes 801-804 and accompanying text.

922 *See supra* note 865 and accompanying text.

923 *See supra* note 800 and accompanying text.

924 *See supra* section V.F.; *see also* note 800 and accompanying text.

liquidity regulations: (i) exempting funds that are small entities from proposed rule 22e-4, and/or establishing different requirements under proposed rule 22e-4 to account for resources available to small entities; (ii) exempting funds that are small entities from the proposed disclosure and reporting requirements, or establishing different disclosure and reporting requirements, or different reporting frequency, to account for resources available to small entities; and (iii) exempting funds that are small entities from proposed rule 22c-1(a)(3) and the recordkeeping requirements of the proposed amendments to rule 31a-2.

We do not believe that exempting any subset of funds, including funds that are small entities, from proposed rule 22e-4 would permit us to achieve our stated objectives. As discussed above, we believe that the proposed liquidity regulations would result in multiple investor protection benefits, and these benefits should apply to investors in smaller funds as well as investors in larger funds.[925] Small funds do not entail less liquidity risk than larger funds, and investors in small funds could suffer from ineffective liquidity risk management just as investors in larger funds could. Indeed, analysis by staff economists has shown that funds with relatively low assets can actually experience greater flow volatility (including more volatility in unexpected flows) than funds with higher assets, which in turn could lead to increased liquidity risk for investors in smaller funds.[926] Moreover, we understand, based on staff outreach, that small funds today are less likely than large funds to employ relatively comprehensive portfolio liquidity classification practices and liquidity risk management practices. Thus, while small funds may face increased liquidity risk, these funds currently may have less effective systems in place to address and mitigate this risk than larger funds. We therefore do not believe it would be

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[925] *See supra* section IV.C.1.b.

[926] *See supra* note 727 and accompanying text.

appropriate to exempt funds that are small entities from the liquidity risk management requirements of proposed rule 22e-4. We do note, however, that we are proposing a delayed compliance period for proposed rule 22e-4 for funds that are small entities.[927]

We also do not believe that it would be desirable to establish different requirements applicable to funds of different sizes under proposed rule 22e-4 to account for resources available to small entities. We believe that all of the proposed program elements would be necessary for a fund to effectively assess and manage its liquidity risk, and we anticipate that all of the proposed program elements would work together to produce the anticipated investor protection benefits. We do note that the costs associated with proposed rule 22e-4 would vary depending on the fund's particular circumstances, and thus the proposed rule could result in different burdens on funds' resources. In particular, we expect that a fund that pursues an investment strategy that involves greater liquidity risk may have greater costs associated with its liquidity risk management program. However, we believe that it is appropriate to correlate the costs associated with the proposed rule with the level of liquidity risk facing a fund, and not necessarily with the fund's size. Under the proposed rule, a fund would be permitted to customize its liquidity risk management program precisely to reflect the liquidity risks that it typically faces, and that it could face in stressed market conditions. This flexibility in permitting a fund to customize its liquidity risk management program is meant to result in programs whose scope, and related costs and burdens, are appropriate to manage the actual amount of liquidity risk faced by a particular fund. Thus, to the extent a fund that is a small entity faces relatively little liquidity risk, it would incur relatively low costs to comply with proposed rule 22e-4. However, as discussed above, we believe that small funds could generally entail relatively high

927 *See supra* section III.H.

liquidity risk compared to larger funds, and thus these funds could incur relatively high costs to comply with proposed rule 22e-4.[928]

Similarly, we do not believe that the interest of investors would be served by exempting funds that are small entities from the proposed disclosure and reporting requirements, or subjecting these funds to different disclosure and reporting requirements than larger funds. We believe that all fund investors, including investors in funds that are small entities, would benefit from disclosure and reporting requirements that would permit them to make investment choices that better match their risk tolerances.[929] We also believe that all fund investors would benefit from enhanced Commission monitoring and oversight of the fund industry, which we anticipate would result from the proposed disclosure and reporting requirements. We note that the current disclosure requirements for reports on Form N-1A, and the proposed requirements for reports on proposed Form N-PORT and proposed Form N-CEN, do not distinguish between small entities and other funds.[930] However, as discussed above, proposed Form N-PORT has a delayed compliance period for small entities that would file reports on this form, and we are also proposing a delayed compliance period for the amendments to proposed Form N-PORT that we are proposing today.[931]

Finally, we are not exempting funds that are small entities from proposed rule 22c-1(a)(3) because we believe that all funds should be able to use swing pricing as a voluntary tool to

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928 *See supra* note 926 and accompanying text.

929 *See supra* section IV.C.3.b.

930 *See* Investment Company Reporting Modernization Release, *supra* note 104, at section IV.F (noting that small entities currently follow the same requirements that large entities do when filing reports on Form N-SAR, Form N-CSR, and Form N-Q, and stating that the Commission believes that establishing different reporting requirements or frequency for small entities (including with respect to proposed Form N-PORT and proposed Form N-CEN) would not be consistent with the Commission's goal of industry oversight and investor protection).

931 *See supra* section III.H.

mitigate potential shareholder dilution.[932] We do not believe that the potential dilution that proposed rule 22c-1(a)(3) is meant to prevent would affect large funds and their shareholders more significantly than small funds and investors in small funds. Also, because the adoption of swing pricing policies and procedures would be permitted, but not required, under proposed rule 22c-1(a)(3), a fund that is a small entity would not need to incur the costs of compliance with the proposed rule if the fund (and the fund's board) were to determine that the advantages of swing pricing would not outweigh the associated disadvantages, including compliance costs.

G. General Request for Comment

The Commission requests comments regarding this analysis. We request comment on the number of small entities that would be subject to the proposed liquidity regulations and whether the proposed liquidity regulations 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 proposed liquidity regulations and provide empirical data to support the nature and extent of such effects. We also request comment on the estimated compliance burdens of the proposed liquidity regulations and how they would affect small entities.

VII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"), the Commission must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or

932 *See supra* section IV.C.2.b.

- Significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a "major rule" for purposes of SBREFA. 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.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VIII. STATUTORY AUTHORITY AND TEXT OF PROPOSED AMENDMENTS

The Commission is proposing new rule 22e-4 under the authority set forth in sections 22(c), 22(e) and 38(a) of the Investment Company Act [15 U.S.C. 80a-37(a)]. The Commission is proposing amendments to rule 22c-1 under the authority set forth in sections 22(c) and 38(a) of the Investment Company Act [15 U.S.C. 80a-22(c) and 80a-37(a)]. The Commission is proposing amendments to rule 31a-2 under the authority set forth in section 31(a) of the Investment Company Act [15 U.S.C. 80a-31(a)]. The Commission is proposing amendments to Form N-1A, Regulation S-X, proposed Form N-PORT, and proposed Form N-CEN under the authority set forth in the Securities Act, particularly section 19 thereof [15 U.S.C. 77a *et seq.*], the Trust Indenture Act, particularly, section 19 thereof [15 U.S.C. 77aaa *et seq.*], the Exchange Act, particularly sections 10, 13, 15, and 23, and 35A thereof [15 U.S.C. 78a *et seq.*], and the Investment Company Act, particularly, sections 8, 30, and 38 thereof [15 U.S.C. 80a *et seq.*].

TEXT OF RULES AND FORMS

List of Subjects

17 CFR Part 210

Accounting, Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, 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:

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

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

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

2. Amend §210.6-02 by adding paragraphs (e), (f) and (g) to read as follows:

§210.6-02 Definition of certain terms.

* * * * *

(e) *Illiquid investment.* The term *illiquid investment* means an investment that is a 15% standard asset, as defined in §270.22e-4(a)(4).

(f) *Illiquid securities.* The term *illiquid securities* means securities that are 15% standard assets, as defined in §270.22e-4(a)(4).

(g) *Swing pricing.* The term *swing pricing* shall have the meaning given in §270.22c-1(a)(3)(v)(C).

3. Section 210.6-03 is further amended, as proposed at 80 FR 33687, June 12, 2015, by adding paragraph (n) to read as follows:

§210.6-03 Special rules of general application to registered investment companies and business development companies.

* * * * *

(n) *Swing Pricing*. For a registered investment company that has adopted swing pricing policies and procedures, state in a note the general methods used in determining whether the company's net asset value per share will swing, if the company's net asset value per share has swung during the year, and a general description of the effects of swing pricing on the company's financial statements.

4. Section 210.6-04 is further amended, as proposed at 80 FR 33688, June 12, 2015 by revising item 19 to read as follows:

§210.6-04 Balance sheets

* * * * *

19. *Net assets applicable to outstanding units of capital.* State the net asset value per share as adjusted pursuant to swing pricing policies and procedures, if applicable.

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

5. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39, and Pub. L. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

6. Amend §270.22c-1 by adding paragraph (a)(3) to read as follows:

§ 270.22c-1 Pricing of redeemable securities for distribution, redemption and repurchase.

(a) * * *

(3) Notwithstanding this paragraph (a), a registered open-end management investment

company (but not a registered open-end management investment company that is regulated as a money market fund under § 270.2a-7 or an exchange-traded fund as defined in paragraph (a)(3)(v)(A) of this section) (a "fund") may use swing pricing to adjust its current net asset value per share to mitigate dilution of the value of its outstanding redeemable securities as a result of shareholder purchase and redemption activity, provided that it has established and implemented swing pricing policies and procedures in compliance with the paragraphs (a)(3)(i)-(v) of this section.

(i) The fund's swing pricing policies and procedures shall:

(A) Provide that the fund must adjust its net asset value per share by a swing factor, determined pursuant to paragraph (a)(3)(i)(D) of this section, once the level of net purchases into or net redemptions from such fund has exceeded the fund's swing threshold, determined pursuant to paragraph (a)(3)(i)(B) of this section. In determining whether the fund's level of net purchases or net redemptions has exceeded the fund's swing threshold, the person(s) responsible for administering the fund's swing pricing policies and procedures pursuant to paragraph (a)(3)(ii)(B) of this section: shall be permitted to make such determination on the basis of information obtained after reasonable inquiry; and shall exclude any purchases or redemptions that are made in kind and not in cash.

(B) Specify the fund's swing threshold to be used pursuant to paragraph (3)(i)(A) of this section, considering:

(1) The size, frequency, and volatility of historical net purchases or net redemptions of fund shares during normal and stressed periods;

(2) The fund's investment strategy and the liquidity of the fund's portfolio assets;

(3) The fund's holdings of cash and cash equivalents, as well as borrowing arrangements

and other funding sources; and

(4) The costs associated with transactions in the markets in which the fund invests.

(C) Provide for the periodic review, no less frequently than annually, of the fund's swing threshold, considering the factors set forth in paragraph (a)(3)(i)(B) of this section.

(D) Specify how the swing factor to be used pursuant to paragraph (a)(3)(i)(A) of this section shall be determined, and whether the swing factor would be subject to any upper limit. The determination of the swing factor, as well as any upper limit on the swing factor, must take into account:

(1) Any near-term costs expected to be incurred by the fund as a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's net asset value per share, including any market impact costs, spread costs, and transaction fees and charges arising from asset purchases or asset sales to satisfy those purchases or redemptions, as well as any borrowing-related costs associated with satisfying redemptions; and

(2) The value of assets purchased or sold by the fund as a result of net purchases or net redemptions that occur on the day the swing factor is used to adjust the fund's net asset value per share, if that information would not be reflected in the current net asset value of the fund computed that day.

(ii) The fund's swing pricing policies and procedures shall be subject to the following approval and oversight requirements:

(A) The fund's board of directors, including a majority of directors who are not interested persons of the fund, shall approve the swing pricing policies and procedures (including the fund's swing threshold, and any swing factor upper limit specified under the fund's swing pricing policies and procedures), as well as any material change to the policies and procedures (including any change to the fund's swing threshold, a change to any swing factor upper limit specified under the fund's swing pricing policies and procedures, or any decision to suspend or terminate the fund's swing pricing policies and procedures).

(B) The fund's board of directors shall designate the fund's investment adviser or officers responsible for administering the swing pricing policies and procedures, and for determining the swing factor that will be used each time the swing threshold is breached; provided that determination of the swing factor must be reasonably segregated from the portfolio management function of the fund.

(iii) The fund shall maintain a written copy of the policies and procedures adopted by the fund under this paragraph (a)(3) that are in effect, or at any time within the past six years were in effect, in an easily accessible place.

(iv) Any fund (a "feeder fund") that invests, pursuant to section 12(d)(1)(E) of the Act (15 U.S.C. 80a-12(d)(1)(E)), in another fund (a "master fund") may not use swing pricing to adjust the feeder fund's net asset value per share; however, a master fund may use swing pricing to adjust the master fund's net asset value per share, pursuant to the requirements set forth in this paragraph (a)(3).

(v) For purposes of this paragraph (a)(3):

(A) *Exchange-traded fund* means an open-end management investment company or a class thereof, the shares of which are traded on a national securities exchange, and that operates pursuant to an exemptive order granted by the Commission or in reliance on an exemptive rule adopted by the Commission.

(B) *Swing factor* means the amount, expressed as a percentage of the fund's net asset value and determined pursuant to the fund's swing pricing procedures, by which a fund adjusts its net asset value per share when the level of net purchases into or net redemptions from the fund has exceeded the fund's swing threshold.

(C) *Swing pricing* means the process of adjusting a fund's current net asset value per share to mitigate dilution of the value of its outstanding redeemable securities as a result of shareholder purchase and redemption activity, pursuant to the requirements set forth in this paragraph (a)(3).

(D) *Swing threshold* means the amount of net purchases into or net redemptions from a fund, expressed as a percentage of the fund's net asset value, that triggers the initiation of swing pricing.

(E) *Transaction fees and charges* means brokerage commissions, custody fees, and any other charges, fees, and taxes associated with portfolio asset purchases and sales.

*   *   *   *   *

7. Section §270.22e-4 is added to read as follows:

§270.22e-4 Liquidity risk management programs.

(a) Definitions. For purposes of this section:

(1) Acquisition *(or acquire)* means any purchase or subsequent rollover.

(2) Business *day* means any day, other than Saturday, Sunday, or any customary business holiday.

(3) Convertible *to cash* means the ability to be sold, with the sale settled.

(4) *15% standard asset* means an asset that may not be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund. For purposes of this definition, the fund does not need to consider the size of the fund's

position in the asset or the number of days associated with receipt of proceeds of sale or disposition of the asset.

(5) *Fund* means an open-end management investment company that is registered or required to register under section 8 of the Act (15 U.S.C. 80a-8) and includes a separate series of such an investment company, but does not include a registered open-end management investment company that is regulated as a money market fund under § 270.2a-7.

(6) *Less liquid asset* means any position of a fund in an asset (or portion of the fund's position in an asset) that is not a three-day liquid asset. In determining whether a position or portion of a position in an asset is a less liquid asset, a fund must take into account the factors set forth in paragraph (b)(2)(ii) of this section, to the extent applicable.

(7) *Liquidity risk* means the risk that the fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value.

(8) *Three-day liquid asset* means any cash held by a fund and any position of a fund in an asset (or portion of the fund's position in an asset) that the fund believes is convertible into cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale. In determining whether a position or portion of a position in an asset is a three-day liquid asset, a fund must take into account the factors set forth in paragraph (b)(2)(ii) of this section, to the extent applicable.

(9) *Three-day liquid asset minimum* means the percentage of the fund's net assets to be invested in three-day liquid assets pursuant to section (b)(2)(iv)(A) and (C) of this section.

(b) *Adoption and implementation of liquidity risk management program.*

(1) Program requirement. Each fund shall adopt and implement a written liquidity risk management program ("program") that is reasonably designed to assess and manage the fund's liquidity risk. The program shall include policies and procedures incorporating the elements of paragraphs (b)(2)(i) through (iv) of this section. The program shall be administered by the fund's investment adviser, or an officer or officers of the fund, but may not be administered solely by portfolio managers of the fund.

(2) Required program elements. Each fund must:

(i) Classify and engage in an ongoing review of each of the fund's positions in a portfolio asset (or portions of a position in a particular asset) based on the following categories of number of days in which it is determined, using information obtained after reasonable inquiry, that the fund's position in the asset (or portion thereof) would be convertible to cash at a price that does not materially affect the value of that asset immediately prior to sale:

(A) Convertible to cash within 1 business day;

(B) Convertible to cash within 2-3 business days;

(C) Convertible to cash within 4-7 calendar days;

(D) Convertible to cash within 8-15 calendar days;

(E) Convertible to cash within 16-30 calendar days; and

(F) Convertible to cash in more than 30 calendar days.

Note to paragraph (b)(2)(i): In situations in which the period to convert a position to cash could be viewed either as two-to-three business days or four-to-seven calendar days, a fund should classify the position based on the shorter period (*i.e.*, two-to-three business days, not four-to-seven calendar days).

(ii) For purposes of classifying and reviewing the liquidity of a fund's position in a portfolio asset (or portion thereof) under paragraph (b)(2)(i) of this section, take into account the following factors, to the extent applicable, with respect to the asset (or similar asset(s), to the extent that data concerning the portfolio asset is not available to the fund):

(A) Existence of an active market for the asset, including whether the asset is listed on an exchange, as well as the number, diversity, and quality of market participants;

(B) Frequency of trades or quotes for the asset and average daily trading volume of the asset (regardless of whether the asset is a security traded on an exchange);

(C) Volatility of trading prices for the asset;

(D) Bid-ask spreads for the asset;

(E) Whether the asset has a relatively standardized and simple structure;

(F) For fixed income securities, maturity and date of issue;

(G) Restrictions on trading of the asset and limitations on transfer of the asset;

(H) The size of the fund's position in the asset relative to the asset's average daily trading volume and, as applicable, the number of units of the asset outstanding. Analysis of position size should consider the extent to which the timing of disposing of the position could create any market value impact; and

(I) Relationship of the asset to another portfolio asset.

(iii) Assess and periodically review the fund's liquidity risk, considering the fund's:

(A) Short-term and long-term cash flow projections, taking into account the following considerations:

(*1*) Size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods;

(*2*) Fund's redemption policies;

(*3*) Fund's shareholder ownership concentration;

(*4*) Fund's distribution channels; and

(*5*) Degree of certainty associated with the fund's short-term and long-term cash flow projections.

(B) Investment strategy and liquidity of portfolio assets;

(C) Use of borrowings and derivatives for investment purposes; and

(D) Holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources.

(iv) Manage the fund's liquidity risk, including that the fund will:

(A) Determine the fund's three-day liquid asset minimum, considering the factors specified in paragraphs (b)(2)(iii)(A) through (D) of this section;

(B) Periodically review, no less frequently than semi-annually, the adequacy of the fund's three-day liquid asset minimum, considering the factors incorporated in paragraphs (b)(2)(iii)(A) through (D) of this section;

(C) Not acquire any less liquid asset if, immediately after the acquisition, the fund would have invested less than its three-day liquid asset minimum in three-day liquid assets;

(D) Not acquire any 15% standard asset if, immediately after the acquisition, the fund would have invested more than 15% of its total assets in 15% standard assets; and

(E) Establish policies and procedures regarding redemptions in kind, to the extent that the fund engages in or reserves the right to engage in redemptions in kind.

(3) Board approval and oversight of the program.

(i) The fund shall obtain initial approval of the liquidity risk management program (including the fund's three-day liquid asset minimum), as well as any material change to the program (including a change to the fund's three-day liquid asset minimum), from the fund's board of directors, including a majority of directors who are not interested persons of the fund.

(ii) The fund's board of directors, including a majority of directors who are not interested persons of the fund, shall review, no less frequently than annually, a written report prepared by the fund's investment adviser or officers administering the liquidity risk management program that describes the adequacy of the fund's liquidity risk management program, including the fund's three-day liquid asset minimum, and the effectiveness of its implementation.

(iii) The fund shall designate the fund's investment adviser or officers (which may not be solely portfolio managers of the fund) responsible for administering the policies and procedures incorporating the elements of paragraphs (b)(2)(i) through (iv) of this section, whose designation must be approved by the fund's board of directors, including a majority of the directors who are not interested persons of the fund.

(c) *Recordkeeping*. The fund must maintain:

(1) A written copy of the policies and procedures adopted by the fund under paragraphs (b)(1) of this section that are in effect, or at any time within the past five years were in effect, in an easily accessible place;

(2) Copies of any materials provided to the board of directors in connection with its approval under paragraph (b)(3)(i) of this section, and written reports provided to the board of directors under paragraph (b)(3)(ii) of this section, for at least five years after the end of the fiscal year in which the documents were provided, the first two years in an easily accessible place; and

(3) A written record of how the three-day liquid asset minimum, and any adjustments thereto, were determined, including assessment of the factors incorporated in paragraphs (b)(2)(iii)(A) through (D) of this section, for a period of not less than five years (the first two years in an easily accessible place) following the determination of and each change to the three-day liquid asset minimum.

8. Section §270.31a-2 is amended by revising paragraph (a)(2) to read as follows:

§270.31a-2 Records to be preserved by registered investment companies, certain majority-owned subsidiaries thereof, and other persons having transactions with registered investment companies.

(a) * * *

(2) Preserve for a period not less than six years from the end of the fiscal year in which any transactions occurred, the first two years in an easily accessible place, all books and records required to be made pursuant to paragraphs (5) through (12) of §270.31a-1(b) and all vouchers, memoranda, correspondence, checkbooks, bank statements, cancelled checks, cash reconciliations, cancelled stock certificates, and all schedules evidencing and supporting each computation of net asset value of the investment company shares, including schedules evidencing and supporting each computation of an adjustment to net asset value of the investment company shares based on swing pricing policies and procedures established and implemented pursuant to §270.22c-1(a)(3), and other documents required to be maintained by §270.31a-1(a) and not enumerated in §270.31a-1(b).

* * * * *

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

9. The general authority citation for part 274 continues to read as follows, and the sectional authorities for §§274.101 and 274.130 are removed:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, 80a-29, and Pub. L. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

10. Amend Form N-1A (referenced in 274.11A) by:

a. In Item 6 adding paragraph (d);

b. In Item 11 removing paragraph (c)(3) and redesignating paragraphs (c)(4), (c)(5), (c)(6) and (c)(7) as paragraphs (c)(3), (c)(4), (c)(5) and (c)(6), respectively;

c. In Item 11 adding new paragraph (c)(7) and paragraph (c)(8);

d. In Item 13, adding "Capital Adjustments Due to Swing Pricing" after "Total Distributions" to the list in paragraph (a);

e. In Item 13, Instruction 2., adding paragraphs (d) and (e);

f. In Item 13, Instruction 3., revising paragraphs (a) and (d);

g. In Item 26(b)(1), adding a sentence to the end of Instruction 4.

h. In Item 26(b)(2), adding a sentence to the end of Instruction 6.

i. In Item 26(b)(3), adding a sentence to the end of Instruction 6.

j. In Item 28, redesignating paragraphs (h), (i) (j), (k), (l), (m), (n), (o) and (p) as paragraphs (i), (j), (k), (l), (m), (n), (o), (p), and (q) respectively; and

k. In Item 28, adding new paragraph (h).

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

Form N-1A

*　*　*　*　*

Item 6. Purchase and Sale of Fund Shares

(d) If the Fund uses swing pricing, an explanation of the circumstances under which it will use swing pricing and the effects of using swing pricing. With respect to any portion of a Fund's assets that is invested in one or more open-end management investment companies that are registered under the Investment Company Act, the Fund shall include a statement that the Fund's net asset value is calculated based upon the net asset values of the registered open-end management investment companies in which the Fund invests, and that the prospectuses for those companies explain the circumstances under which those companies will use swing pricing and the effects of using swing pricing.

* * * * *

Item 11. Shareholder Information

(c) * * *

(7) The number of days following receipt of shareholder redemption requests in which the fund will pay redemption proceeds to redeeming shareholders. If the number of days differs by distribution channel, disclose the number of days for each channel.

(8) The methods that the Fund uses to meet redemption requests, and whether those methods are used regularly, or only in stressed market conditions (*e.g.*, sales of portfolio assets, holdings of cash or cash equivalents, lines of credit, interfund lending, and/or ability to redeem in kind).

* * * * *

Item 13. Financial Highlights Information

* * * * *

Instructions * * *

2. *Per Share Operating Performance.* * * *

(d) The amount shown at the Capital Adjustments Due to Swing Pricing caption should include the per share impact of any amounts retained by the Fund pursuant to its swing pricing policies and procedures, if applicable.

(e) The amounts shown at the Net Asset Value, End of Period and Net Asset Value, Beginning of Period captions should be the Fund's net asset value per share as adjusted pursuant to its swing pricing policies and procedures, if applicable.

3. Total Return.

(a) Assume an initial investment made at the net asset value calculated on the last business day before the first day of each period shown, as adjusted pursuant to the Fund's swing pricing policies and procedures, if applicable.

* * *

(d) Assume a redemption at the price calculated on the last business day of each period shown, as adjusted pursuant to the Fund's swing pricing policies and procedures, if applicable.

Item 26. Calculation of Performance Data

* * * * *

(b)

* * *

(1) *Average Annual Total Return Quotation.*

* * *

Instructions * * *

4. * * * The ending redeemable value should assume a value as adjusted pursuant to swing pricing policies and procedures, if applicable.

*   *   *

(2) *Average Annual Total Return (After Taxes on Distributions) Quotation.*

*   *   *

Instructions *   *   *

6. *   *   * The ending value should assume a value as adjusted pursuant to swing pricing policies and procedures, if applicable.

(3) *Average Annual Total Return (After Taxes on Distributions and Redemption) Quotation*

*   *   *

Instructions *   *   *

6. *   *   * The ending value should assume a value as adjusted pursuant to swing pricing policies and procedures, if applicable.

Item 28. Exhibits

*   *   *   *   *

(h) Credit Agreements. Agreements relating to lines of credit for the benefit of the Fund.

Instruction: The specific fees paid in connection with the credit agreements need not be disclosed.

11. Further amend Form N-CEN (referenced in 274.101) as proposed at 80 FR 33699, June 12, 2015 by:

a. In Part C, redesignating Items 44 through 79 as Items 45 through 80;

b. In Part C, adding new Item 44;

c. In Part E, adding paragraph g. to newly redesignated Item 60.

§274.101 Form N-CEN, annual report of registered investment companies.

*   *   *   *   *

Part C.   Additional Questions for Management Investment Companies

*   *   *

Item 44.   Lines of credit, interfund lending and borrowing, and swing pricing. For open-end management investment companies, respond to the following:

a. Does the Fund have available a committed line of credit? [Yes/No]

i. If yes, what size is the line of credit? [insert dollar amount]

ii. If yes, with which institution(s) is the line of credit? [list name(s)]

iii. If yes, is the line of credit just for the Fund, or is it shared among multiple funds? [sole/shared]

1. If shared, list names of other funds that may use the line of credit. [list names and SEC File numbers]

iv. If yes, did the Fund draw on the line of credit this period? [Yes/No]

v. If the Fund drew on the line of credit during this period, what was the average amount outstanding when the line of credit was in use? [insert dollar amount]

vi. If the Fund drew on the line of credit during this period, what was the number of days that the line of credit was in use? [insert amount]

b. Did the Fund engage in interfund lending? [Yes/No]

i. If yes, what was the average amount of the interfund loan when the loan was outstanding? [insert dollar amount.]

ii. If yes, what was the number of days that the interfund loan was outstanding? [insert amount]

c. Did the Fund engage in interfund borrowing? [Yes/No]

i. If yes, what was the average amount of the interfund loan when the loan was outstanding? [insert dollar amount.]

ii. If yes, what was the number of days that the interfund loan was outstanding? [insert amount]

d. Did the Fund (if not a Money Market Fund, Exchange-Traded Fund, or Exchange-Traded Managed Fund) engage in swing pricing? [Yes/No]

Part E. Additional Questions for Exchange-Traded Funds and Exchange-Traded Managed Funds

* * *

Item 60.

* * *

g. Did the Fund require that an authorized participant post collateral to the Fund or any of its designated service providers in connection with the purchase or redemption of Fund shares during the reporting period? [Y/N]

12. Amend Form N-PORT (referenced in 274.150), as proposed at 80 FR 33712, June 12, 2015 by:

a. In the General Instructions, removing the definition of "Illiquid Asset;"

b. In the General Instructions, adding a definition of "15% Standard Asset."

c. In the General Instructions, adding a definition of "Three-Day Liquid Asset Minimum;"

d. In Part B., adding Item B.7;

e. In Part C, revising Item C.7; and

f. In Part C, adding Item C.13

§274.150 Form N-PORT, Monthly portfolio holdings report.

*   *   *   *   *

E. Definitions

*   *   *

15% Standard Asset has the meaning defined in rule 22e-4(a)(4).

Three-Day Liquid Asset Minimum has the meaning defined in rule 22e-4(a)(9).

*   *   *

Part B: Information About the Fund

*   *   *

Item B.7 Liquidity information. For open-end investment companies, provide the Three-Day Liquid Asset Minimum.

*   *   *

Part C: Schedule of Portfolio Investments

*   *   *

Item C.7 For portfolio investments of registered open-end management investment companies, is the investment a 15% Standard Asset? [Y/N]

*   *   *

Item C.13 For portfolio investments of open-end management investment companies, indicate the liquidity classification for each portfolio asset (or portion thereof) among the following categories as specified in rule 22e-4. For portfolio assets with multiple liquidity classifications, indicate the dollar amount attributable to each classification:

Convertible to cash within 1 business day

Convertible to cash within 2-3 business days

Convertible to cash within 4-7 calendar days

Convertible to cash within 8-15 calendar days

Convertible to cash within 16-30 calendar days

Convertible to cash in more than 30 calendar days

* * * * *

By the Commission.

Dated: September 22, 2015

Brent J. Fields
Secretary

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9925 / September 23, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75967 / September 23, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4206 / September 23, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31847 / September 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16829

In the Matter of

WILLIAM B. FRETZ, JR.,
JOHN P. FREEMAN,
COVENANT CAPITAL
MANAGEMENT PARTNERS,
L.P., AND COVENANT
PARTNERS, L.P.,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b), AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940 MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 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 William B. Fretz, Jr., John P. Freeman, Covenant Capital Management Partners, L.P., and Covenant Partners, L.P. ("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 as to Fretz and Freeman, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b), and 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of an offering fraud and investment advisory fraud orchestrated by William B. Fretz, Jr. ("Fretz") and John P. Freeman ("Freeman") through sales of partnership interests in Covenant Partners, L.P. ("Covenant" or the "Fund") and the operation of its adviser, Covenant Capital Management Partners, L.P. ("CCMP"), which Fretz and Freeman controlled.

Since 1999, Fretz and Freeman raised approximately $7.3 million through the sale of Covenant partnership interests to 58 limited partners. To induce investments in the Fund, Fretz and Freeman represented to investors, in offering documents and orally, that Covenant would primarily invest in direct marketing companies, that Covenant would only pay the adviser performance fees if certain conditions were met, and that Fretz and Freeman would act as fiduciaries in the best interests of the fund. After some initial investment consistent with these representations, Fretz and Freeman, through CCMP, ultimately used the majority of Covenant investor funds for their own purposes and benefit, contrary to their representations and in breach of their fiduciary duties. Through various means, Fretz and Freeman funneled in excess of $1.1 million into a failing broker-dealer they operated and controlled, known as the Keystone Equities Group, L.P. ("Keystone"). They knew or were reckless in not knowing that Covenant would not recoup those funds and in fact, Keystone ultimately collapsed. Despite failing to meet the performance benchmarks set forth in Covenant offering documents, Fretz and Freeman awarded themselves nearly $600,000 in improper performance fees. Finally, when unable to repay personal obligations to a third-party private equity fund, Fretz and Freeman eventually

[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.

transferred Covenant assets valued at nearly $4 million to the private equity fund. While engaging in this misconduct, Fretz and Freeman continued to solicit new investors based on the same representations, knowing they were false.

Respondents

1. William B. Fretz, Jr., age 50, resides in Souderton, Pennsylvania. He is a limited partner of CCMP, a Director and shareholder of Covenant Capital Management, Inc. ("CCM, Inc."), and was President of Keystone, prior to the termination of Keystone's registration. Fretz held Series 55 and 65 licenses during portions of the relevant time period. On May 30, 2013, FINRA barred Fretz from associating with any FINRA member firm in any capacity. That decision is currently pending appeal.

2. John P. Freeman, age 55, resides in Newtown, Pennsylvania. He is a limited partner of CCMP, President, CEO, a Director and shareholder of CCM, Inc., and was a partner in Keystone, prior to the termination of Keystone's registration. Freeman held Series 7 and 63 licenses during portions of the relevant time period. On May 30, 2013, FINRA barred Freeman from associating with any FINRA member firm in any capacity. That decision is currently pending appeal.

3. Covenant Partners, L.P., is a Pennsylvania partnership based in Oaks, Pennsylvania. It has never had a class of securities registered with the Commission. Covenant was established in 1996. On September 19, 2014, Covenant filed a Voluntary Petition for Bankruptcy under Chapter 7 of the Bankruptcy Code (the "Bankruptcy Proceedings"). At that time it had approximately 58 limited partners, consisting of primarily family and friends of Fretz and Freeman.

4. Covenant Capital Management Partners, L.P., a Delaware limited partnership, is the general partner of Covenant and was the investment adviser to the Fund prior to its bankruptcy petition. CCMP is comprised of one general partner, Covenant Capital Management, Inc., which owns 1% of CCMP. Fretz and Freeman are the limited partners of CCMP, each owning 49.5%, and control all decisions of CCMP, and thus made all decisions on behalf of the Fund prior to its bankruptcy. CCMP has never been registered with the Commission in any capacity or with any state as an investment adviser.

Other Relevant Persons and Entities

5. Covenant Capital Management, Inc., a Delaware corporation, is the general partner of CCMP and holds a 1% interest in CCMP. Fretz and Freeman each own 50% of the common stock of CCM, Inc.

6. The Keystone Equities Group, L.P., was previously a registered broker-dealer located in Oaks, Pennsylvania. Fretz and Freeman were both principals of Keystone, which they operated and controlled. Keystone served as the broker-dealer to Covenant. From January 2008

through December 2010, Keystone employed only three registered representatives, in addition to Fretz and Freeman. On May 30, 2013, FINRA fined Keystone $25,000 relating to misstatements made to FINRA by Fretz and Freeman on behalf of Keystone that related to the transfer of Covenant assets to Keystone. This decision is pending appeal. On August 12, 2013, Keystone's registration with FINRA was cancelled for failure to pay outstanding fees. Keystone's SEC registration was terminated on August 31, 2013 and it no longer conducts any business.

Facts

Background

7. Prior to filing for bankruptcy, Covenant was a private equity fund managed by its general partner, CCMP. Fretz and Freeman are the only limited partners of CCMP and each owns 49.5%, with the remaining 1% owned by CCM, Inc., which was owned 50% by Fretz and 50% by Freeman. Fretz and Freeman collectively exercised complete control over CCMP and Covenant.

8. Fretz and Freeman were both investment advisers to the Fund. Fretz and Freeman made all day-to-day decisions regarding the management of Covenant, including how to invest, disperse, or otherwise use Covenant's assets. They also were responsible for soliciting all investors in the Fund.

9. From 1999 through 2014, Fretz and Freeman, through CCMP and Covenant, raised approximately $7.3 million from investors who became limited partners of Covenant. Covenant has approximately 58 limited partners who have invested capital into the Fund.

Disclosures Regarding the Use of Investor Funds

10. Fretz and Freeman handled all marketing and sales of the Covenant limited partnership interests. Partnership interests were sold to friends and family through oral statements about the Fund, and through the distribution of Covenant's Offering Circular. In addition, all investors were required to sign the Limited Partnership Agreement. Fretz and Freeman had ultimate authority over the drafting and distribution of the Covenant Offering Circular and the Limited Partnership Agreement used to solicit investors.

11. These documents define the duties and responsibilities of CCMP on behalf of Covenant and describe how the partnership assets are to be used. For example, the Offering Circular states that Covenant's proceeds will be "invested in securities and otherwise applied to the business and expenses of the Partnership." The Limited Partnership Agreement dictates that the "purpose and business of the Partnership generally is to acquire, purchase, invest in, hold for investment, own, exchange, assign, sell or otherwise dispose of, trade in . . . or otherwise deal in Securities and Commodity Interests . . . including, without limitation, borrowing and lending Securities, Commodity Interests and funds." The Limited Partnership Agreement defines "Securities" as "securities, repurchase agreements and other intangible investment instruments and vehicles of every kind and nature . . ."

12. Covenant's Offering Circular states that "[t]he emphasis of the portfolio management will be on stock selection" and that "[t]he Partnership intends to concentrate a major portion of its investments in companies that utilize state-of-the-art direct and data base marketing techniques in their operations as a service provider or that have internally implemented such techniques."

13. The Offering Circular further states that the General Partner is "a fiduciary and consequently must exercise good faith and integrity in handling partnership affairs" and that the general partner will not "unfairly profit from any transaction" with Covenant.

Improper Transfers to Keystone

14. During the relevant time period, Keystone was a registered broker-dealer operated and controlled by Fretz and Freeman. It purportedly provided investment banking services to small and medium sized companies and employed three registered representatives in addition to Fretz and Freeman.

15. Keystone was not profitable from 2008 through 2010 and experienced significant financial difficulty. In 2008, Keystone sustained net losses exceeding $600,000. In 2009, its losses exceeded $546,000 and in 2010 Keystone had losses of nearly $600,000. Keystone's 2010 audited financial statements contained a "going concern" clause, reflecting its auditors' doubts about the company's ability to stay in business.

16. These financial losses at Keystone occurred despite massive cash infusions by Covenant. From 2008 through 2012, Fretz and Freeman transferred at least $1,100,500 from Covenant into Keystone in a failed attempt to sustain its operations. At times, Fretz or Freeman transferred funds to themselves and then to Keystone and at other times they transferred the funds directly to Keystone.

17. At various times Fretz and Freeman caused these payments to be recorded on Covenant's books and records as loans to Fretz, distributions from Fretz's or Freeman's capital accounts, or as direct loans to Keystone. Fretz and Freeman did not disclose these payments to Covenant investors, even though they made these payments to Keystone, rather than investing these funds in the types of investments that were the stated focus of the fund.

18. In fact, the Limited Partnership Agreement required Covenant and CCMP to obtain and distribute to investors yearly audited financial statements for the Fund. These audited financial statements would have been required to reflect the transfers to Keystone. But Fretz, Freeman, CCMP and Covenant failed to obtain audited financial statements for Covenant in 2008, 2009, and 2010, or to take any other steps to disclose these payments, and thus investors were not alerted to the payments to Keystone.

19. The movement of funds from Covenant to Keystone frequently coincided with capital investments into Covenant by new or existing limited partners. The investments were solicited to be used for the purposes described in the Offering Circular. However, after January 1, 2010, Covenant made no new investments in direct marketing companies or other securities.

Incoming limited partner contributions received thereafter, more than $620,000, were used almost entirely to fund Keystone and make payments to Fretz and Freeman.

20. None of the purported "loans" to Fretz were ever reduced to writing and no payments of interest or principal were ever made. After years of accepting payments from Covenant without documentation and without making any interest or principal payments to Covenant, Keystone executed a purported Promissory Note to Covenant dated December 31, 2010 for $1,410,573 at a 10% annual interest rate, apparently intended to cover prior cash transfers to Keystone plus interest. The note did not call for periodic payments, but instead required all principal and interest to be paid on or before December 31, 2012. Fretz signed this Promissory Note on behalf of Keystone and Freeman signed on behalf of Covenant. As with the initial transfers of money from Covenant to Keystone, the Promissory Note was not disclosed to Covenant investors.

21. Keystone never paid any interest or principal on the Promissory Note. Given the financial performance of Keystone, Fretz and Freeman knew or were reckless in not knowing that Keystone would not be able to pay back such funds as required by the Promissory Note, even at the time they entered into the loan agreement.

Use of Fund Assets to Satisfy Personal Debts

22. Fretz and Freeman also used Covenant assets to secure their personal debts, in breach of their fiduciary duties to the Fund. Fretz, Freeman, and CCMP caused Covenant to transfer Fund assets in violation of the stated uses in the Offering Circular and Limited Partnership Agreement. In doing so, they stripped the Fund and its limited partners of assets valued at nearly $4 million.

23. In approximately March 2011, in three separate loans, Fretz and Freeman borrowed money individually and on behalf of Covenant from a private equity fund ("Partnership A"). Freeman borrowed $50,000 at a 10% annual interest rate, Fretz borrowed $450,000 at a 10% annual interest rate and together, on behalf of Covenant, they borrowed $300,000 at a 12% annual interest rate. Each note contained a maturity date of November 30, 2011, and the loans were initially unsecured.

24. These loans were not repaid by the maturity date. Instead, Fretz and Freeman engaged in lengthy discussions and negotiations with Partnership A's manager ("Partner A") for alternative payment terms. During those discussions, Partner A demanded collateral for the three loans, and ultimately demanded assets of Covenant as that collateral.

25. These negotiations over alternative payment terms continued for two years after maturity of the loans. Ultimately they agreed to Partner A's demand to transfer ownership of 5 million shares of common stock in a closely-held corporation ("Issuer") owned by Covenant as "collateral" for personal obligations and the Covenant loan. Fretz and Freeman signed papers "acknowledging" that a debt of over $1 million was a debt of Covenant's. This statement was false. At no time did the Fund borrow more than $300,000 in principal from Partnership A.

Moreover, the Fund made a cash payment of $125,000 to Partnership A during 2012, reducing the principal owed to only $175,000.

26. The 5 million Issuer shares that Fretz and Freeman transferred out of Covenant were valued on Covenant's books and records at $3.8 million at the time pledged. While the shares were initially transferred as "collateral," none have been returned to the Fund because Fretz and Freeman never repaid their loans. Covenant failed to disclose these improper transfers and continued to solicit new investors based on the same representations, knowing they were misleading as to how Fund assets were being used.

Improper Performance Fees

27. During the relevant time period, Fretz and Freeman also directed the Fund to pay CCMP improper and unearned performance fees.

28. Covenant's Offering Circular states that CCMP, as general partner, was entitled to a 1% annual management fee, to be assessed against limited partner accounts quarterly. The Offering Circular also states that CCMP was entitled to a 20% performance fee if, and only if, the fund complied with a "high water mark" provision. That provision states that the prior years' losses must be recouped before any performance fee may be assessed. Fretz and Freeman directed CCMP to take performance fees even when the Fund did not meet this "high water mark" condition.

29. Fretz and Freeman, through CCMP and Covenant, took performance fees of $490,373 in 2009 and $102,248 in 2010 when Covenant had unrecouped losses, and thus, no fees should have been taken.

Violations

30. As a result of the conduct described above, Fretz, Freeman, and CCMP willfully violated and Covenant 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.

31. As a result of the conduct described above, Fretz, Freeman and CCMP willfully violated Section 206(1) of the Advisers Act, which prohibits an investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client.

32. As a result of the conduct described above, Fretz, Freeman and CCMP willfully 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.

33. As a result of the conduct described above, Fretz, Freeman and CCMP willfully violated Section 206(4) of the Advisers Act, which prohibits fraudulent conduct by an

investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits defrauding any investor or prospective investor in a pooled investment vehicle.

Undertakings

Respondents Fretz, Freeman and CCMP have undertaken to waive any and all rights to any and all equity in Covenant, and any and all claims (including for management, performance or other fees, indemnification and/or contribution) that they, or any entity they control or have an interest in, are or may be entitled to, against Covenant (the "Waived Interests"). In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b), and 21C of the Exchange Act, Sections 203(e), 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 Fretz cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent Freeman cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

C. Respondent CCMP cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

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

E. Respondent Fretz be, and hereby is:

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

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

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

F. Respondent Freeman be, and hereby is:

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

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

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

G. Any reapplication for association by Respondents Fretz or Freeman 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.

H. Respondents shall, within 14 days of the submission of the Chapter 7 Trustee for Covenant Partners, L.P's Final Report to the Office of the United States Trustee (the "Trustee's Final Report") in the related Bankruptcy Proceedings, pay, jointly and severally, disgorgement of $5,476,928, and prejudgment interest of $353,582 to the Securities and Exchange Commission, some or all of which may be offset as described below in paragraph IV K. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

I. Within 14 days of the submission of the Trustee's Final Report in the related Bankruptcy Proceedings, Respondent Fretz shall pay a civil penalty of $500,000, and Respondent Freeman shall pay a civil penalty of $500,000 to the Securities and Exchange Commission, some or all of which may be offset as described below in paragraph IV K. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payments 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 William B. Fretz, Jr., John P. Freeman, Covenant Capital Management Partners, L.P., and Covenant Partners, L.P. 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 G. Jeffrey Boujoukos, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, One Penn Center, 1617 JFK Boulevard, Suite 520, Philadelphia, PA 19103.

J. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, 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 civil penalties 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.

K. Based on Respondents' above-stated undertakings to waive any and all rights to the Waived Interests, and contingent upon the fulfillment of these undertakings, Respondents Fretz, Freeman and CCMP shall receive a dollar-for-dollar offset against disgorgement, prejudgment interest and civil penalty (in that order) for the dollar value that the Bankruptcy Trustee determines that Respondents Fretz, Freeman and CCMP would otherwise have been entitled to at the conclusion of the Bankruptcy Proceedings had they not waived any and all rights to the Waived Interests, taking into account any distribution to limited partners of monies recovered by the Commission in this action. The Bankruptcy Trustee has agreed to determine such amounts and make a report to the Commission staff upon closing of the Bankruptcy Proceedings concurrent with the Trustee's Final Report. To the extent additional funds are paid to Covenant in Delaware Chancery Court Docket No. 10123-VCL after the initial closing of the Bankruptcy Proceedings, relating to its ownership of Issuer common shares, prior to its acquisition, Respondents Fretz, Freeman and CCMP shall receive an additional dollar-for-dollar offset against disgorgement, prejudgment interest and civil penalty (in that order) for the dollar value that Respondents Fretz, Freeman and CCMP would otherwise have been entitled to had they not waived any and all rights to the Waived Interests, which shall be calculated using the information regarding the pro rata value of the Waived Interests provided in the Bankruptcy Trustee's report to the Commission staff.

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 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

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

Release Nos. 33-9926, 34-75968, IA-4207, IC-31848, File No. S7-17-15

Regulatory Flexibility Agenda

AGENCY: Securities and Exchange Commission.

ACTION: Notice of semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission approved the publication of an agenda of its rulemaking actions pursuant to the Regulatory Flexibility Act. The agenda, which is not a part of or attached to this document, was submitted by the Commission to the Regulatory Information Service Center for inclusion in the Unified Agenda of Federal Regulatory and Deregulatory Actions, which is scheduled for publication in its entirety on www.reginfo.gov in Fall 2015. The version of the Unified Agenda to be published in the Federal Register will include only those rules for which the agency has indicated that preparation of an analysis under the Regulatory Flexibility Act is required. Information in the Chair's agenda was accurate on September 23, 2015, the date on which the Commission's staff completed compilation of the data.[1] The items listed in the Regulatory Flexibility Agenda for Fall 2015 reflect only the priorities of the Chair of the U.S. Securities and Exchange Commission, and do not necessarily reflect the view and priorities of any individual Commissioner. To the extent possible, rulemaking actions by the Commission after that date will be reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

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1 The items listed in the Regulatory Flexibility Agenda for fall 2015 reflect only the priorities of the Chair of the U.S. Securities and Exchange Commission, and do not necessarily reflect the view and priorities of any individual Commissioner.

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

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-17-15 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 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 S7-17-15. 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/other.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The Regulatory Flexibility Act ("RFA"), (Pub. L. No. 96-354, 94 Stat. 1164 (September 19, 1980), requires each federal agency in April and October of each year to publish in the Federal Register an agenda identifying rules that the agency expects to consider in the next twelve months that are likely to have a significant economic impact on a substantial number of small entities (5 U.S.C. 602(a)). The RFA specifically provides that publication of the agenda does not preclude an agency from considering or acting on any matter not included in the agenda, and that an agency is not required to consider or act on any matter that is included in the agenda (5 U.S.C. 602(d)). The Commission may consider or act on any matter earlier or later than the estimated date provided on the agenda. While the agenda reflects the current intent to complete a number of rulemakings in the next year, the precise dates for each rulemaking at this point are uncertain. Actions that do not have an estimated date are placed in the long term category; the Commission may nevertheless act on items in that category within the next twelve months. The agenda includes new entries, entries carried over from previous publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda. The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.

Brent J. Fields
Secretary

Dated: September 23, 2015

MINUTE COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75971 / September 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16830

In the Matter of **Samdrew VI, Inc., and** **Subei Business Development, 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 Samdrew VI, Inc. and Subei Business Development, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Samdrew VI, Inc. (CIK No. 1346859) is a void Delaware corporation located in Hewlett Neck, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Samdrew VI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2007, which reported a net loss of $15,013 for the prior six months.

2. Subei Business Development, Inc. (CIK No. 1309052) 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). Subei Business is delinquent in its

periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 2005.

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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75981 / September 24, 2015

Admin. Proc. File No. 3-16022

In the Matter of the Applications of

BLAIR C. MIELKE
and
FREDERICK W. SHULTZ

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDINGS

Failure to Provide Written Notice to and Obtain Written Approval from Firm Regarding Private Securities Transactions

Failure to Provide Written Notice to Firm of Outside Business Activities

Failure to Provide Requested Information

Failure to Appear for On-The-Record Interview

Conduct Inconsistent with Just and Equitable Principles of Trade

Misuse of Customer Funds

Causing Firm's Books and Records to Be Inaccurate

Registered representatives engaged in private securities transactions without giving written notice to or obtaining written approval from employer member firm of registered securities association; engaged in outside business activities without providing prompt written notice to firm; failed to provide requested information in connection with FINRA investigation; failed to appear timely for on-the-record interview; made misstatements on inaccurate books and records. *Held*, association's findings of violations and sanctions imposed are *sustained.*

APPEARANCES:

James E. Stoltz, of Stoltz Law Office, Evansville, IN, for Blair C. Mielke and Frederick W. Shultz.

Alan Lawhead, *Michael Garawski*, and *Jante C. Turner*, for FINRA.

Appeal filed: August 25, 2014
Last brief received: December 8, 2014

Blair C. Mielke and Frederick W. Shultz, both formerly registered representatives associated with Brookstone Securities, Inc. ("Brookstone"), a FINRA member firm, appeal from FINRA disciplinary action. FINRA found that Mielke and Shultz violated NASD Rules 3040 and 2110 and FINRA Rule 2010 by engaging in private securities transactions without giving written notice to and obtaining written approval from Brookstone, and that they violated NASD Rules 3030 and 2110 and FINRA Rule 2010 by engaging in outside business activities without providing prompt written notice to Brookstone.[1] As a unitary sanction for these violations, FINRA barred each Applicant from associating with a FINRA member firm in any capacity.

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[1] On July 26, 2007, the Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to the Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Release No. 56148, 2007 WL 2159604, at *2 (July 26, 2007). Following the consolidation, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Release No. 58643, 2008 WL 4468749 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008).

NASD Rule 3040 provides that "[n]o person associated with a member shall participate in any manner in a private securities transaction except in accordance with the requirements of [Rule 3040]," which include the requirement that the representative provide the member with written notice and, if receiving compensation for the private securities transaction, receive written approval from the member. NASD Rule 3040 has not yet been replaced by a new FINRA Rule in the Consolidated Rulebook, and it remains in effect. NASD Rule 3030 provided that "[n]o person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity . . . outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member." In December 2010, after the conduct at issue here, the Commission approved new FINRA Rule 3270, which replaced NASD Rule 3030. The new rule, among other things, clarified the types of positions an associated person could not hold with an outside business, and it specifically required that the associated person provide written notice to the member *before* engaging in outside business activities. *See FINRA Regulatory Notice 10-49* (Dec. 2010).

(continued...)

FINRA also found that Applicants engaged in conduct inconsistent with just and equitable principles of trade, in violation of NASD Rule 2110 and FINRA Rule 2010, by making misstatements regarding outside business activities on Brookstone's annual Outside Business Interests Schedules submitted by Mielke in April 2008 and by both Applicants in April 2009. For these violations, FINRA also barred both Applicants in all capacities.

FINRA further found that Mielke and Shultz violated FINRA Rules 8210 and 2010. FINRA found that, in connection with its investigation of Applicants, Mielke failed to respond completely and timely to FINRA's requests for information and Shultz failed to appear timely for on-the-record testimony.[2] FINRA barred both Applicants in all capacities for these violations as well.

Finally, FINRA found that Shultz violated FINRA Rules 2150 and 2010 by misusing customer funds and violated NASD Rule 3110 and FINRA Rule 2010 by causing Brookstone to maintain inaccurate books and records.[3] For each of these violations, FINRA found that a $10,000 fine and a one-year suspension would be appropriate, but FINRA declined to impose those sanctions in light of the three bars it was imposing on Shultz as sanctions for the violations discussed above.

(...continued)

NASD Rule 2110 provided that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." According to "our long-standing and judicially-recognized policy . . . a violation of another Commission or NASD rule or regulation . . . constitutes a violation of [NASD] Rule 2110." *Stephen J. Gluckman*, Exchange Act Release No. 41628, 54 SEC 175, 1999 WL 507864, at *6, (July 20, 1999). In September 2008, the Commission approved new FINRA Rule 2010, which replaced NASD Rule 2110. The new rule, which became effective December 15, 2008, is not different in any material respect from the prior rule. *See FINRA Regulatory Notice 08-57* (Oct. 2008). NASD Rule 2110 applied to the portion of Mielke's conduct that occurred before December 15, 2008, and new FINRA Rule 2010 applies to Mielke's and Shultz's conduct after that date.

2 FINRA Rule 8210 requires associated persons to provide "information or testimony" in connection with a FINRA investigation.

3 NASD Rule 3110 requires member firms to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with [FINRA Rules] and as prescribed by SEC Rule 17a-3. The record keeping format, medium, and retention period shall comply with Rule 17a-4 under the [Exchange Act]." NASD Rule 3110 has not yet been replaced by a new FINRA Rule in the Consolidated Rulebook, and it remains in effect.

FINRA Rule 2150 states that "[n]o member or person associated with a member shall make improper use of a customer's securities or funds."

On appeal, Applicants claim that they had provided oral notice to Brookstone officers before commencing their outside business activities and private securities transactions; that their failures to comply with FINRA information requests were partial and can be excused because of personal and family health problems; that any misstatements on their Outside Business Interests Schedules were unintentional and should be viewed in light of their purported oral disclosures of their activities to Brookstone officers; that the misuse of customer funds and books and records violations were the result of sloppy bookkeeping and were unintentional; and that the sanctions FINRA imposed should be reduced. Based on our independent review of the record, we sustain FINRA's findings of violations and its imposition of sanctions.[4]

I. Background

A. January 2008—November 2008: Applicants formed Midwest and began to promote and sell interests in it, but did not tell Brookstone.

Mielke entered the securities industry in September 1988, and he remained continuously registered with various FINRA member firms from that time until November 2009. Mielke joined Brookstone in June 2007 and remained employed there until November 2009, when Brookstone terminated his employment. Mielke is not currently associated with a FINRA member firm.

Shultz, a retired mathematician and family friend of Mielke, entered the securities industry (at Mielke's recommendation) as a registered representative in 2006 and joined Brookstone along with Mielke in June 2007. Brookstone terminated Shultz's employment in November 2009. Shultz is not currently associated with a FINRA member firm.

In January 2008, shortly after becoming associated with Brookstone, Mielke and another individual who is not relevant to this proceeding formed Midwest Investment Partners, LLC ("Midwest"), a limited liability company that sought to attract investments by accredited investors who wanted to "pursue medium to long-term capital appreciation" by investing their pooled money in certain hedge funds. Mielke immediately began promoting and selling Midwest nonvoting membership interests. Mielke hired Shultz in September 2008 to handle Midwest's financial and accounting matters.

In its private placement memorandum, Midwest described an investment in its membership interests as speculative and involving a high degree of risk. Midwest offered up to $100 million of the company's restricted nonvoting membership interests to accredited investors and sought a minimum investment of $250,000. Investors were to receive 50 percent of Midwest's profits on an annual basis, with the other 50 percent going to Midwest's Manager, as discussed below.[5] Midwest invested the proceeds of its offering in two hedge funds, Vestium

4 In addition to the three bars FINRA imposed, it also ordered Applicants to pay, jointly and severally, appeal costs of $2,468.85.

5 The record contains two different versions of Midwest's private placement memorandum,

(continued...)

Equity Fund, LLC and Arcanum Equity Fund, LLC, which Mielke testified were "basically the same company" and invested in "medium term notes."

Applicants ran virtually every aspect of Midwest's business. From Midwest's inception, Mielke was its President and Chief Executive Officer. Beginning in January 2008, he hired an attorney to prepare Midwest's offering documents; conducted due diligence on Midwest's investment in certain hedge funds and handled the relationships with the hedge funds' managers; hired other registered representative to sell Midwest;[6] and marketed Midwest to prospective investors.

Shultz was Midwest's Chief Financial Officer and earned a salary of $1,000 per month. Shultz decided who qualified as an accredited investor and filed certain documents with the Commission, including a Form D Notice of Exempt Offering of Securities. He also mailed offering documents to prospective investors, obtained investors' money, answered investors' questions about Midwest, processed redemption requests, and handled a variety of formal correspondence and agreements. In general, Shultz "handled the money" and performed general accounting and office management duties for Midwest.

Applicants managed Midwest's day-to-day business through Harvest Midwest Group, LLC ("Harvest"), an Indiana limited liability company that owned all of Midwest's voting membership interests. Mielke formed Harvest in early 2008 and was its President, Chief Executive Officer, and a Director. Beginning in September 2008, Shultz was Harvest's Chief Financial Officer and a Director and administered Harvest's financial operations, such as tracking distributions from investments, accounting for expenses, making distributions to the company and investors, and issuing account statements to investors. As Midwest's Manager, Harvest paid for Midwest's expenses and received 50 percent of Midwest's profits on an annual basis.

(...continued)
one of which Brookstone never approved and another that Brookstone approved in June and August 2009. The versions of the private placement memorandum do not appear to differ in any material respect germane to the violations at issue in this proceeding.

6 The registered representatives Mielke hired to sell Midwest interests, Thomas J. Gorter and Michael L. Trier, were charged in FINRA's complaint in this proceeding. After a four-day hearing, the FINRA Hearing Panel imposed three separate bars against Gorter after finding that he had participated in undisclosed private securities transactions, caused Brookstone to maintain inaccurate books and records, failed to respond timely to FINRA's information and document requests, and failed to appear timely for on-the-record testimony. Gorter appealed the Hearing Panel's decision to FINRA's National Adjudicatory Council, but Gorter and FINRA Enforcement then submitted a proposed settlement to the NAC, which the NAC accepted.

FINRA's complaint charged Trier only with participation in undisclosed private securities transactions. The Hearing Panel found that Trier had committed the violations as charged and suspended Trier in all capacities for thirty business days and fined him $2,500. Neither Trier nor FINRA Enforcement appealed the Hearing Panel's decision to the NAC.

Applicants indirectly owned Midwest. Harvest, Midwest's manager, was a wholly owned subsidiary of a limited liability company, Harvest Holding Company LLC ("Harvest Holding"), that Mielke created in 1995. Mielke owned 75 percent and Shultz owned five percent of Harvest Holding's stock, respectively.[7] Mielke was Harvest Holding's President, Chief Executive Officer, and a Director, and, starting in September 2008, Shultz was its Chief Financial Officer and a Director. Harvest Holding paid for Midwest's and Harvest's expenses (essentially reimbursing Harvest for having covered Harvest's and Midwest's expenses).

Mielke and Shultz do not dispute that they were entitled to receive some of Midwest's profits because they owned 80 percent of the stock of Harvest Holding, which wholly owned Harvest, which was entitled to 50 percent of Midwest's profits. Mielke testified that he was entitled to receive a pro rata percentage of Midwest's profits based on his proportional ownership in Harvest Holding. Shultz testified at the hearing in this matter that "everything, income, expenses, everything would flow up to Harvest Holding."

During the time that Mielke and Shultz were associated with Brookstone and owned and managed Midwest, thirty-one investors purchased approximately $4.62 million worth of Midwest membership interests.[8] Mielke directly sold $1.1 million of Midwest's membership interests to five investors, two of whom were Brookstone customers.[9] Mielke made his first direct sale of Midwest interests, for $500,000, in January 2008. He then made an additional three direct sales of Midwest interests, totaling another $500,000, before December 2008.

One of the Brookstone customers to whom Mielke sold Midwest made a $100,000 investment in Midwest in November 2008. That investor testified that she spoke about her Midwest investment only to Mielke, who had told her "to trust him." The investor testified that Mielke described Midwest as a "guaranteed" investment and did not tell her that she risked losing money by investing in Midwest.

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7 Four other shareholders who are not at issue in this proceeding owned the remaining 20%.

8 During this same time period, in a separate disciplinary action, FINRA fined Mielke $5,000 and suspended him in all capacities for six months (running from May 19, 2008 through November 18, 2008) for participating in undisclosed private securities transactions unrelated to his involvement in Midwest. Mielke agreed to the suspension pursuant to a settlement agreement in which he consented to findings that he had failed to provide prior written notice of his involvement in private securities transactions to his prior employer, failed to obtain the firm's written approval, and failed to disclose that he had referred customers to a third-party entity.

9 Gorter and Trier sold the remaining amount to twenty-six other investors. Shultz made no direct sales of Midwest membership interests.

B. December 2008—June 2009: Unbeknownst to Brookstone, Applicants continued to run Midwest while they were negotiating the sale of Midwest's membership interests through the firm.

Mielke testified that he began to discuss Midwest with Brookstone officials as early as January 2008. Mielke testified that David Locy, Brookstone's President and compliance officer, orally approved sales of Midwest through Brookstone in January 2008. Mielke also stated that he told Antony Turbeville, Brookstone's majority owner and President,[10] about Midwest when he joined Brookstone in June 2007, and that he discussed Midwest in several conference calls with Brookstone officers. Mielke further testified that he knew about "emails going back between [Midwest's securities attorney] and Locy." But Mielke did not testify as to the content of any such emails, nor did Applicants call the securities attorney as a witness to testify about the content of such emails or about any of Applicants' other claims that they had disclosed the sales transactions to Brookstone before they began selling Midwest membership interests to investors.

Locy's and Turbeville's testimony contradicted Applicants' description of the purported disclosures about Midwest to Brookstone. Turbeville testified that he first heard about Midwest at a December 2008 meeting with Mielke and Shultz at the Orlando airport. Turbeville stated that, at that meeting, Applicants described Midwest as an extremely safe private placement offering that could produce high investor returns and high sales commissions. But Turbeville told Applicants that he could not "just take somebody's word for something and approve something like that." Turbeville instructed Applicants to submit a written proposal to Locy, who was responsible for reviewing and approving the sale of private placements by Brookstone's sales representatives. Turbeville testified that Applicants did not tell him at the December 2008 meeting that they already had been selling Midwest membership interests for nearly a year. When asked to respond to Mielke's claim that he had approved the sale of membership interests in December 2008 in Orlando, Turbeville said, "Absolutely not." Turbeville explained that "it just doesn't make much business sense" that Brookstone would have approved the transactions without the firm supervising them because "[a]nything sold puts the firm at risk . . . so we have risk, [but] we have no revenue from the product being sold."

Locy's testimony was consistent with Turbeville's characterization of Brookstone's discussions with Applicants about Midwest. Locy testified that he had not heard anything about Midwest until after Turbeville's initial meeting in December 2008 and that he had "no reason to suspect that [Mielke and Shultz] would be selling an unapproved . . . offering."[11] In January 2009, Brookstone began reviewing drafts of Midwest's offering documents. On January 8, 2009, Turbeville received Midwest's drafts from a law firm and forwarded them to Locy. Within a few days, Locy told Mielke that he could not approve the drafts because they were incomplete and

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[10] Turbeville owned 80% of Brookstone. The record does not indicate who owned the remainder.

[11] Also, on December 14, 2009, Brookstone's Director of Legal and Regulatory Affairs responded to a FINRA inquiry by stating that "Brookstone had no knowledge [before November 2009] that Midwest was being sold at any Brookstone branch."

contained insufficient disclosures regarding risks and other information related to a restricted offering. Locy suggested that Mielke find counsel who could do a better job of drafting the required documents.

Several months passed before Locy received another draft of Midwest's offering documents. In June 2009, Mielke gave Locy revised documents that had been drafted by a different attorney. Locy decided that the documents provided sufficient disclosures and had remedied the deficiencies he had found in the earlier draft, and on June 26, 2009, Turbeville signed a selling agreement that authorized Brookstone representatives to sell Midwest membership interests. Locy approved the last of Midwest's offering documents, a private placement memorandum, on August 13, 2009.[12]

Sales of Midwest continued through approximately October 2009. But Turbeville and Locy testified that the firm did not know that any Brookstone registered representatives had been selling Midwest membership interests until November 2009, when FINRA began an investigation and inquired of Brookstone about the sales. Brookstone was unaware of Midwest's sales because Applicants did not tell Brookstone orally or in writing that they or any other person associated with Brookstone were selling Midwest; did not accurately complete or update Brookstone's annual Outside Business Interests Schedules; and did not provide Brookstone with any documentation about Midwest's sales so that the firm could record the information in its books and records. Denise Zumbrun, a Brookstone compliance officer, testified that Turbeville and Locy were "surprised" when they learned from FINRA in November 2009 that Applicants had already sold Midwest membership interests to firm customers. Brookstone fired Applicants in November 2009, based on FINRA staff's explanation about Applicants' sales of Midwest.

C. Applicants made misstatements on their 2008 and 2009 annual Outside Business Interests Schedules.

Brookstone's written supervisory procedures ("WSPs") required the firm's registered representatives to disclose all outside business activities and certify annually that they were not engaged in any outside business activity without formal written approval from Brookstone. Applicants testified that they had received Brookstone's compliance manual which described the procedures related to private securities transactions and outside business activities. Both Applicants also signed a document saying they had read the manual.

In April 2008, after he had already begun to make direct sales of Midwest membership interests, Mielke completed Brookstone's annual Outside Business Interests Schedule, in which

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12 Locy was the Brookstone employee responsible for approving the sale of Midwest interests through Brookstone, but Turbeville signed the selling agreement on behalf of Brookstone. Locy initialed and dated his approval for the final Midwest private placement memorandum "8/13/08." Locy testified that his approval was actually given on August 13, 2009, and that his handwritten date, in 2008, was a typographical error. This testimony is consistent with Locy's handwritten notes from his meetings with Mielke, which occurred in July 2009.

he certified that he was not engaged in any undisclosed outside business activities. He did not include any information about Midwest or its private securities offering.[13] Mielke testified that Midwest provided the "bulk" of his income during the time period covered by this Outside Business Interests Schedule. And he had already made direct sales of Midwest membership interests and conducted numerous other activities on Midwest's behalf.

Mielke and Shultz each completed Brookstone's annual Outside Business Interests Schedules in April 2009. Shultz testified that he filled out both his and Mielke's schedules after discussing them with Mielke, and that he wrote exactly what Mielke told him to on the forms. Mielke's and Shultz's April 2009 Outside Business Interests Schedules were identical and included no direct reference to Midwest, their employment with Midwest, or their receipt of compensation from Midwest. Rather the schedules referred only indirectly to Midwest, stating that Mielke and Shultz were "in the planning stages of . . . working with an investment group dealing in medium term notes."

In reality, by April 2009, Midwest had sold twenty-two membership interests and raised more than $3 million. As Mielke acknowledged, both Mielke and Shultz received a share of Midwest's profits as the owners of Harvest Holding, and Shultz received an additional monthly salary of $1,000 as Midwest's CFO. The record also includes copies of Midwest's general transactions ledger, which documents payments by Midwest to Harvest, Mielke, and Shultz during 2008 and 2009, including payments to Mielke for commissions and to Shultz as reimbursements for expenses related to Midwest meetings and other travel.

D. Shultz did not provide documentation supporting sales of Midwest after Brookstone approved sales of Midwest in June 2009, and, as a result, Brookstone did not maintain required documentation of Midwest transactions.

After Brookstone signed a selling agreement with Midwest in June 2009, Shultz (as Midwest's CFO) was responsible for providing Brookstone with documentation in support of any sales made pursuant to this approval. Brookstone's WSPs stated that all approved securities transactions should be recorded in the firm's books and records. Locy also testified that he informed Applicants that all sales transactions must be processed through Brookstone. Yet, although Midwest received nine new purchases of membership interests between August and October 2009 totaling $1.47 million—after Brookstone had signed the selling agreement—Shultz did not route sales documentation for any of these transactions through Brookstone.

E. Shultz improperly distributed certain customer funds to Harvest.

Shultz had responsibility for calculating Midwest's profits and dividing them between Harvest and Midwest's other investors. In September and October 2009, Midwest received $374,500 in investments from three investors, but Shultz did not invest these funds in Vestium

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[13] Shultz was not yet employed with Midwest in April 2008.

and Arcanum (as he did with all of the other investments in Midwest), instead leaving those funds in Midwest's checking account. In a series of withdrawals between September and November 2009, Shultz allocated $147,000 of this amount to Harvest, describing the payments as "Part of Profits" or "Part of Harvest Profits." Shultz conceded that he allocated too much profit to Harvest, blaming the "mistake" on "bad accounting." Shultz's error was discovered by an accountant Midwest hired in June 2010, and that accountant replaced $45,000 of the amount (the $147,000 minus $102,000 in accrued profits Harvest was owed at the time) by making a transfer from Harvest to Midwest.

F. Mielke failed to respond completely and timely to information requests.

In late 2009, FINRA commenced an investigation of Applicants, in connection with which Mielke provided on-the-record testimony on January 14, 2010. During this testimony, Mielke claimed that certain evidence, including correspondence between Midwest's attorney and Brookstone, would indicate that Brookstone was aware of and had approved the Midwest sales transactions as early as January 2008, before any Midwest sales had occurred. On January 22, 2010, FINRA requested certain information related to Mielke's OTR testimony in an effort to substantiate his claims. Specifically, FINRA requested: (1) correspondence between Brookstone and Midwest's attorney; (2) Mielke's tax returns and bank account statements for the relevant period; (3) documentation of due diligence Mielke performed related to the Midwest offering; (4) spreadsheets showing funds, profit allocations, and payments to Midwest investors; and (5) a list of Midwest's investors. On February 19, 2010, Mielke provided FINRA with copies of his tax returns for 2007 and 2008, but he did not provide any other responsive documents. As a result, FINRA charged him with failure to provide requested information under Rule 8210.

In January 2012, shortly before the scheduled hearing date, Mielke provided certain additional documents in response to the Rule 8210 request from nearly two years earlier, including a spreadsheet that contained investor and profit information. Subsequently, before the hearing, Mielke additionally provided updated copies of his tax returns, investor logs, and disbursement of profits from Midwest. But this information was not complete and, in fact, inaccurately stated that Gorter did not sell Midwest securities. To date, Mielke has still failed to provide several of the categories of information included in FINRA's original request. Specifically, Mielke has not provided any correspondence between Brookstone and Midwest's attorney, any check registers or copies of payments made to Midwest investors, or a list of Midwest investors. At the hearing, Mielke explained that he failed to comply with FINRA's 8210 requests because he was unaware of them and had delegated compliance with them to another Midwest employee.

G. Shultz failed to appear timely to provide OTR testimony.

In December 2009, in connection with its investigation of Applicants, FINRA requested that Shultz provide OTR testimony. FINRA initially requested that Shultz appear on December 18, 2009 at its Chicago district office. In order to allow Applicants to travel together for their OTRs, however, FINRA rescheduled Shultz's testimony to occur on January 15, 2010, one day after Mielke's testimony, with both OTRs in Louisville, Kentucky. At the close of Mielke's testimony, the attorney who was then representing both Applicants stated that he would not be able to continue to represent both men because of a conflict of interest. Shultz requested an opportunity to obtain new counsel, and FINRA rescheduled his testimony for March 5, 2010, in Chicago.[14] But, when that time came, Shultz asserted that he was unable to attend the testimony because of illnesses of his daughter and wife that required his full attention. Shultz also stated that Harvest Holding was expecting shortly to receive the results of an accounting audit, which Shultz claimed would render his testimony "moot."

Shultz later requested that FINRA postpone his testimony indefinitely until FINRA received and reviewed the results of the accounting audit. When FINRA denied his request, Shultz, who had been warned that failure to appear for testimony could result in a bar being imposed against him, stated that he simply wanted to know "where to send his license" and voluntarily withdraw from registration with any FINRA member firm. Shultz did not appear for testimony for nearly two years after that, and he ultimately agreed to testify only when the hearing date drew near and it was clear that his continued failure to appear would likely result in a bar.

H. FINRA found that Mielke and Shultz violated FINRA Rules as charged and imposed sanctions.

After a four-day hearing in March 2012, a FINRA Hearing Panel found Mielke and Shultz liable on all counts charged in FINRA's complaint: that Mielke and Shultz participated in undisclosed private securities transactions involving the sales of Midwest membership interests, engaged in undisclosed outside business activities because of their involvement with Midwest, and made false statements by failing to disclose their involvement in Midwest on their Brookstone Outside Business Interests Schedule. The Hearing Panel also found that Mielke failed to respond completely and timely to FINRA's information requests. The Hearing Panel further found that Shultz misused customer funds, caused Brookstone to maintain inaccurate books and records, and failed to appear timely for OTR testimony. The Hearing Panel imposed three bars each against Mielke and Shultz: one for their undisclosed private securities transactions and outside business activities, a second for their false statements on the Outside Business Interest Schedules, and a third for their failures to comply with FINRA's information requests. In light of the three bars it imposed against Shultz, the Hearing Panel declined to impose any additional sanctions against him for misuse of customer funds and causing books and records violations.

In reaching its finding, the Hearing Panel expressly found not credible Mielke's and Shultz's "uncorroborated claims" that they gave written and oral notice of the Midwest transactions and their involvement with Midwest to Brookstone before they began selling Midwest membership interests, and that Turbeville and Locy gave oral approval to Mielke and Shultz to sell interests in Midwest. The Hearing Panel also credited and relied on the testimony

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14 The FINRA examiner initially scheduled Shultz's OTR to occur in Chicago (where his original OTR had been scheduled in December 2009) on February 18, 2010, but Shultz requested an extension, which FINRA granted.

of Turbeville and Locy that they "neither knew nor approved [Midwest's] sales before Locy's final approval of the selling agreement in June 2009."

Mielke and Shultz appealed the Hearing Panel's decision to FINRA's National Adjudicatory Council. The NAC affirmed the Hearing Panel's decision and the sanctions it imposed. The NAC stated that it would have fined Shultz $10,000 and suspended him in all capacities for one year for his misuse of customer funds and his books and records violations, but it declined to impose those sanctions in light of the three bars it imposed for his other misconduct.

II. Analysis

A. Standard of Review

We base our findings on an independent review of the record and apply the preponderance-of-the-evidence standard for self-regulatory organization disciplinary actions.[15] Pursuant to Exchange Act Section 19(e)(1), in reviewing an SRO disciplinary action, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violates the SRO's rules, and whether such SRO rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[16]

B. Applicants violated NASD Rule 3040.

NASD Rule 3040 prohibits an associated person from participating "in any manner" in a private securities transaction without prior written notification to the employer. When the associated person receives compensation in connection with a private securities transaction, he must also receive written approval from the member firm before engaging in the transaction. We address each Rule 3040 element below.

1. Midwest membership interests are securities.

Section 2(a)(1) of the Securities Act of 1933 and Exchange Act Section 3(a)(10) define the term "security" to include an "investment contract."[17] In *SEC v. W.J. Howey Co.*, the Supreme Court defined an "investment contract" as "a contract, transaction, or scheme whereby a person invests his or her money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[18] The record establishes that investors bought Midwest membership interests, that the money Midwest received was pooled and invested in

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[15] *See David M. Levine*, Exchange Act Release No. 48760, 2003 WL 22570694, at *9 n.42 (Nov. 7, 2003).

[16] 15 U.S.C. § 78s(e)(1).

[17] 15 U.S.C. §§ 77b(a)(1), 78c(a)(10).

[18] 328 U.S. 293, 298-99 (1946).

hedge funds, and that investors understood they were to receive profits solely from the efforts of Harvest, Midwest's manager.[19] Moreover, Midwest's offering documents describe in great detail the various ways in which the membership interests are securities, and Applicants do not dispute that a Midwest membership interest is, and that they understood it to be, a security.[20] We conclude that Midwest membership interests are securities.

2. The sales of Midwest membership interests were private securities transactions.

Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member." Before June 2009, when Brookstone and Midwest executed the selling agreement, twenty-two investors purchased Midwest membership interests totaling $3.14 million from Applicants and others associated with Brookstone.[21] Mielke sold $1.1 million of Midwest membership interests directly to five investors, including two Brookstone customers, before June 2009. Because Brookstone had not approved these sales, the transactions were outside the regular course or scope of Applicants' jobs with Brookstone. We find that the sales of Midwest membership interests were private securities transactions.

3. Applicants participated in Midwest's private securities transactions.

Applicants were the heart of Midwest and facilitated sales of Midwest membership interests in many ways. Mielke created Midwest and its related companies; served as an officer and/or director for each of those companies; conducted due diligence on Midwest's investment in certain hedge funds and maintained a relationship with the hedge funds' managers; hired all the necessary personnel to market, sell, and administer Midwest; and promoted and directly sold

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19 We have held that pooled interests clearly support the existence of a common enterprise. *See, e.g., Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076, at *8 & n.55 (July 12, 2013) (citing *Howey*, 328 U.S. at 298-99; *Anthony H. Barkate*, Exchange Act Release No. 49542, 57 SEC 488, 2004 WL 762434, at *3 n.13 (Apr. 8, 2004), *aff'd*, 125 F. App'x 892 (9th Cir. 2005); *Joseph Abbondante*, Exchange Act Release No. 53066, 58 SEC 1082, 2006 WL 42393, at *6 n.40 (Jan. 6, 2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006)).

20 For example, the Midwest private placement memorandum states that Midwest's membership interests are "'restricted securities' under the Securities Act and are subject to substantial transfer limitations." And, in September 2009, when Shultz ultimately filed a Form D Notice of Exempt Offering of Securities with the Commission, under the box for "type of securities offered," Shultz referred to Midwest's membership interests as "pooled investment fund interests."

21 Although Brookstone officials testified that they were unaware of any Brookstone sales until approximately November 2009, FINRA based its findings regarding Mielke's and Shultz's private securities transactions violations solely on those transactions that occurred before June 2009, when Turbeville signed the selling agreement.

some of Midwest's membership interests. Mielke hired a securities attorney to draft the Midwest offering documents and hired registered representatives, including Shultz, to help him promote and sell Midwest interests.

Shultz does not dispute that he was also heavily involved in Midwest's transactions. He was an officer or director for the various Midwest entities and had primary responsibility for Midwest's financial and accounting matters, including deciding who qualified as an accredited investor and filing Commission documents. Shultz processed investor transactions virtually from beginning to end. He answered investors' questions about Midwest, mailed them offering documents, received their funds, ensured that the funds were invested in the hedge funds, made distributions, and handled redemption requests. Customer testimony further indicates that Shultz advised some investors about the advantages of maintaining, rather than liquidating, their Midwest investments.

Rule 3040's reach is "very broad" and "encompass[es] the activities of 'an associated person who not only makes a sale but who participates 'in any manner' in the transaction.'"[22] We have held that administrative and sales activities like those of Mielke and Shultz here support a finding that an associated person violated Rule 3040.[23] Indeed, Applicants controlled virtually every aspect of Midwest's business during the relevant period. Accordingly, we find that Applicants participated in Midwest's private securities transactions.

4. Applicants received selling compensation for the securities transactions.

Under Rule 3040(e)(2), "selling compensation" means "any compensation paid directly or indirectly from whatever source in connection with or as a result of the purchase or sale of a security, including, though not limited to, commissions . . . rights of participation in profits . . . as a general partner or otherwise . . . or expense reimbursements." Mielke and Shultz owned 80 percent of Harvest Holding, which wholly owned Harvest. As manager of Midwest, Harvest was entitled to 50 percent of Midwest's profits. Thus, Applicants had rights of participation in Midwest's profits. Mielke also received "commissions" for his direct sale of Midwest membership interests to five investors. And, in addition to his rights to participate in Midwest's profits, Shultz received a monthly salary from Midwest and reimbursement of expenses for his

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22 *Gluckman*, 1999 WL 507864, at *5 & n.24.

23 *See Mark H. Love*, Exchange Act Release No. 49248, 57 SEC 315, 2004 WL 283437, at *2-3 (Feb. 13, 2004) (finding that applicant participated in a private securities transaction where he recommended an investment to customers and facilitated mechanics of the transaction by, among other things, assisting customers with transferring funds and liquidating their firm accounts to purchase the recommended investments); *John P. Goldsworthy*, Exchange Act Release No. 45926, 2002 WL 987627, at *8 (May 15, 2002) (finding that applicant participated in a private securities transaction by signing the investment instruments, making arrangements to sell them, receiving investor checks made payable to him, and accepting funds from the proceeds of sales of the instruments).

Midwest-related travel and other activities. We find that Mielke and Shultz received selling compensation here.

5. Applicants did not provide written notice to or receive written approval from Brookstone.

Written notice under Rule 3040 is defined as "describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction." Under Rule 3040, registered representatives must provide member firms with such written notice before engaging in the transactions.[24] Because Mielke and Shultz received selling compensation, they also were required to obtain written approval from Brookstone before engaging in the Midwest transaction. There is no evidence of any written notice or approval in the record.

Applicants do not claim that they provided Brookstone specific written notice before selling Midwest securities. Instead, Applicants contend that they orally disclosed the transactions to Brookstone officers before January 2008, and, alternatively, that they satisfied the written notice requirement by various other documents they provided to Brookstone after the offering was in progress. They also contend that Brookstone orally approved of the Midwest sales before June 2009. We reject each of their arguments.

Mielke argues that, upon his arrival at Brookstone in June 2007, he began a discussion with Turbeville and Locy about his plan to sell Midwest and that Turbeville and Locy orally approved Mielke's plan before any representatives began to sell Midwest securities. But Rule 3040 requires written notice and approval. Oral notice and approval are insufficient.[25] In any event, FINRA did not credit Mielke's uncorroborated testimony. FINRA did credit the testimony of Locy and Turbeville, who testified that they had no idea before November 2009, when FINRA began its investigation, that anyone associated with Brookstone was selling Midwest securities. They also testified that they did not tell Applicants they could sell Midwest before a written selling agreement with Brookstone was in place. Turbeville's and Locy's testimony is corroborated by documentary evidence. We will not disturb FINRA's credibility findings here.[26]

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[24] *Harry Friedman*, Exchange Act Release No. 64486, 2011 WL 1825025, at *7 (finding violations of Rule 3040 where applicant failed to provide written notice to member firm before engaging in the transactions at issue).

[25] *See id.* at *5 (citing *Joseph J. Vastano*, Exchange Act Release No. 50219, 2004 WL 1857139, at *4 (Aug. 19, 2004) (finding that "any such oral exchange could not substitute for the written notice (and approval when compensation is to be received) required by the rule" and that "oral notice is not sufficient to satisfy the requirements of NASD Conduct Rule 3040")).

[26] Such determinations, based on hearing the witness's testimony and observing demeanor, are entitled to considerable deference. *See Wanda P. Sears*, Exchange Act Release No. 58075, 2008 WL 2597567, at *2 (July 1, 2008) (quoting *Jon R. Butzen*, Exchange Act Release No. 36512, 52 SEC 512, 1995 WL 699189, at *2 & n.7 (Nov. 27, 1995) ("[T]he credibility determination of the initial decision maker [in a FINRA disciplinary proceeding] is entitled to

(continued...)

The record and Applicants' own admissions in their briefs on appeal further undermine Applicants' claims that Brookstone had provided oral approval of Midwest sales before June 2009. For example, Mielke and Shultz acknowledge on appeal that, in late 2008 and early 2009, "Turbeville said Brookstone would need to review and approve the offering materials for Midwest before Brookstone would sell Midwest." They also note that Locy "rejected the first private placement memorandum he received from Midwest" in early 2009. Such admissions are inconsistent with Applicants' claim that Brookstone had provided Mielke with oral permission to sell Midwest as early as the beginning of 2008.

On appeal, Applicants further assert that Turbeville "approved the sale of the Midwest offering in 2008 but wanted to refrain from discussions about having Brookstone sell Midwest until Mielke's suspension ended." But this characterization does not make sense. Mielke was employed at Brookstone throughout 2008, including while he was suspended for six months. Turbeville testified that he would not have approved of his employee engaging in private securities transactions without the ability to supervise and monitor them. We find Turbeville's and Locy's testimony on this point to be consistent and credible.

Applicants alternatively argue that their 2008 and 2009 Outside Business Interests Schedules provided sufficient written notice to Brookstone. But in Mielke's schedule dated April 30, 2008, he did not mention Midwest. And Applicants' April 2009 schedules, both completed by Shultz, obliquely state, "In the planning stages of . . . working with an investment group dealing in medium term notes." That is insufficient detail to provide Brookstone notice of Midwest's sales or Applicants' roles in such sales.

Applicants cite a December 2008 internal Brookstone audit report as providing notice to Brookstone of the Midwest transactions. This report was not prepared by either Mielke or Shultz, but rather by an internal examiner at Brookstone. And December 2008 was over eleven months after Mielke formed Midwest and began to sell membership interests. The report did not notify Brookstone of Midwest's sales of membership interests, but merely flagged Mielke's and Shultz's involvement and advised Brookstone to "[l]ook into Vestium."

Applicants next assert that the Midwest offering documents they provided to Brookstone in the course of seeking Locy's approval adequately notified Brookstone because, according to Applicants, the documents indicated that Midwest already was being sold to investors.[27] But

(...continued)
considerable weight and deference, since it is based on hearing the witnesses' testimony and observing their demeanor.")).

27 Applicants point to the use of the present tense in the offering documents. For example, the private placement memorandum received by Locy in January 2009 states that Midwest "currently markets and sells its investments through licensed agents throughout the United States." But these statements were in draft offering documents and there was no reason for Brookstone to think that Applicants were currently selling Midwest membership interests when Brookstone had not yet approved those sales.

Rule 3040 requires written notice of proposed transactions before (not after) those transactions are completed. Sales began in January 2008, one year before Brookstone first saw drafts of the offering documents.

Even for transactions that occurred after Brookstone received the draft offering documents, Applicants' argument fails. Applicants described the documents as "proposed offering materials" and acknowledged that they were given to Brookstone as part of the approval process to offer Midwest through the firm. Locy rejected the initial drafts Applicants submitted and told them to hire new counsel and to try again. Locy and Turbeville understood these documents to be drafts because they were not signed or dated. Consistent with that understanding, Locy and Turbeville testified that they had no reason to think that Applicants would be selling an unapproved offering. Thus, the drafts standing alone did not provide adequate notice.

Further, because Applicants received compensation from sales, Rule 3040 required them to obtain written approval of the transactions from Brookstone. There is no evidence that Brookstone provided Applicants with written approval to sell Midwest until Brookstone approved a final version of an offering document, the Midwest selling agreement, in June 2009.

6. Rules 3040 and 2110 are, and were applied, in a manner consistent with the purposes of the Exchange Act.

We have stated repeatedly that the prohibition on private securities transactions is fundamental to an associated person's duties to his customers and his firm.[28] Such misconduct deprives investors of a brokerage firm's oversight, due diligence, and supervision—protections investors have a right to expect.[29] Consequently, Rule 3040 is, and FINRA applied the rule in a manner, consistent with the purposes of the Exchange Act.

* * *

We find that Mielke and Shultz engaged in private securities transactions without providing written notice to their member firm employer. Further, they received selling compensation without obtaining written approval of the transactions by their member firm employer. There is no documentary evidence showing the required written notice and written approval by Brookstone (before the June 2009 selling agreement), and the testimony of Locy and Turbeville, which FINRA credited, supports a finding that Applicants had not provided oral notice that they were selling Midwest membership interests before Brookstone learned about such sales in November 2009. We therefore sustain FINRA's finding that Applicants violated FINRA Rule 3040.

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28 *See Friedman*, 2011 WL 1825025, at *10 & n.34.

29 *Id.* at n.35 (citing *Barkate*, 2004 WL 762434, at *5 & n.27).

C. Applicants violated NASD Rule 3030 by failing to provide prompt written notice to Brookstone of their outside business activities.

NASD Rule 3030 states that "[n]o person associated with a member in any registered capacity shall be employed by, or accept compensation from, any other person as a result of any business activity, other than a passive investment, outside the scope of his relationship with his employer firm, unless he has provided prompt written notice to the member."

Mielke and Shultz owned and managed Midwest. Mielke received selling commissions and Shultz received a monthly salary in addition to their pro rata shares of any Midwest profits that were distributed to them through Harvest, Midwest's Manager. Yet Applicants failed to provide Brookstone with prompt written notice of their involvement in Midwest. For example, their Outside Business Interest Schedules included no information specifically referring to Midwest or to Applicants' Midwest-related compensation.

On appeal, Applicants concede that there was a "problem" with the Outside Business Interests Schedules that they submitted to Brookstone in 2008 and 2009, but they claim that they did not believe a full disclosure of their involvement with Midwest was necessary in those documents, based on their "good faith belief" that "Brookstone was already aware of the facts." As discussed above, we find that the record, including the credible testimony of Locy and Turbeville, does not support Applicants' claim that Brookstone knew about their sales at the time Applicants submitted their Outside Business Interests Schedules. And even if we accepted Applicants' argument that Brookstone was aware of their involvement in Midwest because of ongoing discussions with Midwest's securities attorney, such notice does not satisfy Rule 3030's requirement of written notice.[30]

Rule 3030 is consistent with the purposes of the Exchange Act because prompt written disclosure of outside business activities allows member firms to raise any objections to the outside activities in a timely manner and to exercise appropriate supervision of the activities of registered persons.[31] We therefore sustain FINRA's finding that Applicants violated Rule 3030 and 2110 by engaging in undisclosed outside business activities and that Rule 3030 is, and FINRA applied the rule in a manner, consistent with the purposes of the Exchange Act.[32]

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30 We have held that constructive notice does not satisfy the requirements of Rule 3030. *See Sears*, 2008 WL 2597567, at *4 & n.24.

31 *See Order Approving Proposed Rule Change Relating to Outside Business Activities of Associated Persons of Member Firms*, Exchange Act Release No. 26178, 1988 WL 902783, at *1 (Oct. 13, 1988) (approving NASD's enactment of Rule 3030 to address the securities industry's growing concern about preventing harm to the investing public or a firm's entanglement in legal difficulties based on an associated person's unmonitored outside business activities).

32 These violations also constitute violations of NASD Rule 2110 and FINRA Rule 2010, which require members to observe "high standards of commercial honor and just and equitable principles of trade." *See supra* note 1.

D. Applicants engaged in conduct inconsistent with just and equitable principles of trade by making misstatements on their 2008 and 2009 Outside Business Interests Schedules.

As discussed above, FINRA Rule 2010, and its predecessor NASD Rule 2110, prohibit conduct by associated persons of member firms that is inconsistent with just and equitable principles of trade. It is well established that FINRA's "disciplinary authority [under Rule 2110] is broad enough to encompass business-related conduct that is inconsistent with just and equitable principles of trade even if that activity does not involve a security."[33] We have stated that Rule 2110 applies where the conduct at issue "reflects on the associated person's ability to comply with the regulatory requirements of the securities business."[34]

Here, Mielke submitted an Outside Business Interests Schedule to Brookstone in April 2008 that included no mention of his involvement with Midwest, even though he had formed Midwest in January 2008 and had already begun, before April 2008, to sell membership interests both personally and through other registered representatives, raising approximately $500,000. In April 2009, both Mielke and Shultz submitted identical Outside Business Interests Schedules, which made no specific reference to Midwest and included only vague allusions to being "in the planning stages of . . . working with an investment group dealing in medium term notes," even though Midwest had already sold several million dollars of membership interests at that time. Applicants claim that these disclosures adequately informed Brookstone about their involvement in Midwest, but as discussed above, we find the disclosures to be wholly inadequate. Applicants were in charge of all aspects of Midwest's operations, with Mielke receiving the "bulk" of his income from Midwest and Shultz receiving a monthly salary and serving as Midwest's primary money manager.

The false statements Applicants made on their Outside Business Interests Schedules were inconsistent with just and equitable principles of trade and reflect poorly on their ability to comply with regulatory requirements. We therefore sustain FINRA's findings that Mielke violated NASD Rule 2110 and FINRA Rule 2010 and Shultz violated FINRA Rule 2010 and that these rules are, and FINRA applied them in a manner, consistent with the purposes of the Exchange Act.

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33 *Vail v. SEC*, 101 F.3d 37, 39 (5th Cir. 1996); *see also Ialeggio v. SEC*, 185 F.3d 867, 1999 WL 362896, at *2 (9th Cir. 1999) (Table) (same); *Daniel D. Manoff*, Exchange Act Release No. 46708, 2002 WL 31769236, at *4 (Oct. 23, 2002) (noting that application of Rule 2110 to business-related conduct not involving a security "is well established"); *Thomas E. Jackson*, Exchange Act Release No. 11476, 1975 WL 162936, at *2 (June 16, 1975) (stating that, although "[applicant's] wrongdoing in this instance did not involve securities, [FINRA] could justifiably conclude that on another occasion it might").

34 *Manoff*, 2002 WL 31769236, at *4.

E Shultz violated NASD Rule 3110 by causing Brookstone to maintain inaccur ate books and records.

NASD Rule 3110 requires member firms to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of [FINRA] and as prescribed by SEC Rule 17a-3."[35] Under Exchange Act Rules 17a-3 and 17a-4, FINRA member firms must make and keep books and records documenting their business activities, including documentation of the securities transactions executed by their associated persons.[36] Under these provisions, Brookstone was required to record in its books and records all sales of securities by its associated persons.

After Brookstone approved Midwest's sales of membership interests through the June 2009 selling agreement, new investors purchased an additional $1.47 million in Midwest membership interests. Shultz acknowledges that he failed to route sales documentation for the post-June 2009 Midwest transactions through Brookstone. Without such information, Brookstone did not include in its books and records crucial information related to those transactions, including the dates and amounts of the transactions at issue and the registered representatives who made the sales. Associated persons responsible for a member firm's failure to maintain accurate and complete books and records are responsible for causing the firm's violations of Rule 3110.[37]

Shultz primarily claims that he was not aware of his obligations to provide Brookstone with such documentation. But, as discussed above, Brookstone's WSPs clearly stated that the appropriate personnel were required to route sales transactions through the member firm in order to comply with recordkeeping obligations, and Locy testified that, upon approving the sale of Midwest through Brookstone, he had informed Shultz of his obligations. And, in any event, Shultz's claims of ignorance of his obligations do not excuse the violations.[38]

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35 The Rule further states that the format of such records "shall comply with Rule 17a-4 under the [Exchange Act]."

36 17 C.F.R. § 240.17a-3(a)(6)(i), 17 C.F.R. § 240.17a-4(b)(1).

37 *See North Woodward Fin. Corp. and Douglas A. Troszak*, Exchange Act Release No. 60505, 2009 WL 2488066, at *5 (Aug. 14, 2009) (finding that associated person's failure to prepare and maintain a current general ledger and trial balance, as required by Rule 17a-3, caused violations of Rule 3110).

38 *See, e.g., Friedman*, 2011 WL 1825025, at *6 & n.16 (citing *Phillipe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 3313843, at *6 & n.18 (Nov. 8, 2006) (noting that registered representative's "claimed ignorance of his obligations is only aggravated in light of his fifteen years of experience in the securities industry"); *see also Ryan R. Henry*, Exchange Act Release No. 53957, 2006 WL 1565128, at *3 & n.13(Jun. 8, 2006) ("A registered representative is assumed as a matter of law to have read and have knowledge of [SRO] rules and requirements.") (citing *Carter v. SEC*, 726 F.2d 472, 473-74 (9th Cir. 1983); *Walter T. Black*, Exchange Act

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Rule 3110 protects investors because it requires that member firms "conduct their business operations with regularity and that their records accurately reflect those operations."[39] Shultz's failures here made it impossible for Brookstone to keep track of the securities being sold by its registered representatives for purposes of meeting Brookstone's obligations under NASD Rule 3040. Therefore, FINRA's application of Rule 3110 here was, and the rule is, consistent with the purposes of the Exchange Act.[40]

F. Shultz violated FINRA Rule 2150 by misusing customer funds.

FINRA Rule 2150 states that "[n]o member or person associated with a member shall make improper use of a customer's securities or funds." As Midwest's CFO, Shultz was responsible for calculating Midwest's profits and dividing them between Harvest and the investors, with each receiving 50 percent. In September and October 2009, Midwest received $374,500 in new investor funds, but Shultz did not invest those funds in Vestium, as he was supposed to do. Rather, Shultz left those funds in Midwest's checking account and misallocated $147,000 of that amount to Harvest, describing it as "[p]art of profits." Shultz described his misallocation as a mistake caused by "bad accounting," an explanation that FINRA accepted.[41] The error was discovered by an outside accountant Midwest hired to assist with Midwest's books and records. The outside accountant ultimately determined that, of the $147,000 Shultz improperly misallocated to Harvest, Harvest was entitled to $102,000 in accrued, but previously unpaid, profits. Therefore, he determined that Shultz had misused approximately $45,000 of customer funds.[42]

(...continued)
Release No. 28630, 50 SEC 424, 1990 WL 322246, at *2 (Nov. 20, 1990) ("[L]ack of familiarity with the NASD's rules cannot excuse [registered representative's] conduct."))).

39 *See John F. Lebens*, Exchange Act Release No. 36691, 1996 WL 20836, at *2 (Jan. 5, 1996).

40 These violations also constitute violations of FINRA Rule 2010, which requires members to observe "high standards of commercial honor and just and equitable principles of trade." *See supra* note 1.

41 We have held that violations involving the misuse of customer funds do not require a showing of scienter. *Blair Alexander West*, Exchange Act Release No. 74030, 2015 WL 137266, at *8 (Jan. 9, 2015) (finding no need to establish scienter to support a violation relating to misuse of customer funds, but finding the facts of the case at issue supported such a finding). Further, to the extent Shultz's arguments are intended to mitigate the severity of his violations for sanctions purposes, as discussed elsewhere in this opinion, FINRA imposed no sanctions for Shultz's violations of Rule 2150, in light of the bars it imposed for his other violations.

42 As discussed above, through a transfer from Harvest to Midwest, this $45,000 was returned to the affected investors. But those investors were denied any benefit they may have accrued if their money had been properly invested at the time they purchased their membership interests.

"[M]isuse of customer funds is 'patently antithetical to the high standards of commercial honor and just and equitable principles of trade that [FINRA] seeks to promote.'"[43] Based on Shultz's admitted improper diversion of significant funds invested with Midwest, we sustain FINRA's finding that Shultz violated FINRA Rules 2150 and 2110, and that Rule 2150 is, and find that FINRA applied the rule in a manner, consistent with the purposes of the Exchange Act.[44]

G. Applicants violated FINRA Rules 8210 and 2010 by failing to respond to FINRA's requests in a timely manner.

Rule 8210(a)(1) requires a person subject to FINRA's jurisdiction to provide information upon FINRA's request.[45] As we have emphasized, Rule 8210 is essential to FINRA's ability to investigate possible misconduct by its members and associated persons.[46] We have long recognized that the language of Rule 8210 is "unequivocal" regarding an associated person's responsibility to cooperate with FINRA information requests and that vigorous enforcement of Rule 8210 "helps ensure the continued strength of the self-regulatory system—and thereby enhances the integrity of the securities markets and protects investors. . . ."[47]

Applicants admit that they failed to comply fully with FINRA's information requests. FINRA made multiple requests for information from Mielke. But Mielke responded only partially to FINRA's information requests and waited over two years, until just before his scheduled hearing date, to provide most of the limited information that he eventually submitted. We have held that associated persons may not decide which specific FINRA information requests they will fulfill.[48] In the end, Mielke never provided responsive answers to most of the

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43 *Henry E. Vail*, Exchange Act Release No. 35872, 1995 WL 380152, at *2 n.12 (June 20, 1995) (quoting *Wheaton D. Blanchard*, Exchange Act Release No. 12484, 1976 WL 160367, at *1 (May 27, 1976)), *aff'd*, 101 F.3d 37 (5th Cir. 1996); *see also Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 WL 358737, at *16 & n.21 (Feb. 1, 2010) (same), *petition denied*, 647 F.3d 1156 (D.C. Cir. 2011).

44 These violations also constitute violations of FINRA Rule 2010, which requires members to observe "high standards of commercial honor and just and equitable principles of trade." *See supra* note 1.

45 *Morton Bruce Erenstein*, Exchange Act Release No. 56768, 2007 WL 3306103, at *4 (Nov. 8, 2007).

46 Rule 8210 is the principal means by which FINRA obtains information from member firms and associated persons in order to detect and address industry misconduct. *See, e.g., Charles C. Fawcett, IV*, Securities Exchange Act Release No. 56770, 2007 WL 3306105, at *6 (Nov. 8, 2007) (stating that, because of a lack of subpoena power, Rule 8210 is a "vitally important" tool to acquire information).

47 *See Howard Brett Berger*, Exchange Act Release No. 58950, 2008 WL 4899010, at *4 (Nov. 14, 2008), *aff'd*, 347 F. App'x 692 (2d Cir. 2009).

48 *See CMG Inst. Trading, LLC*, Exchange Act Release No. 59325, 2009 WL 223617, at *6

(continued...)

key requests that FINRA made in 2009 and 2010, including documents showing emails and other communications between Midwest's attorney and Brookstone, which Mielke claimed would prove that he had disclosed the Midwest transactions.

Shultz repeatedly refused to appear for OTR testimony before FINRA, despite numerous efforts by FINRA to accommodate his scheduling requests. At one point, after refusing to appear on several separate occasions, Shultz told FINRA, through his counsel, that he simply wished to turn in his license. Shultz finally provided testimony to FINRA two years after his originally scheduled OTR date, and only a few months before the scheduled hearing date.

On the basis of these findings, we sustain FINRA's finding that both Applicants violated Rule 8210 and that the rule is, and that FINRA applied the rule in a manner, consistent with the purposes of the Exchange Act.[49]

III. Sanctions

A. Standard of Review

Exchange Act Section 19(e)(2) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[50] As part of this review, we must consider any aggravating or mitigating factors[51] and whether the sanctions imposed by FINRA are remedial in nature and not punitive.[52] Although the Commission is not bound by FINRA's Sanction Guidelines, we use them as a benchmark in

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& n.23 (stating that "associated persons 'may not ignore NASD inquiries; nor take it upon themselves to determine whether information is material to an NASD investigation of their conduct'") (quoting *Gen. Bond & Share Co. v. SEC*, 39 F.3d 1451, 1461 (10th Cir. 1994) (affirming Commission's finding that member violated predecessor to NASD Rule 8210)).

49 These violations also constitute violations of FINRA Rule 2010, which requires members to observe "high standards of commercial honor and just and equitable principles of trade." *See supra* note 1.

50 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that FINRA's sanctions imposed an undue burden on competition.

51 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

52 *Paz Sec.*, 494 F.3d at 1065 ("The purpose of the order [must be] remedial, not penal.") (quoting *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940); *see also* FINRA Sanction Guidelines at 2 ("Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.").

conducting our review under Section 19(e)(2).[53] As discussed below, we find the sanctions imposed on Applicants to be consistent with the statutory requirements and sustain them.

B. FINRA's bars of Mielke and Shultz for their violations of Rules 3040 and 3030 are neither excessive nor oppressive.

The Sanction Guidelines authorize the aggregation or "batching" of violations for purposes of determining sanctions if, among other things, the violations result from a single systemic problem or cause.[54] FINRA found that, although the Guidelines permitted it to assess separate sanctions for each of Applicants' violations, the Rule 3040 and 3030 violations at issue here were related and a unitary sanction was appropriate. We agree with FINRA that Applicants' violations of Rules 3040 and 3030 both derive from their significant involvement and control of Midwest, and we sustain FINRA's determination to impose a unitary sanction for those violations.

For engaging in private securities transactions without providing prior written notice and obtaining the required approval, the Sanction Guidelines recommend a fine between $5,000 and $50,000, a suspension of at least one year, or a bar.[55] For engaging in outside business activities, the Guidelines suggest a suspension of up to one year or, in egregious cases, a bar.[56] The Guidelines for both Rule 3040 and Rule 3030 enumerate a number of specific aggravating and mitigating circumstances, each of which FINRA considered and found to weigh in favor of a bar.

FINRA found a number of aggravating factors. Mielke and Shultz owned a significant percentage of Midwest through their ownership of Harvest and Harvest Holding. They derived a financial benefit from the sales of Midwest membership interests.[57] They did not provide Brookstone with oral notice of the transactions.[58] And the managers of the Vestium and Arcanum funds, into which Midwest invested member's proceeds, were enjoined against violations of the antifraud provisions of the federal securities laws; if Applicants had properly disclosed their sales of Midwest, Brookstone could have supervised the investments and protected its customers from exposure to such fraudsters.[59]

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53 *See, e.g., John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013).

54 *See* FINRA Sanction Guidelines, at 4 (General Principles Applicable to All Sanctions Determinations, No. 4).

55 *Id.* at 14.

56 *Id.* at 13.

57 *Id.*

58 *Id.* at 15 (Principal Considerations in Determining Sanctions, No. 9).

59 *Id.* at 14.

Individual aggravating factors also apply to each Applicant. For example, Mielke had the primary responsibility for setting up Midwest, including arranging for the preparation of offering documents, hiring registered representatives to sell membership interests, and conducting due diligence on Vestium and Arcanum. And, as discussed above, Mielke has a disciplinary history of violations of Rule 3040 and was serving a six-month suspension for violating Rule 3040 at the time of some of the conduct at issue here. We sustain FINRA's finding that such a disciplinary history is a significant aggravating factor.[60] FINRA also found it aggravating that Mielke's conduct had extended over a 17-month period from January 2008 through June 2009. During this period, investors (including some Brookstone customers) purchased millions of dollars of Midwest membership interests.[61] FINRA found that the accumulation of these aggravating factors warranted a bar against Mielke.

Although Mielke may have initiated the Midwest offering, FINRA also found that Shultz's role in Midwest was quite significant. Shultz managed the daily operations of Midwest and was identified as the "Manager" of the Midwest offering. Shultz calculated the profits of the enterprise and made determinations regarding the amounts of distributions owed to investors. He also consulted with investors regarding redemption requests. As with Mielke, FINRA found that the extent and length of Shultz's involvement in the conduct at issue (from approximately September 2008 through June 2009) were aggravating factors. FINRA also noted as aggravating factors the number of transactions that occurred while Shultz managed Midwest's operations and the dollar amounts involved in those transactions. On these bases, FINRA found that Shultz's misconduct was egregious and warranted a bar.

FINRA found no mitigating factors. On appeal, Applicants suggest that it is mitigating that there is no specific evidence of customer harm resulting from their violations. But even assuming Applicants are correct in arguing that they did not harm customers financially by their Rule 3040 and 3030 violations, such a finding would not be mitigating.[62] As described above, the violations at issue harmed the customers by depriving them of Brookstone's supervision of their investments, regardless of whether the investors suffered financial harm.

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60 *See id.* at 2 (General Principles Applicable to All Sanctions Determinations, No. 2), 6 (Principal Considerations in Determining Sanctions, No. 1).

61 *Id.* at 15 (Principal Considerations determining Sanctions, No. 11).

62 *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *18 & n.137 (Nov. 15, 2013) ("[T]he absence of . . . customer harm is not mitigating, as our public analysis focus[es] . . . on the welfare of investors generally.") (citing *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *7 & n.25 (Feb. 24, 2012) (internal quotations omitted); *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 WL 1697153, at *5 (Apr. 11, 2008) (holding that applicants' failure to comply with NASD rule "are not mitigated because those failures did not, in themselves, produce a monetary benefit to Applicants or result in injury to the investing public"), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009); *Coastline Fin., Inc.*, Exchange Act Release No. 41989, 54 SEC 388, 1999 WL 798874, at *5 (Oct. 7, 1999) (rejecting absence of customer harm as a mitigating factor for sanctions)).

Applicants also argue that their violations of Rules 3040 and 3030 are mitigated because Mielke retained securities counsel "to insure compliance with FINRA rules and to negotiate a selling agreement with Brookstone." To establish a valid advice-of-counsel claim, Applicants must show: (1) that they made complete disclosure to counsel; (2) that they sought advice on the legality of the intended conduct; (3) that they received advice that the intended conduct was legal; and (4) that they relied in good faith on counsel's advice.[63] But Mielke admitted in his testimony that he did not recall what he discussed with the securities counsel "in the aspect of what was to be disclosed and what wasn't to be disclosed." And Shultz's testimony also did not establish that the securities attorney had notified Brookstone of the ongoing Midwest sales transactions but merely that Shultz understood that the attorney "had been discussing Midwest with Brookstone all along and that [Brookstone] knew that we were operating Midwest."

Because we agree with FINRA's findings that Applicants' Rule 3040 and Rule 3030 violations were egregious and presented numerous aggravating factors and no mitigating factors, we sustain FINRA's imposition of bars in all capacities against both Applicants for these violations.

C. FINRA's bars of Mielke and Shultz for their misstatements on the April 2008 and 2009 Outside Business Interests Schedules are neither excessive nor oppressive.

Although the Guidelines contain no specific recommendation for misstatements on member firm compliance forms, FINRA concluded that the most closely analogous guideline was for forgery or falsification of records.[64] We have sustained FINRA disciplinary sanctions where FINRA applied those Guidelines in a case involving misstatements on firm compliance documents.[65] Those Guidelines recommend a bar in egregious cases.[66] As discussed below,

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63 *Zacharias v. SEC*, 569 F.3d 458, 467 (D.C. Cir. 2009); *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994); *C.E. Carlson v. SEC*, 859 F.2d 1429, 1436 (10th Cir. 1988); *SEC v. Goldfield Deep Mines Co. of Nevada*, 758 F.2d 459, 467 (9th Cir. 1985); *SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981). *See also Vastano*, 2004 WL 1857139, at *5 & n.22; *Barkate*, 2004 WL 762434, at *4 & nn.19-20; *Toni Valentino*, Exchange Act Release No. 49255, 57 SEC 330, 2004 WL 3000098, at *5 & n.11 (Feb. 13, 2004).

64 The Guidelines make clear that they "are not intended to be absolute," and "[f]or violations that are not addressed specifically, [a]djudicators are encouraged to look to the guidelines for analogous violations." *See* Guidelines, Overview. *See also Robert Conway Kakit Ng*, Exchange Act Release No. 70833, 2013 WL 5960703, at *10 & n.48 (Nov. 7, 2013).

65 *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *8 (Feb. 24, 2012) (finding that "FINRA reasonably determined that the falsification of records was the most analogous guideline" where applicant had failed to provide written notice of his outside brokerage accounts on compliance forms submitted to member firm employer).

66 *See Guidelines*, at 37.

FINRA considered each Applicant's violation individually and determined that they were egregious and warranted a bar.

At the time Mielke completed his 2008 Outside Business Interests Schedule, he had already raised $500,000 for Midwest. At the time of his 2009 schedule, Mielke himself had directly sold membership interests to five investors, including two Brookstone customers, totaling over $1 million. And, at that time, Midwest had received twenty-two investments totaling over $3 million. Given the significant number and dollar amount of these transactions, Mielke was obviously aware of his involvement in Midwest at the time he submitted these schedules. FINRA correctly found that the record demonstrated that Mielke's misstatements were intentional and misled Brookstone about the extent of Mielke's involvement in Midwest while Mielke negotiated the terms of a selling agreement with Brookstone. This is an aggravating factor under the Guidelines for falsification.[67]

On appeal, Mielke argues that his violations of Rule 2110 and 2010 should be viewed "in light of the ongoing communications between Midwest and Brookstone." But, by Mielke's own admission, neither Turbeville nor Locy had approved the sale of Midwest securities in writing until June 2009. Therefore, Mielke knew that he was repeatedly selling Midwest securities to investors while using an offering memorandum that had not been approved by his member firm employer.

We concur with FINRA's finding that Mielke's misstatements on the Outside Business Interests Schedules were egregious. Mielke's failure to disclose his significant role at Midwest undermined Brookstone's "ability to detect actual or potential conflicts of interest, or other violative conduct."[68] Such a violation is serious because it impedes detection of other potentially violative conduct.[69] We sustain FINRA's imposition of a bar against Mielke for his misstatements on the 2008 and 2009 Outside Business Interests Schedules.

Shultz's misstatements on his 2009 Outside Business Interests Schedule were similarly egregious. As with Mielke, Shultz was aware of his significant involvement in Midwest at the time he submitted his schedule, and the schedule neither mentioned Midwest by name nor explained that millions of dollars in membership interests had already been sold at the time he submitted the schedule. Further, FINRA correctly noted that, if Shultz had not made the misstatements, his other violations for misuse of customer funds and causing Brookstone's books and records violations may have been avoided, because Brookstone would have exercised supervisory authority over the transactions.

FINRA noted that Shultz had less securities industry experience and made misstatements only on one Schedule (as opposed to Mielke's two Schedules), but it found that those factors did

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67 *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 13).

68 *See Braff*, 2012 WL 601003, at *7.

69 *Id.*

not outweigh the significant aggravating factors. Regardless of the length of Shultz's experience in the industry, Shultz was a retired mathematician and FINRA correctly pointed to his "life experience" as supporting a finding that he should have had awareness of the importance of providing true statements regarding his involvement with Midwest to his member firm employer. Shultz also claimed that he merely followed Mielke's instructions in filling out the schedule, but FINRA correctly rejected this argument, noting that associated persons are responsible for their own compliance with FINRA Rules and cannot shift that responsibility to another individual.[70]

D. FINRA's bars of Mielke and Shultz for their Rule 8210 violations are neither excessive nor oppressive.

Rule 8210 "provides a means, in the absence of subpoena power, for [FINRA] to obtain from its members information necessary to conduct investigations."[71] This rule is at the "heart of the self-regulatory system for the securities industry"[72] and is an "essential cornerstone of [FINRA's] ability to police the securities markets and should be rigorously enforced."[73] "Failures to comply are serious violations because they subvert [FINRA's] ability to carry out its regulatory responsibilities," threatening investors and the markets.[74] Rather than respond to FINRA's Rule 8210 requests, Mielke repeatedly refused to provide responsive documents and, when he did provide some documents, his responses only partially fulfilled FINRA's requests and included certain patently false information. And Shultz continuously refused to provide OTR testimony for over two years, at one point expressing a desire to "send in his license" and voluntarily withdraw. It is well established that an individual may not "second guess" a Rule 8210 request or "set conditions on their compliance."[75] The bars FINRA imposed on Mielke and Shultz are remedial because they will protect the investing public by encouraging timely cooperation essential to the prompt discovery and remediation of industry misconduct. The bars also will deter others from ignoring FINRA's information requests.

The sanctions imposed on Mielke and Shultz are consistent with the Sanction Guidelines. FINRA determined that Mielke provided a partial response because he timely appeared for an OTR and provided some documents. The Guidelines identify three principal considerations for determining sanctions for a partial response: the "[i]mportance of the information requested as

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70 *Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *21 (Jan. 30, 2009) ("We have held repeatedly that a 'respondent cannot shift his or her responsibility for compliance with an applicable requirement to a supervisor or to the NASD.'") (citation omitted), *aff'd*, 416 F. App'x 142 (3d Cir. 2010).

71 *See supra* note 46.

72 *Id.*

73 *Jay Alan Ochanpaugh*, Exchange Act Release No. 54363, 2006 WL 2482466, at *5 (Aug. 25, 2006).

74 *Plunkett*, 2013 WL 2898033, at *9 (citations omitted).

75 *CMG Inst'l Trading*, 2009 WL 223617, at *8 (Jan. 30, 2009) (citations omitted).

viewed from FINRA's perspective"; the "[n]umber of requests made and the degree of regulatory pressure required to obtain a response"; and the "[l]ength of time to respond."[76] The Guidelines also provide that a bar is standard for a partial but incomplete response unless the person can demonstrate substantial compliance with all respects of the request.

We acknowledge, as FINRA did, that Mielke appeared for his scheduled OTR testimony and provided some of the information that FINRA requested, including providing copies of his tax returns and (two years later) additional information including some Midwest-related documentation. But we agree with FINRA that "[i]n most respects, however, the [8210] request for information and documents remained unfulfilled." Specifically, we agree with FINRA that some of the information Mielke failed to provide were "documents necessary to assist in FINRA's investigation of [Midwest] and the offering."

We also agree with FINRA that Mielke's failure to provide the requested documentation substantiating Mielke's claims that he had proof of Brookstone's awareness of the Midwest sales "curtailed FINRA's ability to verify his claims." Such inhibition of FINRA's regulatory functions is a "serious violation justifying stringent sanctions."[77]

Mielke claims that his personal health issues explain his Rule 8210 violations. While we do not doubt the existence of Mielke's significant health issues, it was his obligation to contact FINRA, explain the reasons why his response would be delayed, and propose alternate arrangements, none of which Mielke did here.[78]

We also note that Mielke failed to provide any responsive information to FINRA for nearly two years, and provided much of the additional information only on the cusp of his hearing. Much of the information he ultimately provided, such as his narrative description of his involvement with Midwest, was readily available to him throughout this two-year period. But it took the institution of a disciplinary proceeding and the threat of imminent sanctions before Mielke provided even a partial response. Mielke fails to offer any persuasive reason why he could not have provided this information when FINRA initially requested it.

Shultz's Rule 8210 failure was treated as a complete failure because he did not appear for his requested OTR testimony until after FINRA instituted disciplinary proceedings against him. Under such circumstances, the Guidelines recommend a bar.[79] We have emphasized that a bar is

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76 *Guidelines*, at 33.

77 *Elliot M. Hershberg*, Exchange Act Release No. 53145, 2006 WL 140646, at *3 (Jan. 19, 2006) (stating that "[f]ailure to comply is a serious violation justifying stringent sanctions because it subverts NASD's ability to execute its regulatory functions"), *pet. denied*, 210 F. App'x 125 (2d Cir. 2006).

78 *See Fawcett*, 2007 WL 3306105, at *5.

79 *See* Guidelines, at 33.

an appropriate sanction in such circumstances because FINRA "should not have to initiate a disciplinary action to elicit a response to its information requests."[80]

Shultz cites his daughter's and wife's health concerns as reasons for his failure to appear for testimony. But, as with Mielke's claims regarding his own health issues, Shultz made no effort to explain his needs or propose alternate arrangements.[81] Shultz also now claims that his failure to appear resulted from his inability to obtain new counsel after his former counsel had withdrawn from representing him at the time of Mielke's OTR testimony. But the record indicates that Shultz obtained new counsel promptly after his former counsel withdrew. Further, "[a]lthough FINRA's rules permit the participation of counsel, it is well established that 'there is no right to counsel in [its] disciplinary proceedings.'"[82] Given Shultz's complete failure to respond to FINRA's request for testimony until he was about to be barred or suspended, and the lack of mitigating factors, we sustain FINRA's bar of Shultz for his Rule 8210 violations.

We find the sanctions imposed on Mielke and Shultz to be neither excessive nor oppressive.[83]

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80 *Joseph Ricupero*, Exchange Act Release No. 62891, 2010 WL 3523186, at *4 (Sept. 10, 2010), *aff'd*, 436 F. App'x 31 (2d Cir. 2011).

81 *See supra* note 78.

82 *See Robert D. Tucker*, Exchange Act Release No. 68210, 2012 WL 5462896, at *12 (Nov. 9, 2012) (quoting *Jason A. Craig*, Exchange Act Release No. 59137, 2008 WL 5328784, at *6 (Dec. 22, 2008).

83 FINRA also ordered Mielke and Shultz to pay, jointly and severally, appeal costs of $2,468.85. Because we find that the sanctions FINRA imposed were appropriately tailored to the violations at issue, we likewise sustain its imposition of costs.

As discussed above, FINRA stated that it would have fined Shultz $10,000 and suspended him in all capacities for one year for his violations of Rules 2150 and 2010 involving the misuse of customer funds and his violations of Rules 3110 and 2010 for causing Brookstone to maintain inaccurate books and records, but FINRA did not impose these sanctions in light of the bars it imposed for Shultz's other violations. Since FINRA imposed no sanctions for these violations, Shultz's argument on appeal that these violations merited only "minimal" sanctions is not relevant in this appeal.

We note, however, the presence of aggravating factors for both violations. Shultz's misuse of customer funds lasted for nine months, from September 2009 until its discovery in June 2010, and was only discovered by an outside accountant. *See* Guidelines, at 6 (Principal Considerations in Determining Sanctions, No. 9). This discovery was undoubtedly delayed by Applicants' failure to disclose the Midwest sales to Brookstone more promptly. Shultz also misused approximately $45,000 in investor funds, a significant amount of money, which is aggravating. *See id.* at 7 (Principal Considerations in Determining Sanctions, No. 18). In light of these aggravating factors, while we sustain FINRA's determination not to impose additional sanctions for Shultz's misuse of customer funds, we agree with FINRA that a $10,000 fine and a

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An appropriate order will issue.[84]

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

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

(...continued)
one-year suspension would have been appropriate.

With respect to Shultz's books and records violations, Shultz claims that his attorney never instructed him about his obligation to route sales documentation through Brookstone. A reasonable reliance on competent legal or accounting advice can be a mitigating factor in determining sanctions. *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 7). But, as discussed above, Shultz has not shown that he met the requirements for a valid advice of counsel defense. *See supra* note 63. Shultz also claims that the selling agreement between Brookstone and Midwest did not specifically alert him to his responsibility to route sales documentation through Brookstone. But, as discussed above, both Locy and Brookstone's WSPs made clear that Shultz, as the manager of Midwest, had the responsibility to assist Brookstone in maintaining accurate books and records by providing documentation in support of sales transactions. In light of the absence of mitigating factors, while we sustain FINRA's determination not to impose additional sanctions for Shultz's causing Brookstone to violate Rule 3110 and 2010, we agree with FINRA that a $10,000 fine and a one-year suspension would have been appropriate.

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75981/September 24, 2015

Admin. Proc. File No. 3-16022

In the Matter of the Applications of

BLAIR C. MIELKE
and
FREDERICK W. SHULTZ

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the disciplinary action taken by FINRA against Blaire C. Mielke and Frederick W. Shultz, and the assessment of costs imposed, is sustained.

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 EXCHANGE ACT OF 1934
Release No. 75982 / September 24, 2015

Admin. Proc. File No. 3-16155

In the Matter of NICHOLAS ROWE	ORDER DENYING MOTION FOR SUMMARY AFFIRMANCE AND REMANDING FOR ADDITIONAL PROCEEDINGS

Nicholas Rowe appeals from an initial decision in which an administrative law judge permanently barred him from associating with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization pursuant to Section 203(f) of the Investment Advisers Act of 1940.[1] As explained below, we find that the existing record contains sufficient evidence to establish the threshold statutory prerequisites to institute a proceeding under Advisers Act Section 203(f), but does not contain enough evidence to allow us to determine what sanction is in the public interest. We therefore remand this matter to the law judge for further proceedings.

I. We instituted these proceedings against Rowe after he consented to an order issued by the New Hampshire Bureau of Securities Regulation that barred him from the securities industry and was based on alleged antifraud violations.

We instituted this follow-on proceeding pursuant to Advisers Act Section 203(f) on September 23, 2014, alleging in our order instituting proceedings (the "OIP") that Rowe had consented to an order issued on March 12, 2013 by the New Hampshire Bureau of Securities Regulation (the "Consent Order").[2] The Consent Order alleged that from January 1, 2007, to March 12, 2013, Rowe, an investment adviser representative, and Focus Capital Wealth Management, Inc., an investment adviser ("Focus"; together with Rowe, "Respondents"), engaged in highly risky trading strategies that were unsuitable for certain New Hampshire

1 *Nicholas Rowe*, Initial Decision Release No. 746, 2015 WL 847167, at *8 (Feb. 27, 2015).

2 *Nicholas Rowe*, COM20111-0037, Consent Order (State of N. H. Bureau of Sec. Reg., Dep't of State Mar. 12, 2013).

customers, thereby violating antifraud provisions of New Hampshire state securities laws.[3] Specifically, the Consent Order alleged that "[a]lthough Rowe claimed he was engaging in a legitimate and complicated trading strategy, analysis of the NH Customers' accounts revealed that Rowe was essentially placing large, short-term and very speculative directional bets on the stock market while increasing the NH Customers' risk tolerances over time," "completely ignor[ing] the NH Customers' individual and specific risk tolerances." The Consent Order further alleged that Rowe failed to disclose the risks associated with the investments in question and failed to disclose the basis for the fees he charged. Rowe and Focus agreed to cease and desist from any alleged violations of 421-B:4,[4] to pay a $5,000 fine and a $15,000 penalty, to pay restitution to certain customers, and to be permanently barred from any securities licensure in the state of New Hampshire.[5] Respondents further agreed that they would not "take any action or make or permit to be made any public statement . . . denying, directly or indirectly, any allegation in this Consent Order or creating the impression that the Consent Order is without factual basis." But despite that general waiver, Respondents specifically retained the right "to take contrary legal or factual positions in litigation or other legal proceedings in which the State of New Hampshire is not a party."

After we instituted these proceedings, the Division of Enforcement moved for summary disposition. The law judge granted the Division's motion, finding that there was no genuine issue of material fact and that the Division was entitled to summary disposition as a matter of law.[6]

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3 The Consent Order alleged that Capital and Rowe violated New Hampshire Revised Statutes Annotated Section 421-B:4, V, incorporating by reference Section 421-B:4, I, which together prohibit an investment adviser or investment adviser representative from employing any device, scheme, or artifice to defraud another person, or engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon the other person. The Consent Order specifically alleged that Rowe violated Section 421-B:V(a), which prohibits recommending to clients the purchase of any security without reasonable grounds to believe the recommendation is suitable, and Section 421-B:V(h), which prohibits, among other things, misrepresenting to clients the fees to be charged for advisory services, or omitting to state a material fact necessary to make the statements regarding fees, in light of the circumstances under which they are made, not misleading. N.H. Rev. Stat. Ann. §§ 421-B:V(a), (h).

4 Rowe also agreed to cease and desist from any alleged violations of Section 421-B:3, another antifraud provision.

5 Respondents also agreed "to waive their right to an administrative hearing and any appeal therein."

6 *See* Rule of Practice 250(b), 17 C.F.R. § 201.250(b) (setting forth conditions under which summary disposition may be granted).

II. The statutory prerequisites for this proceeding exist.

Advisers Act Section 203(f), incorporating by reference Section 203(e)(9), authorizes the Commission to impose certain sanctions on a person who "is subject to any final order of a State securities commission (or any agency . . . performing like functions)" that "bars such person from engaging in the business of securities" or that is "based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct," and who, at the time of the alleged misconduct, was associated with an investment adviser.[7] As discussed below, we find, as the law judge did, that there is no genuine issue of material fact that these statutory prerequisites for instituting an administrative proceeding are satisfied.

A. The Consent Order provided a valid basis for initiating a follow-on proceeding.

We find that the Consent Order is a final order for purposes of this proceeding. Although Section 203(e)(9) does not define the term "final order," we recently determined in the context of administrative proceedings under Section 15(b)(4)(H) of the Exchange Act, which uses identical language without defining the term "final order," that "final order" means "a written directive or declaratory statement issued by a state agency under statutory authority that provides for notice and opportunity for a hearing and constitutes a final disposition or action by the state agency."[8] Under this definition, we find that the Consent Order is a "final order" under Section 203(e)(9) because it is a written directive issued by the New Hampshire Bureau of Securities Regulation[9] that constitutes a final disposition of the securities law violations against Rowe,[10] and the New Hampshire statutes authorizing such proceedings provided notice and the opportunity for a hearing.[11]

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[7] 15 U.S.C. § 80b-3(f) (incorporating by reference 15 U.S.C. § 80b-3(e)(9)). Section 203(f) also authorizes sanctions against other types of respondents based on other actions, omissions, convictions, or injunctions; we note in the text only those applicable to Rowe.

[8] *See Nicholas Savva*, Exchange Act Release No. 72485, 2014 WL 2887272, at *7 (June 26, 2014). *See also Disqualification of Felons and other "Bad Actors" from Rule 506 Offerings*, Securities Act Release No. 9414, 2013 WL 3817311, at *22-24 (July 10, 2013) (adopting similar definition of "final order" in Rule 501(g) of Regulation D, 17 C.F.R. § 230.501(g)).

[9] *See* N.H. Rev. Stat. Ann. §§ 421-B:21, I & I-a (granting secretary of state and appointees various securities-related authorities and jurisdictions), 421-B:10 (granting secretary of state power to deny, suspend, or revoke securities licenses).

[10] The disposition is final because Rowe explicitly waived his right to appeal. *See supra* note 5.

[11] *See generally* N.H. Rev. Stat. § 421-B:26-a (setting forth hearing procedures to be used in administrative proceedings brought pursuant to N.H. Rev. Stat. Ann., Title XXXVII, Chap. 421-B, Securities). *See also* N.H. Rev. Stat. § 421-B:26-aV(a) (providing that if the secretary of state issues an order granting any part of a staff petition for relief in an adjudicatory proceeding

(continued...)

We also find that the Consent Order bars Rowe from engaging in the business of securities in New Hampshire. In the Consent Order, Rowe agreed to be, and was, by the terms of the order, barred from securities licensure in New Hampshire. New Hampshire statutes make it unlawful for unlicensed persons to transact business in the state as a broker-dealer, issuer-dealer, investment adviser, or agent.[12] Because investment adviser representatives are required to be licensed as agents,[13] unlicensed investment adviser representatives would also be barred from transacting business in New Hampshire. Thus, the bar that Rowe agreed to and that was imposed in the Consent Order bars him from engaging in the securities business in New Hampshire, and the Consent Order therefore satisfies the requirements of Section 203(e)(9)(A).

We further find that the Consent Order was based on violations of statutes that prohibit fraudulent, manipulative, or deceptive conduct.[14] While Rowe denies that he committed such violations, the Consent Order is nonetheless "based on" such violations, and thus satisfies the requirements of Section 203(e)(9)(B).[15]

Rowe argues that the Consent Order is not valid because it was entered under duress.[16] But this is not the forum in which to litigate that claim. We have no power to vacate the Consent Order ourselves. Any challenge to the Consent Order should be directed to whatever judicial or

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(...continued)

brought pursuant to Title XXXVII, Ch. 421-B, "the respondent shall be informed, as part of the hearing notice, of the respondent's right to a hearing"). As noted above, *see supra* note 5, Rowe waived his right to a hearing.

12 N.H. Rev. Stat. Ann. § 421-B:6.1.

13 *Id.*

14 *See supra* note 3.

15 While we find that the Consent Order satisfies the requirements of both Section 203(e)(9)(A) and Section 203(9)(B), either of those subsections, standing alone, would be sufficient basis for proceeding under Section 203(f).

16 In his brief on appeal, Rowe relies on what purports to be an affidavit signed by an attorney who represented Respondents in bankruptcy proceedings to support his argument that New Hampshire officials used duress to induce him to sign the Consent Order. Indeed, the affidavit, dated March 18, 2015, states that representatives of the New Hampshire Bureau of Securities Regulation used duress to this end. While this appeal was pending, however, our Office of the Secretary received an unsolicited submission dated June 26, 2015, apparently from the same attorney who signed the earlier affidavit, in which the attorney states that he "[does] not believe that [the New Hampshire officials] used any unethical tactics or unlawful means" to persuade Rowe to agree to the Consent Order, nor that they "exerted any undue influence" against Rowe. Since we do not address the question of duress, neither the affidavit nor the June 26, 2015 submission plays any role in our consideration of this matter.

other forum might have jurisdiction over such a claim.[17] If the Consent Order were vacated following such a challenge on this or any other ground, Rowe could then file a motion in this proceeding to vacate or reconsider any order issued by us.[18]

Rowe also argues that the Consent Order is not final because he plans to appeal. But even if he had actually filed an appeal, a pending appeal "ordinarily does not detract from [a lower court order's] finality (and therefore its preclusive effect) for purposes of subsequent litigation."[19] It thus does not remove the basis for this administrative proceeding, nor does it provide a reason to delay the proceeding.[20]

B. Rowe was associated with an investment adviser at the time of the alleged misconduct.

Section 202(11) of the Advisers Act defines "investment adviser," in relevant part, as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities."[21] Section 202(17) defines "person associated with an investment adviser," in relevant part, as "any partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser."[22]

A Form ADV for Focus, filed with the Commission on August 6, 2012, indicates that Focus provided investment advisory services, including financial planning services and portfolio management, to between eleven and twenty-five clients during its most recently completed fiscal year, and that it was compensated for those services by a percentage of assets under

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17 *Cf. James E. Franklin*, Exchange Act Release No. 56649, 2007 WL 2974200, at *4 (Oct. 12, 2007) (finding that "the appropriate forum for Franklin's challenge to the validity of the injunction [entered by a federal district court] is through an appeal to the United States Court of Appeals").

18 *See, e.g.*, *Kenneth E. Mahaffy, Jr.*, Exchange Act Release No. 68462, 2012 WL 6608201, at *1 (Dec. 18, 2012) (granting motion to vacate bar where conviction that provided basis for bar order was reversed by court of appeals); *Jimmy Dale Swink, Jr.*, Exchange Act Release No. 36042, 1995 WL 467600, at *1 (Aug 1, 1995) (same). Rowe has stated that he plans to appeal, notwithstanding the waiver contained in the Consent Order. *See supra* note 5.

19 *Blinder Robinson & Co. v. SEC*, 837 F.2d 1099, 1104 n.6 (D.C. Cir. 1988).

20 *See Charles Philip Elliot*, Exchange Act Release No. 31202, 1992 WL 258850, at *3 & n.15 (Sept. 17, 1992) (finding no need to delay proceeding until outcome of respondent's appeal), *aff'd*, 36 F.3d 86 (11th Cir. 1994) (per curiam).

21 15 U.S.C. § 80b-2(11).

22 *Id.* § 80b-2(17).

management, hourly charges, fixed fees, and performance-based fees.[23] The form, which was signed by Rowe as president of Focus, identified Rowe as a control person of Focus, and as Focus's president, chief executive officer, and chief compliance officer since January, 2001. Based on this evidence, we find that Rowe was associated with an investment adviser at the time of the alleged misconduct.

IV. The record does not contain enough evidence for a public interest determination.

The law judge determined that a collateral bar was in the public interest based on allegations of a state securities regulator that Rowe settled by way of a consent order. But as discussed below, we find that because Rowe's consent agreement reserved the right to deny the allegations of the state regulator's complaint in proceedings such as this one and Rowe has denied those allegations here, the public interest determination cannot be based solely on those contested allegations. And we find no other basis in the record on which to base such a determination.

In deciding whether to impose a sanction in the public interest under Section 203(f), we look to the factors set forth in *Steadman v. SEC*: "the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations."[24] We may also consider whether a sanction will have a deterrent effect.[25] The inquiry is flexible, and no single factor is dispositive.[26] We look to the entire record of the case, and to the particular circumstances, to determine whether a sanction is in the public interest.[27]

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[23] We take official notice of this Form ADV pursuant to Rule of Practice 323, 17 C.F.R. § 201.323, which allows us to take official notice of, among other things, any matter in the public official records of the Commission. The Form is available at http://www.adviserinfo.sec.gov.

[24] *E.g.*, *Gary M. Kornman*, Securities Exchange Act Release No. 59403, 2009 WL 367635, at *6 (Feb. 13, 2009) (citing *Steadman*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)).

[25] *Toby G. Scammell*, Investment Advisers Act Release No. 3961, 2014 WL 5493265, at *5 & n.35 (Oct. 19, 2014) (citing additional cases).

[26] *Id.* (citing *David Henry Disraeli*, Securities Exchange Act Release No. 57027, 2007 WL 448515, at *15 (Dec. 21, 2007), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009) (per curiam); *Kornman*, 2009 WL 367635, at *6 (same).

[27] *Scammell*, 2014 WL 5493265, at *5 (quoting *Marshall E. Melton*, Investment Advisers Act Release No. 2151, 2003 WL 21729839, at *2 (July 25, 2003)).

When a respondent has consented to the entry of an injunction in an action brought by the Commission, and has agreed not to contest the allegations of the complaint in any later disciplinary proceeding brought by the Commission, we may rely on those allegations in making our public interest finding.[28] Here, however, Rowe's consent agreement specifically reserved his right "to take contrary legal or factual positions in litigation or other legal proceedings in which the State of New Hampshire is not a party." We find that this administrative proceeding is a "legal proceeding" within the meaning of the Consent Order and that the State of New Hampshire is not a party to this proceeding. Thus, the Consent Order did not prevent Rowe from denying the allegations of the Consent Order in this proceeding. In his Answer to the OIP, Rowe denied all of the allegations in the Consent Order. We therefore cannot take the allegations in the Consent Order as true in determining an appropriate sanction in the public interest, and the record does not contain enough additional evidence to allow us to make such a determination.

We therefore remand this matter to the law judge so that he may admit and consider additional evidence from any relevant source, subject to challenge by either party, and, based on such additional evidence, determine an appropriate sanction, if any.[29]

Accordingly, it is ORDERED that the initial decision entered against Rowe 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

By: Jill M. Peterson
Assistant Secretary

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28 *See, e.g.*, *Siris v. SEC*, 773 F.3d 89, 96 (D.C. Cir. 2014) (holding that the Commission's reliance on the complaint "was appropriate because the [consent] judgment unambiguously barred [the respondent] from making any future challenge to the allegations in the complaint"); *Tzemach David Netzer Korem*, Exchange Act Release Number 70044, 2013 WL 3864511, at *2 & n.12, *5 n.43 (July 26, 2013).

29 Given our holding, the Division's motion for summary affirmance is denied.

SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 33-9927; 34-75973; File No. 265-27]

Advisory Committee on Small and Emerging Companies

AGENCY: Securities and Exchange Commission.

ACTION: Notice of Federal Advisory Committee Renewal.

SUMMARY: The Securities and Exchange Commission is publishing this notice to announce the renewal of the Securities and Exchange Commission Advisory Committee on Small and Emerging Companies.

FOR FURTHER INFORMATION CONTACT: Julie Davis, Senior Special Counsel, Office of Small Business Policy, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549, (202) 551-3460.

SUPPLEMENTARY INFORMATION: In accordance with the requirements of the Federal Advisory Committee Act, 5 U.S.C. – App., the Commission is publishing this notice that the Chair of the Commission, with the concurrence of the other Commissioners, has approved the renewal of the Securities and Exchange Commission Advisory Committee on Small and Emerging Companies (the "Committee"). The Chair of the Commission affirms that the renewal of the Committee is necessary and in the public interest.

The Committee's objective is to provide the Commission with advice on its rules, regulations, and policies, with regard to its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, as they relate to the following:

(1) capital raising by emerging privately held small businesses ("emerging companies") and publicly traded companies with less than $250 million in public market capitalization ("smaller public companies") through securities offerings, including private and limited offerings and initial and other public offerings;

(2) trading in the securities of emerging companies and smaller public companies; and

(3) public reporting and corporate governance requirements of emerging companies and smaller public companies.

Up to 20 voting members will be appointed to the Committee who can effectively represent those directly affected by, interested in, and/or qualified to provide advice to the Commission on its rules, regulations, and policies as set forth above. The Committee's membership will continue to be balanced fairly in terms of points of view represented and functions to be performed. Non-voting observers for the Committee from the North American Securities Administrators Association and the U.S. Small Business Administration may also be named.

The charter provides that the duties of the Committee are to be solely advisory. The Commission alone will make any determinations of action to be taken and policy to be expressed with respect to matters within the Commission's authority as to which the Committee provides advice or makes recommendations. The Committee will meet at such intervals as are necessary to carry out its functions. The charter contemplates that the full Committee will meet four times annually. Meetings of subgroups or subcommittees of the full Committee may occur more frequently.

The Committee will operate for two years from the date it was renewed or such earlier date as determined by the Commission unless, before the expiration of that time period, it is renewed in accordance with the Federal Advisory Committee Act. A copy of the charter for the Committee has been filed with the Chair of the Commission, the Committee on Banking, Housing, and Urban Affairs of the United States Senate, the Committee on Financial Services of the United States House of Representatives, the Committee Management Secretariat of the General Services Administration, and the Library of Congress. It also has been posted on the Commission's website at www.sec.gov.

By the Commission.

Dated: September 24, 2015

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9928 / September 24, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75974 / September 24, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4209 / September 24, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16831

In the Matter of **G ASSET MANAGEMENT, LLC AND MICHAEL A. GLICKSTEIN,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND SECTIONS 203(e) AND 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), and Sections 203(e) and 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against G Asset Management, LLC ("GAM") and Michael A. Glickstein ("Glickstein," and collectively with GAM, "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 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, Section 9(b) of the Investment Company Act of 1940, and Sections 203(e) and 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. SUMMARY

1. This proceeding arises out of a press release issued by Respondents on February 21, 2014, announcing that GAM had offered to purchase a majority interest in Barnes & Noble, Inc. ("Barnes & Noble" or the "Company") for $22 per share. Respondents' press release was misleading because it did not disclose material facts, including that GAM had (i) no ability to finance its purported purchase offer and no reasonable basis to believe it could finance its offer in the future; and (ii) recently purchased short-term call options,[1] intending to reap a short-term profit should the market react positively to the press release by selling the options or the shares after the options had been exercised.

2. In the days and hours leading up to the February 21, 2014 press release, Respondents caused investment funds that they manage to purchase thousands of Barnes & Noble shares and call options due to expire on February 22, 2014 and March 22, 2014. After Respondents' press release was issued at 1:20 p.m.[2] on February 21, 2014, Barnes & Noble's stock price increased from $17.05 per share to $18.99 per share in a matter of seconds, causing the NYSE to implement a five-minute trading halt pursuant to its Rule 80C. After trading re-opened in Barnes & Noble stock, the stock price fell to $18.06 but remained above $17.63 throughout the rest of the day and closed at $17.69.

3. Once trading resumed, Respondents caused their investment funds to sell at least 3,000 Barnes & Noble shares and 3,700 Barnes & Noble call options for a profit before the market closed. After market close on February 21, Respondents' investment funds exercised thousands of in-the-money call options, resulting in the purchase of 184,000 Barnes & Noble shares. Respondents then sold 142,600 of those shares for a profit on Monday, February 24, 2014.

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[1] A call option is a financial contract between two parties that gives the buyer the right, but not the obligation, to buy an agreed quantity of stock during a specified time period for a specified price, known as the strike price. A buyer pays a fee, or premium, to purchase this right and generally stands to gain if the price of the stock increases.

[2] All times referenced herein are set forth in Eastern Standard Time.

4. As a result of Respondents' trades before and after the February 21 press release, Respondents' investment funds reaped profits of approximately $168,000.

B. RESPONDENTS

5. **GAM** is a Delaware limited liability corporation with its principal place of business in New York, New York. GAM is an unregistered investment adviser that had less than $3 million in total assets under management in February 2014. GAM served as investment adviser to G Real Estate Partners, L.P., G Value Partners, L.P., and G Value Fund, LLC.

6. **Glickstein**, age 34 and a resident of New York, New York, is the sole owner of GAM and has served as GAM's president and chief investment officer since its formation in January 2011.

C. OTHER RELEVANT ENTITIES

7. **Barnes & Noble,** a Delaware corporation headquartered in New York, New York, is a retail bookseller in the United States. Barnes & Noble's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NYSE. Barnes & Noble files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

8. **G Real Estate Partners, L.P.** ("GREP"), a Delaware limited partnership, is an investment fund operated by Respondents that made investments in real estate and securities, including Barnes & Noble stock and options. GREP has approximately 15 investors.

9. **G Value Partners, L.P.** ("GVP"), a Delaware limited partnership, is an investment fund operated by Respondents that made investments in securities, including Barnes & Noble stock and options. GVP has less than ten investors.

10. **G Value Fund, LLC** ("GVF"), a Delaware limited liability corporation, is an investment fund operated by Respondents that made investments in securities, including Barnes & Noble stock and options. GVF has less than ten investors.

D. BACKGROUND

11. Beginning in early 2011, GAM and Glickstein caused GREP, GVF, and GVP to make investments in Barnes & Noble shares and options. Beginning no later than April 6, 2011, Respondents' representatives contacted Barnes & Noble to propose various transactions, including GAM's potential acquisition of a 51% share of Barnes & Noble. Between April 6, 2011 and November 15, 2013, Respondents also filed Schedule 13Ds reflecting their holdings in Barnes & Noble securities and referencing a proposal to Barnes & Noble. Each time, Barnes & Noble rebuffed Respondents' overtures and Respondents failed to secure any source to fund the proposed transactions.

E. RESPONDENTS' FEBRUARY 21, 2014 PRESS RELEASE

12. At 9:31 p.m. on Thursday, February 20, 2014, Respondents sent an email to Barnes & Noble, proposing to acquire 51% of the Company at $22 per share or, in the alternative, to acquire 51% of the Company's electronic reader business unit ("NOOK business") at $5 per share.

13. As of February 20, 2014, GAM had no ability to finance either of its purported purchase offers and no reasonable basis to believe it could finance the offers in the future even if Barnes & Noble accepted one of these offers. Specifically, as the manager of funds (GREP, GVP, and GVF) with less than $3 million in total assets under management, GAM had no ability to acquire 51% of Barnes & Noble at $22 per share because that would require Respondents to raise approximately $670 million to finance the purchase. Similarly, GAM had no ability to acquire 51% of the NOOK business at $5 per share because that would require Respondents to raise approximately $152 million. While Glickstein claims that he believed GAM could have obtained adequate funding to finance these offers, there is no evidence suggesting that this was a reasonable belief because, in part, GAM had made no progress whatsoever in its efforts to secure the necessary financing.

14. Respondents accumulated a position that was poised to increase if the market believed that GAM had a legitimate prospect of completing its proposed transaction with Barnes & Noble. Indeed, in advance of the press release, Respondents had caused the GREP, GVP, and GVF accounts to hold approximately 14,000 shares of Barnes & Noble common stock and approximately 30,050 Barnes & Noble call options with strike prices between $15 and $22 that were due to expire on February 22, 2014, and March 22, 2014. And in the days and hours leading up to the February 21, 2014 press release, Respondents made the following net purchases of Barnes & Noble securities in the GREP, GVP, and GVF accounts:

- 1,000 shares at approximately $16.79 per share.
- 146 February 22, 2014 call options with a strike price of $16 per share
- 200 February 22, 2014 call options with a strike price of $17 per share
- 2,531 February 22, 2014 call options with a strike price of $18 per share
- 2,000 February 22, 2014 call options with a strike price of $19 per share
- 1,176 February 22, 2014 call options with a strike price of $20 per share
- 1,866 February 22, 2014 call options with a strike price of $21 per share

Respondents made these purchases knowing that they intended to issue a press release announcing their offer to purchase 51% of Barnes & Noble for $22 per share and that the announcement would likely cause an increase in the price of Barnes & Noble stock.

15. At 1:20 p.m. on Friday, February 21, 2014, Respondents issued a press release though a press release distribution service stating that they had made a proposal to acquire 51% of Barnes & Noble, valuing the company at $22 per share, approximately 30% above Barnes & Noble's current market price. Respondents' press release was misleading because it did not disclose material facts, including that:

a. GAM had no ability to finance its purported purchase offer and no reasonable basis to believe it could finance its offer in the future; and

b. Respondents intended to cause their client accounts to <u>sell</u> Barnes & Noble options and shares for a profit shortly after issuing the press release, which was contrary to the stated intent in the press release.

16. Seconds after Respondents issued the February 21, 2014 press release, the Barnes & Noble stock price rose from $17.05 per share to $18.99 per share. As a result of this quick spike of more than 10%, at 1:20 p.m., the NYSE automatically halted trading in Barnes & Noble for five minutes pursuant to its Rule 80C. After trading reopened at 1:25 p.m., the stock price fell to $18.06 per share by 1:31 pm. When news outlets noted that several traders had questioned the ability of Respondents to complete a takeover of Barnes & Noble, the stock price fell further throughout the afternoon to close at $17.69, but was still more than $0.64 above the stock price before the press release was issued.

17. Respondents' February 21, 2014 press release caused a disruption in the market for Barnes & Noble stock as more than 12 million shares of Barnes & Noble were traded on February 21, 2014—with the vast majority trading after the press release was issued at 1:20 p.m.—compared to an average daily volume of 1.3 million shares over the preceding five trading days.

18. Shortly after the February 21, 2014 press release was issued, Respondents caused the GREP, GVP, and GVF accounts to make the following sales of Barnes & Noble securities in order to profit from the subsequent price spike:

- 2,000 shares at approximately $17.96 per share
- 1,000 shares at approximately $17.78 per share
- 1,739 February 22, 2014 call options with a strike price of $17 per share
- 1,471 February 22, 2014 call options with a strike price of $18 per share
- 30 March 22, 2014 call options with a strike price of $13 per share
- 100 March 22, 2014 call options with a strike price of $20 per share
- 60 March 22, 2014 call options with a strike price of $21 per share

19. After the market closed on February 21, 2014, the GREP, GVP, and GVF accounts automatically exercised in-the-money call options to purchase 184,000 shares in Barnes & Noble including: (i) 20,000 shares at $15 per share, (ii) 29,900 shares at $16 per share, and (iii) 134,100 shares at $17 per share. Because the GREP, GVP, and GVF accounts did not have sufficient margin to hold the shares, the accounts were required to sell securities to avoid a margin call. As a result, Respondents' investment funds sold 142,600 shares of Barnes & Noble stock on Monday, February 24, 2014, for a substantial profit.

20. As a result of the February 21, 2014 press release, the GREP, GVP, and GVF accounts reaped profits of $168,000.

21. On Monday, February 24, 2014, Glickstein appeared on the Fox Business television channel. Glickstein stated that GAM had offered to purchase 51% of Barnes & Noble at $22 per share and claimed that Barnes & Noble had been "very responsive" to GAM in the past.

22. However, Barnes & Noble had not given Respondents any indication that the Company was interested in pursuing a transaction with Respondents. Indeed, during a February 26, 2014 earnings call, Barnes & Noble's president stated, "from what we could tell, from publicly available information G Asset Management has one employee extremely limited financial means and as set forth in his letter he has no debt or equity financing to support his proposal," and said, "we do not consider it to be a proposal worthy of further discussion or action by us."

F. RESPONDENTS' PREVIOUS OVERTURES TO BARNES & NOBLE

23. Respondents had a history of making proposals to Barnes & Noble. On both April 6, 2011 and November 16, 2011, Glickstein wrote to Barnes & Noble's board of directors suggesting that the company be split into three separate businesses.

24. The following year, Respondents filed a Schedule 13D on February 17, 2012, stating that they beneficially owned more than 5% of outstanding shares in Barnes & Noble—41,575 shares of common stock and 2,978,600 shares from options exercisable within 60 days. In the Schedule 13D filing, Respondents proposed that the Company spin off the NOOK business and attached a financial analysis in support of their opinion.

25. On February 22, 2012, Respondents filed an amended Schedule 13D, stating that they now beneficially owned less than 5% ownership of Barnes & Noble shares.

26. On March 16, 2012, Respondents proposed to Barnes & Noble that GAM would acquire "51% of the college bookstore business at a valuation for the whole segment of $460 million," claiming GAM would pay with cash, Barnes & Noble shares, and the assumption of up to $410 million in Barnes & Noble debt. The offer also indicated that additional investors would be sought to join Respondents' proposal.

27. On March 21, 2012, Barnes & Noble responded to Respondents' proposal by stating it was not in the best interests of the Barnes & Noble shareholders to pursue the offer.

28. On November 15, 2013, when Barnes & Noble stock price closed at $15.75 per share, Respondents sent a letter offering to acquire 51% of Barnes & Noble for $20 per share, claiming: "We would undertake to arrange the equity and debt financing for the transaction. We anticipate that the cash and [Barnes & Noble] equity portion of the purchase price may come not only from ourselves but from additional investors."

29. On November 15, 2013, Respondents' investment funds beneficially owned approximately 50,000 Barnes & Noble shares—representing approximately .08% of the Company's common shares. Increasing its ownership to 51% Barnes & Noble's shares, would

have required GAM to raise approximately $600 million to finance the acquisition. But Respondents had less than $3 million in assets under management in November 2013 and had not received commitments from any third parties to finance or otherwise join Respondents in the acquisition of a majority stake in Barnes & Noble.

30. In advance of GAM's November 15, 2013 offer, Respondents had purchased more than 3,000 shares and nearly 4,000 call options with strike prices of $15 and $16 and an expiration date of November 16, 2013, in the GVP and GVF brokerage accounts. Though Respondents contacted Bloomberg on November 15, 2013, attempting to publicize this proposal, there does not appear to have been any published news about Respondents' November 15, 2013 offer at that time.

31. On November 22, 2013, Barnes & Noble responded to Respondents' proposal by stating it was not in the best interests of the Company's shareholders to pursue the offer.

* * *

32. As a result of the conduct described above, Respondents 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 or 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, and for the protection of investors to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, Section 9(b) of the Investment Company Act, and Sections 203(e) and 203(f) of the Advisers 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, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent GAM is censured.

C. Respondent Glickstein 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;

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.

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

E. Respondents shall, jointly and severally, pay disgorgement of $168,000 and prejudgment interest of $7,000. Payment of $84,000 of the disgorgement and $3,500 of prejudgment interest is due to the Commission within ten (10) business days of the entry of this Order for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). The remaining disgorgement owed of $84,000 and prejudgment interest of $3,500 shall be deemed satisfied and timely paid by Respondents' payment of disgorgement and prejudgment interest of $87,500 as part of Respondents' resolution of the conduct at issue in the Order with the Office of the Attorney General of the State of New York (the "NYAG"). Within one business day of payment to the NYAG, Respondents shall supply to the Commission staff proof of such payment to the NYAG in a form acceptable to the Commission staff. In the event that Respondents' resolution with the NYAG results in a payment of less than $87,500 in disgorgement and prejudgment interest, the Commission will credit Respondents with the actual amount in disgorgement and prejudgment interest paid in resolution of the NYAG matter, with the remaining balance due and payable to the Commission within ten (10) business days of the announcement of Respondents' resolution with the NYAG. If timely payment is not made to the Commission, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondent Glickstein shall also, within ten (10) business days of the entry of this Order, pay a civil penalty in the amount of $100,000 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 of the foregoing amounts 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 GAM and Glickstein 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 Joseph Sansone, New York Regional Office, Securities and Exchange Commission, 200 Vesey Street, New York, NY 10281-1022. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent Glickstein agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Glickstein's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Glickstein agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent Glickstein 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, 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 Glickstein, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Glickstein 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 Glickstein 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 Part 210

Release No. 33-9929; 34-75985; IC-31849; File No. S7-20-15

REQUEST FOR COMMENT ON THE EFFECTIVENESS OF FINANCIAL DISCLOSURES ABOUT ENTITIES OTHER THAN THE REGISTRANT

AGENCY: Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Commission is publishing this request for comment to seek public comment regarding the financial disclosure requirements in Regulation S-X for certain entities other than a registrant. These disclosure requirements require registrants to provide financial information about acquired businesses, subsidiaries not consolidated and 50 percent or less owned persons, guarantors and issuers of guaranteed securities, and affiliates whose securities collateralize registered securities. This request for comment is related to an initiative by the Division of Corporation Finance to review the disclosure requirements applicable to public companies to consider ways to improve the requirements for the benefit of investors and public companies.

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/other.shtml);

  or

- Send an email to rule-comments@sec.gov. Please include File Number S7-20-15 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 S7-20-15. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/other.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Todd E. Hardiman, Associate Chief Accountant, at (202) 551-3516, Division of Corporation Finance; Duc Dang, Special Counsel, at (202) 551-3386, Office of the Chief Accountant; or Matthew Giordano, Chief Accountant, at (202) 551-6892, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

TABLE OF CONTENTS

I. Introduction

Over the years, the Commission has considered its disclosure system and engaged periodically in rulemakings designed to enhance our disclosure and registration requirements. Some requirements have been considered and updated relatively frequently, while others have changed little since they were first adopted. For example, the Commission has revised the registration requirements a number of times, most recently in 2005 with Securities Offering Reform, and at that time, the Commission also adopted new methods of communicating offering information.[1] As another example, the disclosure requirements applicable to small businesses also have been updated on a variety of occasions, most recently in 2007.[2] In contrast, other requirements in Regulations S-K[3] and S-X,[4] which encompass many of the Commission's financial and non-financial disclosure rules, have not been updated frequently.

In 2013, the staff issued its *Report on Review of Disclosure Requirements in Regulation S-K,*[5] which was mandated by Section 108 of the Jumpstart Our Business Startups Act (the "JOBS Act").[6] Section 108(b) of the JOBS Act required the Commission to submit a report to Congress including the specific recommendations of the Commission on how to streamline the registration process in order to make it more efficient and less burdensome for the Commission and for prospective issuers who are emerging growth companies. The Commission staff

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1 See *Securities Offering Reform*, Release No. 33-8591 (July 19, 2005) [70 FR 44722].

2 See *Smaller Reporting Company Regulatory Relief and Simplification,* Release No. 33-8876 (Dec. 19, 2007) [73 FR 934].

3 17 CFR 229.10 *et seq.*

4 17 CFR part 210.

5 *Report on Review of Disclosure Requirements in Regulation S-K* (Dec. 2013), available at http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf. Section 108(a) of the JOBS Act directed the Commission to conduct a review of Regulation S-K to (1) comprehensively analyze the current registration requirements of such regulation; and (2) determine how such requirements can be updated to modernize and simplify the registration process and reduce the costs and other burdens associated with these requirements for issuers who are emerging growth companies.

6 Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

recommended the development of a plan to systematically review the disclosure requirements in the Commission's rules and forms, including both Regulation S-K and Regulation S-X, and the presentation and delivery of information to investors and the marketplace. At the time the report was issued, Commission Chair Mary Jo White asked the staff to develop specific recommendations for updating the rules that dictate what a company must disclose in its filings.[7] Pursuant to this request, the staff is undertaking a broad-based review of the disclosure requirements and the presentation and delivery of the disclosures, which the Commission may consider whether to review. This ongoing review by the staff is known as the Disclosure Effectiveness Initiative.

Initially, the staff is focusing on the business and financial information that is required to be disclosed in periodic and current reports, namely Forms 10-K, 10-Q and 8-K, and registration statements.[8] As part of the review, the staff requested public input,[9] and received a number of comments. Two of the comment letters addressed Regulation S-X,[10] which is the subject of this request for comment and the first product resulting from the Disclosure Effectiveness Initiative.

Regulation S-X contains disclosure requirements that dictate the form and content of financial statements to be included in filings with the Commission. It addresses both registrant financial statements and financial statements of certain entities other than the registrant. As an

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7 See SEC Press Release 2013-269, dated December 20, 2013, available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540530982.

8 See Keith F. Higgins, Disclosure Effectiveness: Remarks Before the American Bar Association Business Law Section Spring Meeting (April 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370541479332.

9 See request for public comment at http://www.sec.gov/spotlight/disclosure-effectiveness.shtml.

10 See letter from Thomas J. Kim, Chair, Disclosure Effectiveness Working Group of the Federal Regulation of Securities Committee and the Law and Accounting Committee, Business Law Section, American Bar Association, November 14, 2014 available at http://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-23.pdf; but see letter from Sandra J. Peters and James C. Allen, CFA Institute, November 12, 2014 available at http://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-24.pdf.

initial step in the review of Regulation S-X, we are considering the requirements applicable to these other entities, which is a discrete, but important, subset of the Regulation S-X disclosure requirements. The staff is continuing to evaluate other Regulation S-X disclosure requirements applicable to the registrant and how those requirements integrate with, for example, Regulation S-K and the applicable accounting standards and will make further recommendations to the Commission for consideration. In this request for comment, we are seeking public comment on the following rules, along with certain related requirements:

- Rule 3-05, Financial Statements of Businesses Acquired or to be Acquired;[11]
- Rule 3-09, Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons;[12]
- Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered;[13] and
- Rule 3-16, Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered.[14]

We seek to better understand how well these requirements, some of which have remained largely the same for many years,[15] are informing investors and we are soliciting comment on how investors use the disclosures to make investment and voting decisions. We are also interested in learning about any challenges that registrants face in preparing and providing the required disclosures. Finally, we are interested in potential changes to these requirements that

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11 17 CFR 210.3-05.

12 17 CFR 210.3-09.

13 17 CFR 210.3-10.

14 17 CFR 210.3-16.

15 Rule 3-05 has not been thoroughly reconsidered since 1996. See *Streamlining Disclosure Requirements Related to Significant Business Acquisitions*, Release No. 33-7355 (Oct. 10, 1996) [61 FR 54509]. Rules 3-09 and 3-16 have not been thoroughly reconsidered since 1981. See *Separate Financial Statements Required by Regulation S-X*, Release No. 33-6359 (Nov. 6, 1981) [46 FR 56171]. Rule 3-10 was substantially revised in 2000. See *Financial Statements and Periodic Reports for Related Issuers and Guarantors*, Release No. 33-7878 (Aug. 4, 2000) [65 FR 51692].

could enhance the information provided to investors and promote efficiency, competition, and capital formation.[16]

To focus the discussion, this request for comment describes the requirements[17] that apply to domestic registrants[18] that do not qualify as smaller reporting companies[19] or emerging growth companies.[20] When relevant, we note different disclosure requirements triggered by each type of registrant.[21] In addition, unless otherwise noted, the disclosure requirements we describe in this request for comment should be assumed to apply to periodic reporting under the Exchange Act and registration statements filed under the Exchange Act and the Securities Act.

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16 Section 3(f) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78a *et seq.*] requires that, whenever the Commission is engaged in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall consider, in addition to the protection of investors, promotion of efficiency, competition and capital formation. Section 2(b) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77a *et seq.*] also sets forth this same requirement. <u>See also</u> Section 23(a)(2) of the Exchange Act.

17 The descriptions in this release are provided for the convenience of commenters and to facilitate the comment process. The descriptions should not be taken as Commission or staff guidance about the relevant rules.

18 Generally, the requirements described in this release apply to entities registered as investment companies and entities that have elected to be treated as business development companies under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq*]. <u>See</u> Rule 6-03 of Regulation S-X [17 CFR 210.6-03], which states in part, "[t]he financial statements filed for persons to which §§210.6-01 to 210.6-10 are applicable shall be prepared in accordance with the…special rules [§§210.6-01 to 210.6-10] in addition to the general rules in §§210.1-01 to 210.4-10 (Articles 1, 2, 3, and 4). Where the requirements of a special rule differ from those prescribed in a general rule, the requirements of the special rule shall be met."

19 Exchange Act Rule 12b-2 [17 CFR 240.12b-2] defines a smaller reporting company as an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that has a public float of less than $75 million. If an issuer has zero public float, it would be considered a smaller reporting company if its annual revenues are less than $50 million.

20 Section 2(a)(19) of the Securities Act defines an emerging growth company as an issuer that had total gross revenues of less than $1 billion during its most recently completed fiscal year. It retains that status for five years after its initial public offering unless its revenues rise above $1 billion, it issues more than $1 billion of non-convertible debt in a three year period, or it qualifies as a large accelerated filer pursuant to Exchange Act Rule 12b-2.

21 For example, we indicate by footnote where different disclosure requirements apply to foreign private issuers. The definition of foreign private issuer is contained in Securities Act Rule 405 [17 CFR 230.405] and Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50 percent of its outstanding voting securities held of record by U.S. residents and (2) any of the following: (i) a majority of its officers and directors are citizens or residents of the United States; (ii) more than 50 percent of its assets are located in the United States; or (iii) its business is principally administered in the United States.

II. Rule 3-05 of Regulation S-X – Financial Statements of Businesses Acquired or to be Acquired and Related Requirements

A. Current Rule 3-05 Disclosure and Related Requirements

When a registrant acquires a business, Rule 3-05 generally requires it to provide separate audited annual and unaudited interim pre-acquisition financial statements ("Rule 3-05 Financial Statements") of the business[22] if it is significant to the registrant.[23] A registrant determines whether an acquisition is significant using the investment, asset, and income tests defined in Rule 1-02(w) of Regulation S-X.[24] Performing these tests for purposes of applying Rule 3-05 and related requirements can be generally described as follows:

- Investment Test - the purchase consideration is compared to the total assets of a registrant reflected in its most recent annual financial statements required to be filed at or prior to the acquisition date.
- Asset Test - a registrant's proportionate share of the business's total assets reflected in the business's most recent annual pre-acquisition financial statements is compared to the

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22 Registrants determine whether a "business" has been acquired by applying Rule 11-01(d) [17 CFR 210.11-01(d)] of Regulation S-X. This determination is separate and distinct from a determination made under the applicable accounting standards requiring registrants to account for and disclose the transaction in a registrant's financial statements. The definition of "business" in Regulation S-X focuses primarily on whether the nature of the revenue-producing activity of the target will remain generally the same as before the transaction. The definition in the applicable accounting standards (see Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 805, *Business Combinations* in U.S. GAAP and a similar definition in IFRS 3, *Business Combinations*) focuses on whether the target is an integrated set of activities and assets that is capable of being conducted and managed by a market participant for the purpose of providing a return.

23 Domestic issuers file the disclosures required by Rule 3-05 and its related requirements in current reports filed on Form 8-K [17 CFR 249.308] under the Exchange Act, as well as in registration statements. Foreign private issuers, however, only file the disclosures in registration statements. In *Foreign Issuer Reporting Enhancements*, Release No. 33-8900 (Feb. 29, 2008) [73 FR 13404], the Commission proposed requiring foreign private issuers to provide certain financial information required by Rule 3-05 in periodic reports. This requirement was not adopted by the Commission. See *Foreign Issuer Reporting Enhancements*, Release No. 33-8959 (Sept. 23, 2008) [73 FR 58300].

24 17 CFR 210.1-02(w).

total assets of the registrant reflected in its most recent annual financial statements required to be filed at or prior to the acquisition date.

- Income Test - a registrant's equity in the income from continuing operations before income taxes and cumulative effect of a change in accounting principle,[25] as reflected in the business's most recent annual pre-acquisition financial statements, exclusive of amounts attributable to any noncontrolling interests, is compared to the same measure of the registrant reflected in its most recent annual financial statements required to be filed at or prior to the acquisition date.

Rule 3-05 requires more disclosure as the size of the acquisition, relative to the size of the registrant, increases based on the test results. If none of the Rule 3-05 tests exceeds 20 percent, a registrant is not required to file any Rule 3-05 Financial Statements. If any of the Rule 3-05 tests exceeds 20 percent, but none exceeds 40 percent, Rule 3-05 Financial Statements are required for the most recent fiscal year and any required interim periods. If any Rule 3-05 test exceeds 40 percent, but none exceeds 50 percent, a second fiscal year of Rule 3-05 Financial Statements is required. When at least one Rule 3-05 test exceeds 50 percent, a third fiscal year[26] of Rule 3-05 Financial Statements is required unless revenues of the acquired business were less than $50 million in its most recent fiscal year.[27]

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25 Rule 1-02(w) of Regulation S-X refers to extraordinary items, but the FASB eliminated this concept from U.S. GAAP in its Accounting Standards Update No. 2015-1, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*, issued on January 9, 2015. IFRS prohibit the presentation and disclosure of extraordinary items in IAS 1, *Presentation of Financial Statements*.

26 A smaller reporting company is subject to requirements similar to Rule 3-05 that are found in Rule 8-04 of Regulation S-X [17 CFR 210.8-04], but is never required to provide a third fiscal year. An emerging growth company, although subject to Rule 3-05, need not provide a third year of Rule 3-05 Financial Statements when it only presents two years of its own financial statements pursuant to Section 7(a)(2)(A) of the Securities Act.

27 17 CFR 210.3-05(b)(2).

Rule 3-05 Financial Statements must be accompanied by the pro forma financial information described in Article 11 of Regulation S-X ("Pro Forma Information").[28] Pro Forma Information typically includes the most recent balance sheet and most recent annual and interim period income statements. The Pro Forma Information is based on the historical financial statements of the registrant and the acquired business and generally includes adjustments to show how the acquisition might have affected those financial statements had it occurred at an earlier time. Adjustments to the pro forma balance sheet and income statements must be "factually supportable" and "directly attributable to the transaction." An additional criterion, "continuing impact," applies only to adjustments to the pro forma income statement.[29] The adjustments are computed assuming the transaction occurred at the beginning of the fiscal year presented and carried forward through any interim period presented.[30]

A registrant must provide a brief description of a significant acquisition by filing a Form 8-K[31] within four business days after consummation of the acquisition. If Rule 3-05 Financial Statements and Pro Forma Information are not provided with this Form 8-K, the registrant must provide them within approximately 75 days after consummation by filing an amendment to the Form 8-K.[32] The 75-day period is intended to provide sufficient time to obtain the Rule 3-05 Financial Statements and prepare the Pro Forma Information.

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28 17 CFR 210.11. A smaller reporting company provides the pro forma financial information described in Rule 8-05 of Regulation S-X [17 CFR 210.8-05]. Although the preliminary notes to Article 8 indicate that smaller reporting companies may wish to consider Article 11, it is not required.

29 17 CFR 210.11-02(b)(6).

30 For example, amortization expense of an acquired intangible asset would be shown in the fiscal year and subsequent interim period pro forma income statements as if the acquisition occurred on the first day of the fiscal year.

31 General Instruction B.1 of Form 8-K.

32 Item 9.01(a)(4) of Form 8-K requires that the amendment be filed no later than 71 calendar days after the date that the initial Form 8-K must be filed.

When filing certain registration statements,[33] a registrant may need to update, based on the effective date, Rule 3-05 Financial Statements and Pro Forma Information previously provided on Form 8-K.[34] A registrant must also include, in certain registration statements filed ahead of the due date of the Form 8-K, Rule 3-05 Financial Statements and Pro Forma Information for a recently-consummated acquisition when a Rule 3-05 test exceeds 50 percent.[35] Finally, the following additional disclosures that are not required on Form 8-K must be provided in certain registration statements:[36]

- Rule 3-05 Financial Statements and Pro Forma Information for a probable acquisition when a Rule 3-05 test exceeds 50%; and
- Rule 3-05 Financial Statements and Pro Forma Information for the substantial majority of individually insignificant consummated and probable acquisitions since the date of the most recent audited balance sheet if a Rule 3-05 test exceeds 50 percent for any combination of the acquisitions.[37]

The accounting standards require disclosure[38] to enable investors to understand the nature and financial effect of a business combination that occurs during the periods presented in the

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33 These additional requirements do not apply to all registration statements. For example, they do not apply to registration statements filed on Form S-8 [17 CFR 239.16b] or registration statements filed pursuant to Rule 462(b) of Regulation C [17 CFR 230.462(b)].

34 17 CFR 210.3-12.

35 17 CFR 210.3-05(b)(4).

36 In 1996, the Commission partially conformed these reporting requirements in *Streamlining Disclosure Requirements Related to Significant Business Acquisitions,* Release No. 33-7355 (Oct. 10, 1996) [61 FR 54509] and retained these disclosures because it recognized that "an acquisition could be so large relative to an issuer that investors would need financial statements of the acquired business for a reasoned evaluation of any primary capital raising transaction by the issuer."

37 17 CFR 210.3-05(b)(2)(i). Commission staff has clarified that certain significant acquisitions should also be included. See §2035.2 of the Division of Corporation Finance's *Financial Reporting Manual.* This manual was originally prepared by the staff of the Division of Corporation Finance to serve as internal guidance. In 2008, in an effort to increase transparency of informal staff interpretations, the Division of Corporation Finance posted the manual to its website at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml.

38 See FASB ASC 805, *Business Combinations* and IFRS 3, *Business Combinations*.

registrant's financial statements or subsequent to the most recent balance sheet date, but before the registrant's financial statements are issued. Some of the disclosures required by the accounting standards are the same as those required by Rule 3-05 and the related requirements, such as the name and description of the acquired business. Others, such as pro forma financial information, are similar although the Pro Forma Information required by Article 11 of Regulation S-X is significantly more detailed. More significantly, Rule 3-05 requires historical financial statements of the acquired entity and the accounting standards do not.

B. Consideration of Current Rule 3-05 Disclosure and Related Requirements

1. Content of the Rule 3-05 Disclosure and Related Requirements

Financial disclosures required by our rules about a business acquisition are important to investors because an acquisition will result in changes to a registrant's financial condition, results of operations, liquidity, and future prospects. Depending on the impact of the acquisition, those changes could be significant. While it is important to provide investors with information about an acquisition, the types of financial information currently required under the rules may have some limitations as a predictor of the financial condition and results of operations of the combined entity following the acquisition. Prior to the adoption of Rule 3-05 in 1982, some commenters questioned the need for financial statements of acquired businesses for periods prior to the acquisition. Those commenters criticized the utility and relevance of pre-acquisition financial statements in assessing the future impacts of an acquisition on a registrant. Specifically, commenters noted that pre-acquisition financial statements do not reflect the new basis of accounting that arises upon consummation, changes in management, or various other items affected by the acquisition.[39] Although the Pro Forma Information addresses some of these concerns by showing how the accounting for an acquisition might have affected a registrant's historical financial statements had the transaction been consummated at an earlier time, restrictions on pro forma adjustments prohibit a registrant from reflecting other significant changes it expects to result from the acquisition. For example, Commission staff has stated that workforce reductions and facility closings, both actions that registrants frequently take when acquiring businesses, are generally too uncertain to meet the criteria for adjustment.[40] In addition, Pro Forma Information usually lacks comparative prior periods and is unaudited. Finally, unless a registrant files certain registration statements that trigger the required disclosures earlier, investors typically must wait approximately 75 days for the Rule 3-05 Financial Statements and the Pro Forma Information.

Request for Comment

1. How do investors use each of the following: the Rule 3-05 Financial Statements; the Pro Forma Information; and the disclosures required by the applicable accounting standards? Are there challenges that investors face in using these disclosures?

2. Are there changes to these requirements we should consider to further facilitate the disclosure of useful information to investors? For example, is there different or additional information that investors need about acquired businesses or about how the

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39 These comments were received in connection with the proposal, *Instructions for the Presentation and Preparation of Pro Forma Financial Information and Financial Statements of Companies Acquired or to be Acquired*, Release 33-6350 (September 24, 1981) [46 FR 48943]. In the adopting release, *Instructions for the Presentation and Preparation of Pro Forma Financial Information and Requirements for Financial Statements of Businesses Acquired or to be Acquired*, Release No. 33-6413 (June 24, 1982) [47 FR 29832], the Commission considered reducing the required disclosure to condensed or summarized information. However, the Commission decided that full financial statements of an acquired business were necessary because it believed that there was important information in the notes to the financial statements that would not be reflected in condensed or summarized information and that it was essential that financial information about an acquired business be audited by an independent auditor.

40 See §3250.1 of the Division of Corporation Finance's *Financial Reporting Manual*.

combined entities might perform following the acquisition? If so, what information is needed and are there challenges that registrants would face in preparing and providing it?

3. Are there challenges that registrants face in preparing and providing the required disclosures? If so, what are the challenges? Are there changes to these requirements we should consider to address those challenges? If so, what changes and how would those changes affect investors' ability to make informed decisions?

4. Are there requirements that result in disclosures that investors do not consider useful? If so, what changes to these requirements would make them useful or should we consider eliminating or replacing all or part of those requirements?

5. How could we improve the usefulness of the Pro Forma Information? Could we do so by changing the extent of information required and/or the methodologies used to prepare it? For example, should we add a requirement for comparative pro forma income statements of the prior year and/or modify the restrictions on pro forma adjustments? If so, what changes should be made and should auditors have any level of involvement with the information? Are there disclosures we should consider adding to the Pro Forma Information that are currently found only in the Rule 3-05 Financial Statements?

6. If we make changes to improve the usefulness of the Pro Forma Information, should we modify the requirement to provide Rule 3-05 Financial Statements? If so, how? If not, why?

7. Should we modify the amount of time that registrants have to provide disclosures about acquired businesses to investors? If so, under what circumstances and how? If not, why?

8. Should certain registration statements continue to require accelerated and additional disclosure as compared to the Form 8-K requirements? If so, to what extent and why? If not, why?

2. Tests for Determining Disclosure Required by Rule 3-05 and Related Requirements

The Rule 3-05 tests employ bright-line percentage thresholds that a registrant must apply to a limited set of financial statement measures. Use of these thresholds provides registrants with certainty and promotes consistency. At the same time, they do not allow judgment to be applied to all of the facts and circumstances. In addition, the tests can be difficult to apply in certain situations and have not eliminated the need for implementation guidance.[41] Commission staff receives frequent requests[42] to consider anomalous disclosure outcomes, particularly resulting from application of the income test.[43]

Request for Comment

9. Are significance tests the appropriate means to determine the nature, timing, and extent of disclosure under Rule 3-05 and the related requirements?

10. Are there changes or alternatives to the tests that we should consider to further facilitate the disclosure of useful information to investors? If so, what changes and are there challenges that registrants would face as a result?

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41 Topic 2 of the Division of Corporation Finance's *Financial Reporting Manual* addresses several significance testing implementation issues including 1) acquisitions achieved in multiple stages; 2) acquisitions after a reverse merger; 3) aggregation of multiple individually insignificant acquisitions for a registration statement; 4) multiple acquisitions prior to an initial public offering; and 5) acquisitions of foreign businesses where the acquired company uses a different basis of accounting than the registrant.

42 During 2014, Commission staff received approximately 60 requests. The Commission has the authority under Rule 3-13 of Regulation S-X [17 CFR 210.3-13] to permit the omission of one or more of the financial statements required, and the Commission has delegated that authority to the staff.

43 Anomalous results can occur, for example, when applying the income test where the registrant's income is at or near zero. An acquisition of a small entity, in terms of the asset and investment tests, may trigger Rule 3-05 disclosures as a result of the income test even if the acquired business has very modest income.

11. Are there changes to the tests we should consider to address challenges registrants face in preparing and providing the required disclosures? If so, what changes and how would those changes affect investors' ability to make informed decisions?

12. Should we revise the financial measures used to determine significance or change the percentage thresholds? For example, should we consider limiting the use of the income test and/or devise new tests such as purchase price compared to a registrant's market capitalization?

13. Should we allow registrants to apply more judgment in determining what is considered a significant acquisition? If so, why and how? What concerns might arise from allowing registrants to apply more judgment and, if allowed, should registrants disclose the rationale for the judgments?

Additional Request for Comment on Rule 3-05 and Related Requirements

14. Should we consider requiring foreign private issuers to provide disclosures similar to those provided by domestic companies when reporting on Form 8-K? Why or why not? Are there other issues that we should address related to acquisitions by foreign private issuers or acquisitions of foreign businesses?

15. Should smaller reporting companies and emerging growth companies be subject to the same requirements or should requirements for those registrants be scaled? If they should be scaled, in what way? If not, why?

16. Investment companies, and particularly business development companies, generally file Rule 3-05 Financial Statements in cases where the investment company is acquiring one or more private funds. This type of acquisition typically occurs early in the life of the investment company when it has little or no financial information of its own. In these

cases, Rule 3-05 Financial Statements of the private funds(s) may be the primary financial information considered by investors when making investment decisions with respect to the investment company. Should Rule 3-05 continue to apply to investment companies, or should investment companies be subject to different requirements? If so, how and why should the requirements be different? For example, should Rule 3-05 and the related requirements apply when an investment company purchases a significant portion of the assets of a fund, but not all of the assets and liabilities of the fund?

17. Should we align the definition of a business in Rule 11-01(d) with the definitions in the applicable accounting standards? Why or why not?

III. Rule 3-09 of Regulation S-X – Separate Financial Statements of Subsidiaries not Consolidated[44] and 50 Percent or Less Owned Persons and Related Requirements

A. Current Rule 3-09 Disclosure and Related Requirements

When a registrant owns 50 percent or less of an entity ("Investee"), Rule 3-09 of Regulation S-X generally requires the registrant to provide separate audited or unaudited annual financial statements ("Rule 3-09 Financial Statements") of the Investee if it is significant.[45] The Rule 3-09 Financial Statements provide investors with detailed financial information about Investees that have a significant financial impact on the registrant through its investment, but are not subject to the disclosure requirements that would apply if it were a consolidated subsidiary. Insofar as practicable, the Rule 3-09 Financial Statements must be as of the same dates and for

44 Commission staff has observed, based on filing reviews, that investment companies, particularly business development companies, may have unconsolidated subsidiaries not accounted for using the equity method, but other registrants typically do not. As a result, the body of this section focuses on requirements that apply to 50 percent or less owned persons accounted for using the equity method. Requirements applying to unconsolidated subsidiaries, not accounted for using the equity method, if different, are footnoted.

45 Rule 3-09 does not apply to smaller reporting companies nor does Article 8 of Regulation S-X contain similar requirements.

the same periods as a registrant's annual financial statements.[46] Significance is determined using the tests defined in Rule 1-02(w) of Regulation S-X, although only the investment and income tests are used.[47] The Rule 3-09 tests can be generally described as follows:

- Investment Test - a registrant's investment in and advances to the Investee as of the end of each fiscal year presented by a registrant is compared to the total assets of the registrant at the end of each of those same years.
- Income Test - a registrant's equity in the Investee's income from continuing operations before income taxes and cumulative effect of a change in accounting principle, exclusive of amounts attributable to any noncontrolling interests, for each fiscal year presented by a registrant is compared to the same measure of the registrant for each of those same years.

If neither of the Rule 3-09 tests exceeds 20 percent, Rule 3-09 Financial Statements are not required. If at least one Rule 3-09 test exceeds 20 percent, Rule 3-09 Financial Statements are required for all years and must be audited for each year that a test exceeds 20 percent.[48]

Separately, Rule 4-08(g) of Regulation S-X[49] requires disclosure, in the notes to a registrant's audited annual financial statements, of summarized balance sheet and income statement information on an aggregate basis for all Investees ("Summarized Financial Information").[50] These disclosures are only required if a Rule 3-09 test or an additional asset test[51] exceeds 10 percent for any individual Investee or combination of Investees.[52] If a

46 Rule 3-09 does not require the presentation of separate interim financial statements of Investees.

47 17 CFR 210.3-09(a).

48 Registrants with majority-owned subsidiaries that are not consolidated must perform the asset test in addition to the investment and income tests described in Rule 1-02(w). See Rule 3-09(a) of Regulation S-X.

49 17 CFR 210.4-08(g).

50 17 CFR 210.1-02(bb).

51 In 1994, Rule 3-09 was revised to eliminate the asset test; however, the test was retained for Rule 4-08(g) to ensure a minimum level of financial information about an investee when the investment test was small, but a registrant's proportionate interest in the Investee's assets was material, as might be the case for a highly-leveraged Investee. See *Financial Statements of Significant Foreign Equity Investees and Acquired*

registrant includes Rule 3-09 Financial Statements of an Investee in its annual report, then notes to the registrant's financial statements need not include Summarized Financial Information for that particular Investee.[53]

Interim financial statements of a registrant must also include summarized income statement information of individually significant Investees.[54] Individual Investees are considered significant for purposes of this rule if a Rule 3-09 test, using interim period information, exceeds 20 percent.[55]

The applicable accounting standards also require that the notes to the annual financial statements include summarized balance sheet and income statement information about equity-method investees.[56] Commission staff has observed, based on filing reviews, that registrants typically follow the Commission rules rather than making separate judgments under the applicable accounting standards.

Foreign Businesses of Domestic Issuers and Financial Schedules, Release No. 33-7118 (Dec. 13, 1994) [59 FR 65632].

52 A smaller reporting company must provide summarized information in its annual financial statements if a Rule 3-09 test or an additional asset test exceeds 20 percent, rather than 10 percent, for any individual Investee or combination of Investees. Although Article 8 of Regulation S-X does not include an explicit annual requirement analogous to Rule 4-08(g), Commission staff analogizes to Rule 8-03(b)(3) and typically issues a comment to request annual summarized information if it is not otherwise included. See §2420.9 of the Division of Corporation Finance's *Financial Reporting Manual.*

53 See Staff Accounting Bulletin Topic 6.K.4.b. The purpose of the summarized information is to provide minimum standards of disclosure when the impact of Investees on the consolidated financial statements is significant. If the registrant furnishes more financial information in the annual report than is required by these minimum disclosure standards, such as separate audited statements, the summarized information can be excluded.

54 17 CFR 210.10-01(b)(1).

55 A smaller reporting company must provide summarized information in its interim financial statements pursuant to Rule 8-03(b)(3). Unless it is registering securities, a foreign private issuer need not provide interim information because it is not required to file quarterly financial information pursuant to Exchange Act Rules 13a-13 or 15d-13.

56 FASB ASC 323, *Investments-Equity Method and Joint Ventures*, requires disclosure if material in relation to the financial position or results of operations of the registrant. Paragraphs B12 and B13 of IFRS 12, *Disclosure of Interests in Other Entities*, require similar disclosure.

B. Consideration of Current Rule 3-09 Disclosure and Related Requirements

1. Content of the Rule 3-09 Disclosure and Related Requirements

Financial disclosures required by our rules about an Investee are important to investors because the Investee can have a significant financial impact on a registrant. Also, the Investee is not consolidated so it is not subject to the same disclosure requirements that apply to consolidated subsidiaries. While it is important to provide information about Investees, the types of financial information currently required may have limitations and there may be opportunities for improvement. For example, Rule 3-09 Financial Statements may be presented using different accounting standards, fiscal year ends, and/or reporting currencies than those used by a registrant.[57] In addition, Rule 3-09 Financial Statements are required only for significant Investees rather than all Investees that may affect a registrant's financial statements. As a result, Rule 3-09 Financial Statements often cannot be reconciled to the amounts recognized in a registrant's financial statements for that Investee. The Summarized Financial Information also may not be reconcilable because the financial information of multiple Investees, each one with a different percentage owned by a registrant, can be aggregated in the presentation.

Summarized Financial Information is required more often[58] than Rule 3-09 financial statements and it also may have limitations. For example, the aggregate presentation, combined with the lack of reconciliation to amounts recognized in a registrant's financial statements, could diminish an investor's ability to discern the impact of significant Investees on a registrant's financial statements. This ability may be further diminished when Investees with income and Investees with losses are combined in the presentation.

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57 For example, when the Investee is a foreign business.

58 Summarized Financial Information is required by Rule 4-08(g) when certain tests exceed 10%, while Rule 3-09 Financial Statements are required when certain tests exceed 20%.

Request for Comment

18. How do investors use each of the following: the Rule 3-09 Financial Statements; the Summarized Financial Information; and the interim disclosures? Are there challenges that investors face in using these disclosures?

19. Are there changes to these requirements we should consider to further facilitate the disclosure of useful information to investors? For example, is there different or additional information that investors need about Investees? If so, what information is needed and are there challenges that registrants would face in preparing and providing it?

20. Are there challenges that registrants face in preparing and providing the required disclosures? If so, what are the challenges? Are there changes to these requirements we should consider to address those challenges? If so, what changes and how would those changes affect investors' ability to make informed decisions?

21. Are there requirements that result in disclosures that investors do not consider useful? If so, what changes to these requirements would make them useful or should we consider eliminating or replacing all or part of those requirements?

22. How could we improve the usefulness of the Summarized Financial Information? Could we do so by adding a requirement to present separately each significant Investee and/or reconcile the disclosures to the amounts recognized in a registrant's financial statements? Are there disclosures we should consider adding that are currently found only in Rule 3-09 Financial Statements?

23. If we make changes to improve the usefulness of the Summarized Financial Information, would it be appropriate to modify the requirement to provide Rule 3-09 Financial Statements? If so, how? If not, why?

24. Are unaudited Rule 3-09 Financial Statements and Summarized Financial Information for fiscal years during which an Investee was not significant useful to investors? Why or why not?

2. Tests for Determining Disclosure Required by Rule 3-09 and Related Requirements

The tests used for determining disclosure pursuant to Rule 3-09 and the related requirements employ bright-line percentage thresholds similar to Rule 3-05. In addition, the use of these tests to determine the need for disclosure in interim financial statements is different than the other financial statement footnote disclosure requirements specified in Rule 10-01(a)(5) of Regulation S-X.[59] Rule 10-01(a)(5) allows registrants to apply judgment and omit details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year.

Additionally, investment companies may face challenges when applying the income test. The numerator of the income test, as defined in Rule 1-02(w) of Regulation S-X, includes the registrant's equity in the Investee's income from continuing operations; however, investment companies account for their Investees using fair value rather than the equity method. The denominator used for the test includes changes in the fair value of investments that can cause the denominator to fluctuate significantly. As a result, registrants frequently consult with Commission staff about anomalous results.

Request for Comment

25. Are significance tests the appropriate means to determine the nature, timing, and extent of disclosure under Rule 3-09 and the related requirements?

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[59] 17 CFR 210.10-01(a)(5).

26. Are there changes or alternatives to the tests that we should consider to further facilitate the disclosure of useful information to investors? If so, what changes and are there challenges that registrants would face as a result?

27. Are there changes to the tests that we should consider to address challenges that registrants face in preparing and providing the required disclosures? If so, what changes and how would those changes affect investors' ability to make informed decisions?

28. Should we allow more judgment to be applied by registrants in determining significance? Why or why not? What concerns might arise from allowing registrants to apply more judgment and, if allowed, should registrants disclose the rationale for the judgments?

29. Should we revise the current percentage thresholds and/or the financial measures used to determine significance? For example, should we consider limiting the use of the income test or devise new tests?

30. Should we consider revising the requirements to provide interim disclosures about Investees to focus on significant changes similar to Rule 10-01(a)(5) of Regulation S-X, which allows registrants to apply judgment and omit details of accounts that have not changed significantly in amount or composition since the end of the most recently completed fiscal year? Why or why not?

Additional Request for Comment on Rule 3-09 and Related Requirements

31. Should smaller reporting companies and emerging growth companies be subject to the same requirements or should requirements for those registrants be scaled? If they should be scaled, in what way? If not, why?

32. Should investment companies, particularly business development companies, be subject to different requirements? If so, how and why should the requirements be different? For

example, should the significance tests be modified to apply measures other than the income test or asset test that are more relevant to investment companies? Should there be a different income test related to investment companies? Should we tailor the disclosures provided by unconsolidated subsidiaries of investment companies further by, for example, creating separate requirements for Summarized Financial Information and/or requiring a schedule of investments for unconsolidated subsidiaries not accounted for as investment companies[60] that are in similar lines of business?

IV. Rule 3-10 of Regulation S-X – Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered

A. Current Rule 3-10 Disclosure and Related Requirements

A guarantor of a registered security is an issuer because the guarantee of a security is a separate security.[61] As a result, both issuers of registered securities that are guaranteed and guarantors of registered securities must file their own audited annual and unaudited interim[62] financial statements required by Regulation S-X.[63] Rule 3-10 of Regulation S-X provides certain exemptions[64] from those financial reporting requirements and is commonly relied upon by a parent company when it raises capital through: 1) an offering of its own securities guaranteed by one or more of its subsidiaries; or 2) an offering of securities by its subsidiary that it guarantees and, sometimes, that one or more of its other subsidiaries also guarantees. Under Rule 3-10, if the subsidiary issuers and guarantors ("issuers/guarantors") satisfy specified conditions, the

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60 Rule 3-09 Financial Statements for unconsolidated subsidiaries accounted for as investment companies are required to include the schedules required by Rule 6-10 of Regulation S-X.

61 See Section 2(a)(1) of the Securities Act.

62 A foreign private issuer need only provide interim period disclosure in certain registration statements.

63 17 CFR 210.3-10(a).

64 Rule 3-10 exemptions are available to issuers/guarantors of securities that are "debt or debt-like." See *Financial Statements and Periodic Reports for Related Issuers and Guarantors*, Release No. 33-7878 (August 4, 2000) [65 FR 51692].

parent company can provide disclosures in its own annual and interim consolidated financial statements in lieu of providing financial statements of each subsidiary issuer and guarantor ("Alternative Disclosures").

The Alternative Disclosures are available in a variety of fact patterns. The rule addresses six specific fact patterns, two of which are:

- a single subsidiary guarantees securities issued by its parent;[65] and
- an operating subsidiary issues securities guaranteed only by its parent.[66]

All fact patterns must satisfy two primary conditions to qualify for the Alternative Disclosure. First, the subsidiary issuers/guarantors must be "100% owned"[67] by the parent company. Second, the guarantees must be "full and unconditional."[68] Once those two conditions are met, the form and content of the Alternative Disclosure is determined based upon additional conditions. For example, in the fact patterns above, the parent company can provide abbreviated narrative disclosure in its financial statements if: 1) it has no independent assets or operations[69] and 2) all of its subsidiaries other than the issuer or guarantor, depending on the fact pattern, are minor.[70] Otherwise, the parent company must provide the more detailed condensed consolidating financial information ("Consolidating Information") described below.

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65 17 CFR 210.3-10(e).

66 17 CFR 210.3-10(c).

67 17 CFR 210.3-10(h)(1). A subsidiary is "100% owned" if all of its outstanding voting shares are owned, either directly or indirectly, by its parent company. A subsidiary not in corporate form is 100% owned if the sum of all interests are owned, either directly or indirectly, by its parent company other than: 1) securities that are guaranteed by its parent, and, if applicable, other 100%-owned subsidiaries of its parent; and 2) securities that guarantee securities issued by its parent and, if applicable, other 100%-owned subsidiaries of its parent.

68 17 CFR 210.3-10(h)(2). A guarantee is "full and unconditional," if, when an issuer of a guaranteed security has failed to make a scheduled payment, the guarantor is obligated to make the scheduled payment immediately and, if it does not, any holder of the guaranteed security may immediately bring suit directly against the guarantor for payment of all amounts due and payable.

69 17 CFR 210.3-10(h)(5).

70 17 CFR 210.3-10(h)(6).

Consolidating Information is a columnar footnote presentation of each category of parent and subsidiaries as issuer, guarantor, or non-guarantor.[71] It must include all major captions of the balance sheet, income statement, and cash flow statement that are required to be shown separately in interim financial statements under Article 10 of Regulation S-X.[72] In order to distinguish the assets, liabilities, operations and cash flows of the entities that are legally obligated to make payments under the guarantee from those that are not, the columnar presentation must show: 1) a parent company's investments in all consolidated subsidiaries based upon its proportionate share of the net assets;[73] and 2) subsidiary issuer/guarantor investments in certain consolidated subsidiaries using the equity method.[74] This presentation is a unique format designed to ensure, for example, that a subsidiary guarantor does not consolidate, within this presentation, its own non-guarantor subsidiary.

Recently-acquired subsidiary issuers/guarantors create an information gap in the Consolidating Information because the subsidiaries will only be included from the date that the subsidiaries were acquired. The Securities Act registration statement of a parent company[75] must include one year of audited pre-acquisition financial statements for these subsidiaries in its registration statement if: 1) the subsidiary is significant; and 2) the subsidiary is not reflected in the audited consolidated results for at least nine months of the most recent fiscal year.[76] A subsidiary is significant if its net book value or purchase price, whichever is greater, is 20 percent or more of the principal amount of the securities being registered.

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71 17 CFR 210.3-10(i)(6).
72 17 CFR 210.10-01(a).
73 17 CFR 210.3-10(i)(3).
74 17 CFR 210.3-10(i)(5).
75 Filed in connection with the offer and sale of the debt or debt-like securities.
76 17 CFR 210.3-10(g)(1).

Issuers/guarantors availing themselves of the exemption that allows for Alternative Disclosure are automatically exempt from Exchange Act reporting by Exchange Act Rule 12h-5.[77] The parent company, however, must continue to provide the Alternative Disclosure for as long as the guaranteed securities are outstanding.[78] The parent company may not cease to report this information even at such time that the subsidiary issuers/guarantors, had they declined to avail themselves of the exemptions and reported separately, could have suspended their reporting obligations under Section 15(d) of the Exchange Act.[79]

B. Consideration of Current Rule 3-10 Disclosure and Related Requirements

1. Content of the Rule 3-10 Alternative Disclosure

Separate financial disclosures required by our rules about issuers of guaranteed debt and guarantors of those securities are important to investors because the disclosures allow investors to evaluate separately the likelihood of payment by the issuer and guarantors. The content of the Alternative Disclosure, despite being less robust than financial statements required by Regulation S-X, is detailed and unique. For example, the Consolidating Information includes all major captions that are found in quarterly reports filed on Form 10-Q[80] and must be prepared using a unique format that is not found elsewhere in Commission rules or the applicable accounting standards. A parent company may also need to provide, in a registration statement, pre-acquisition financial statements of significant, recently-acquired subsidiary issuers/guarantors. These financial statements are required even if those subsidiaries will qualify for the Alternative

77 17 CFR 240.12h-5.
78 Section III.C.1 of Release No. 33-7878 (August 4, 2000) [65 FR 51692].
79 15 U.S.C. 78o(d).
80 17 CFR 249.308a.

Disclosure once included in a registrant's audited consolidated results for nine months of the most recent fiscal year.

Request for Comment

33. How do investors use the information provided in financial statements of subsidiary issuers/guarantors and the information provided in the Alternative Disclosure? Are there challenges that investors face in using the disclosures?

34. Are there changes to these requirements we should consider to further facilitate the disclosure of useful information to investors? For example, is there different or additional information that investors need about guarantors and issuers of guaranteed securities? If so, what information is needed and are there challenges that registrants would face in preparing and providing it?

35. Are there challenges that registrants face in preparing and providing the required disclosures? If so, what are the challenges? Are there changes to these requirements we should consider to address those challenges? If so, what changes and how would those changes affect investors' ability to make informed decisions?

36. Are there requirements that result in disclosures that investors do not consider useful? If so, what changes would make them useful or should we consider eliminating or replacing all or part of those requirements?

37. How could we improve the usefulness of the Consolidating Information? Could we do so by revising its content requirements? If so, what changes should be made and why?

38. Should we consider revising the requirement to provide Consolidating Information for interim periods to focus on significant changes similar to Rule 10-01(a)(5) of Regulation S-X, which allows registrants to apply judgment and omit details of accounts that have

not changed significantly in amount or composition since the end of the most recently completed fiscal year? Why or why not?

39. Is there other disclosure that would allow us to modify the requirement for separate, audited financial statements of recently-acquired subsidiary issuers/guarantors that would be useful to investors? If so, what disclosure would be appropriate and in what circumstances? If not, why?

2. Conditions to Providing Alternative Disclosure

As stated above, one of the primary conditions that must be met for a parent company to provide the Alternative Disclosure is that the subsidiary issuers/guarantors are "100% owned." For example, the Alternative Disclosure is not available if a subsidiary is organized in a jurisdiction that requires directors to own a small number of shares unless the registrant obtains relief from Commission staff.[81] The condition is intended to ensure the risks associated with an investment in a parent company and the risks associated with its subsidiary are "identical."[82] Similarly, "full and unconditional" is intended to ensure the payment obligations of the issuer and guarantor are "essentially identical."[83] Registrants may not provide the Alternative Disclosure unless the guarantee operates such that, when an issuer of a guaranteed security has failed to make a scheduled payment, the guarantor is obligated to make the scheduled payment immediately and, if it does not, any holder of the guaranteed security may immediately bring suit directly against the guarantor for payment of all amounts due and payable. For example, registrants are not allowed to use the Alternative Disclosure when guarantees become enforceable after the passage of some time period after default. These are precise standards that

81 Release No. 33-7878 (Aug. 4, 2000) [65 FR 51692, fn. 29].
82 Id.
83 Id.

must be met in order to reduce disclosure from, for example, full financial statements to the detailed and unique Consolidating Information.

Separately, the duration of the obligation to provide the Alternative Disclosure is different than the obligation to provide separate financial statements. To obtain the exemption under Rule 12h-5, a parent company must provide the Alternative Disclosures as long as the securities are outstanding, while the obligation to provide separate financial statements can be suspended earlier as provided in Section 15(d) of the Exchange Act.

Request for Comment

40. Do the current conditions to providing the Alternative Disclosure influence the structure of guarantee relationships? If so, how and what are the consequences, if any, to investors and registrants?

41. Should we consider allowing a parent company to provide the Alternative Disclosure if its subsidiary issuers or guarantors do not meet the current definition of 100% owned? If so, how should we revise the Alternative Disclosure conditions and what additional disclosure might address concerns about the presence of outside ownership interests? If not, why?

42. Should we consider allowing a parent company to provide the Alternative Disclosure if a guarantee does not meet the current definition of full and unconditional? If so, how should we revise the Alternative Disclosure conditions? Should we consider, for example, allowing the Alternative Disclosure for guarantees that become enforceable after the passage of some time period after default? What additional disclosure might address concerns about the delayed enforceability? If not, why?

43. Should we consider revising the conditions that must be satisfied to qualify for the abbreviated narrative disclosure? If so, how? If not, why?

44. Should we modify the parent company's requirement to provide the Alternative Disclosure during the period in which the securities are outstanding? If so, how? If not, why?

Additional Request for Comment on Rule 3-10 and Related Requirements

45. Should smaller reporting companies and emerging growth companies be subject to the same requirements or should requirements for those registrants be scaled? If they should be scaled, in what way?

V. Rule 3-16 of Regulation S-X – Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered

A. Current Rule 3-16 Disclosure and Related Requirements

Rule 3-16 of Regulation S-X requires a registrant to provide separate annual and interim financial statements for each affiliate[84] whose securities constitute a substantial portion of the collateral for any class of securities registered or being registered as if the affiliate were a separate registrant ("Rule 3-16 Financial Statements").[85] The affiliate's portion of the collateral is determined by comparing: a) the highest amount among the aggregate principal amount, par value, book value, or market value of the affiliates' securities to b) the principal amount of the

[84] 17 CFR 210.1-02(b) states, "An *affiliate* of, or a person *affiliated* with, a specific person is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." Although not the same, in practice such affiliates are almost always consolidated subsidiaries of the registrant.

[85] Both domestic registrants and foreign private issuers need only provide interim period information in certain registration statements.

securities registered or being registered. If this test equals or exceeds 20 percent for any fiscal year presented by a registrant, Rule 3-16 Financial Statements are required.[86]

Separately, Rule 4-08(b) of Regulation S-X[87] requires disclosure, in the notes to a registrant's annual financial statements, of the amounts of assets mortgaged, pledged, or otherwise subject to lien.

B. Consideration of Current Rule 3-16 Disclosure and Related Requirements

Disclosures required by our rules that facilitate an evaluation of an affiliate's ability to satisfy its commitment in the event of a default by a registrant are important to investors. Rule 3-16 requires financial statements as though the affiliate were a registrant despite the fact that the collateral pledge is not considered a separate security. Also, registrants have suggested, in consultations with Commission staff, that the Rule 3-16 Financial Statements can be confusing. For example, where the securities of a subsidiary of a registrant ("Subsidiary A") are pledged as collateral and the securities of an entity consolidated by Subsidiary A ("Subsidiary B") are also pledged, Rule 3-16 Financial Statements may be required for both subsidiaries and both will include Subsidiary B's assets, liabilities, operations, and cash flows.

The test used in applying Rule 3-16 employs a bright-line percentage threshold that a registrant must apply to a limited set of measures similar to Rules 3-05 and 3-09. Unlike those rules, the market value of an affiliate's securities may not be readily available in the absence of a public market for those securities.

86 17 CFR 210.3-16(b).
87 17 CFR 210.4-08(b).

Request for Comment

46. Do the Rule 3-16 requirements influence the structure of collateral arrangements? If so, how and what are the consequences, if any, to investors and registrants?

47. How do investors use Rule 3-16 Financial Statements and the Rule 4-08(b) footnote disclosures? Are there challenges that investors face in using the disclosures?

48. Are there changes to these requirements we should consider to further facilitate the disclosure of useful information to investors? For example, is there different or additional information that investors need about affiliates whose securities collateralize registered securities? If so, what information is needed and are there challenges that registrants would face in preparing and providing it?

49. Are there challenges that registrants face in preparing and providing the required disclosures? If so, what are the challenges? Are there changes to these requirements we should consider to address those challenges? If so, what changes and how would those changes affect investors' ability to make informed decisions?

50. Are there requirements that result in disclosures that investors do not consider useful? If so, what changes would make them useful or should we consider eliminating or replacing all or part of those requirements?

51. How could we improve the usefulness of the Rule 4-08(b) footnote disclosure? Could we do so by adding a requirement to disclose additional details about the affiliates? If so, what additional details should we require?

52. If we make changes to improve the usefulness of the footnote disclosure, would it be appropriate to modify the requirement to provide Rule 3-16 Financial Statements? If so, how? If not, why?

53. Should we revise the test used in applying Rule 3-16? If so, how? If not, why?

Additional Request for Comment on Rule 3-16 and Related Requirements

54. Should smaller reporting companies and emerging growth companies continue to be subject to the same requirements or should requirements for those registrants be scaled? If they should be scaled, in what way? If not, why?

VI. Other Requirements

In addition to the issues raised in this request for comment, we encourage all interested persons to submit their views on any issues relating to the financial information about entities, or portions of entities, other than a registrant. For example, Rule 3-14, *Special Instructions for Real Estate Operations to be Acquired,*[88] while separate and distinct from Rule 3-05, is intended to achieve similar objectives within a particular industry. In addition, Item 2.01 of Form 8-K uses significance tests to determine when to provide disclosure about asset acquisitions. The requirements addressed in this request for comment may apply more broadly than the situations described. To the extent there may be additional effects, please provide comments.

Request for Comment

55. As we continue our ongoing efforts to review disclosure rules, what other rules and forms should be considered for review and why?

56. Currently, financial disclosures related to entities other than a registrant are filed in XBRL format to the extent that they are part of the registrant's financial statements.[89] Other disclosures, such as the separate financial statements of entities other than the registrant and Pro Forma Financial Information are not required to be presented in a

[88] 17 CFR 210.3-14.

[89] For example, the Summarized Financial Information required by Rule 4-08(g) of Regulation S-X and the Consolidating Information required by Rule 3-10 of Regulation S-X.

structured, machine-readable format. Would investors benefit from having all of the disclosures related to these entities made in an interactive data format? Would it depend on the nature of the information being disclosed (e.g., disclosure related to a one-time transaction such as an acquisition or ongoing disclosure related to an Investee)? What would be the cost to registrants?

57. In what other ways could we utilize technology to further facilitate the disclosure of useful information to investors or address challenges faced by investors and registrants?

58. Are there ways that we could further facilitate the use of information by all types of investors? If so, please explain. For example, should we consider alternative ways of presenting the information, such as specifically allowing or requiring registrants to provide a summary along with more detailed required information to enable investors to review the information at the level of detail that they prefer?

VII. Closing

This request for comment is not intended in any way to limit the scope of comments, views, issues or approaches to be considered. In addition to investors and registrants, the Commission welcomes comment from other market participants and particularly welcomes statistical, empirical, and other data from commenters that may support their views and/or support or refute the views or issues raised.

By the Commission.

Dated: September 25, 2015

Robert W Errett

Robert W. Errett
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75980; File No. 4-668)

September 24, 2015

Joint Industry Plan; Order Approving Amendment No. 2 to the National Market System Plan Governing the Process of Selecting a Plan Processor and Developing a Plan for the Consolidated Audit Trail by BATS Exchange, Inc., BATS-Y Exchange, Inc., BOX Options Exchange LLC, C2 Options Exchange, Incorporated, Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., International Securities Exchange, LLC, ISE Gemini, LLC, Miami International Securities Exchange LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The NASDAQ Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc.

I. Introduction

On March 6, 2015, BATS Exchange, Inc., BATS-Y Exchange, Inc., BOX Options Exchange LLC, C2 Options Exchange, Incorporated, Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., International Securities Exchange, LLC, ISE Gemini, LLC, Miami International Securities Exchange LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The NASDAQ Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc. (collectively, "SROs" or "Participants") filed with the Securities and Exchange Commission ("Commission" or "SEC") pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 608 thereunder,[2] an amendment ("Amendment No. 2") to the National Market System ("NMS") Plan Governing the Process of Selecting a Plan Processor and Developing a Plan for the Consolidated

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

2 17 CFR 242.608.

Audit Trail ("Selection Plan").[3] Amendment No. 2 was published for comment in the Federal Register on June 23, 2015.[4] The Commission received no comment letters on this proposal. This Order approves Amendment No. 2 to the Selection Plan.

II. Background and Description of the Proposal

A. Background

The Commission adopted Rule 613 on July 11, 2012, to require the SROs to jointly submit an NMS plan to create, implement, and maintain a consolidated audit trail ("CAT NMS Plan").[5] In response, the SROs engaged in a request for proposal ("RFP") process to help them develop an NMS Plan proposal and solicit bids ("Bids") for the role of Plan Processor[6] to build, operate, administer, and maintain the consolidated audit trail. The Selection Plan, which was approved by the Commission on February 21, 2014, sets forth the process by which the Participants will review, evaluate, and narrow down the Bids submitted in response to the RFP to "Shortlisted Bids," and ultimately select the Plan Processor following Commission approval of the proposed CAT NMS Plan.[7] Amendment No.1 to the Selection Plan, which the Commission approved on June 17, 2015, among other things, permits the SROs to vote to narrow the set of

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3 The Selection Plan is an NMS Plan approved by the Commission pursuant to Section 11A of the Act and Rule 608 thereunder. See Securities Exchange Act Release No. 71596 (Feb. 21, 2014), 79 FR 11152 (Feb. 27, 2014) ("Order Approving Selection Plan"); see also Securities Exchange Act Release No. 70892 (Nov. 15, 2013), 78 FR 69910 (Nov. 21, 2013) ("Notice of Selection Plan").

4 See Securities Exchange Act Release No. 75193 (June 17, 2015), 80 FR 36006 (June 23, 2015) ("Notice of Amendment No. 2").

5 Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (Aug. 1, 2012).

6 Unless otherwise noted, capitalized terms are used as defined in Rule 613, in the Selection Plan, or in this Order.

7 See Order Approving Selection Plan, supra note 3.

Shortlisted Bids to an even shorter list prior to Commission approval of the proposed CAT NMS Plan.[8] The Selection Plan, as amended, provides that the SROs' Selection Committee will vote to select the Plan Processor from among the remaining bidders, using a two-round voting process, within two months of Commission approval of the proposed CAT NMS Plan.[9]

B. Description of the Proposal

Amendment No. 1 included a provision providing that no SRO shall vote in the process narrowing the set of Shortlisted Bidders if a Bid submitted by the SRO or an Affiliate of the SRO is a Shortlisted Bid or if the SRO or its Affiliate is included as a material subcontractor as part of a Bid (a "Bidding Participant"[10]).[11] The same recusal provision exists in the second—but not the first—round of a two-round voting process by the Selection Committee[12] to select the Plan Processor from among the Shortlisted Bidders.[13] The SROs state that they included the recusal provision to address potential conflicts of interest in selecting the Plan Processor.

In Amendment No. 2, the SROs propose to modify the Selection Plan to require that an SRO that is a Bidding Participant be recused from voting in any round to select the Plan

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8 See Securities Exchange Act Release No. 75192, 80 FR 36028 (June 23, 2015) ("Order Approving Amendment No. 1").

9 See Order Approving Selection Plan, supra note 3; Order Approving Amendment No. 1, supra note 8.

10 The Selection Plan defines "Bidding Participant" as a Participant that: (1) submits a Bid; (2) is an Affiliate of an entity that submits a Bid; or (3) is included, or is an Affiliate of an entity that is included, as a Material Subcontractor as part of a Bid. See Notice of Selection Plan, supra note 3, Exhibit A, at 2.

11 See Order Approving Amendment No. 1, supra note 8.

12 The Selection Committee is composed of one senior officer from each Participant. See Section V.A of the Selection Plan.

13 This two-round voting process would take place after any further narrowing of the Shortlisted Bids, if such narrowing were to occur pursuant to Amendment No. 1. See Order Approving Amendment No. 1, supra note 8, at 36029 & n.21.

Processor in which a Bid from or including such Bidding Participant or its Affiliate is being considered.[14] Amendment No. 2 therefore would extend to the first selection round the recusal requirement that is currently only in place for the second selection round and the vote, if any, that narrows the list of Shortlisted Bidders.

The SROs reiterate that the Selection Plan balances the competing goals of ensuring all SROs participate meaningfully in the process of developing the CAT NMS Plan and mitigating potential conflicts of interest related to the involvement of a bidding SRO through information barriers and the voting limitations.[15] The SROs state that, based on their experience with these existing measures, the Selection Plan adequately addresses the potential conflicts of interest related to bidding SROs.[16] Nonetheless, the SROs explain that requiring recusal in all rounds of the selection process will further the SROs' goal of ensuring the fair and impartial consideration and selection of the CAT Plan Processor.[17]

III. Discussion

After careful review, the Commission finds that Amendment No. 2 is appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, and to remove impediments to, and perfect the mechanisms of, a national market system. By extending the aforementioned recusal requirement to both selection rounds, Amendment No. 2 adds an additional procedural safeguard that is designed to further the fairness and impartiality of the Plan Processor selection.

14 Notice of Amendment No. 2, supra note 4, at 36007.

15 Id.

16 Id.

17 Id.

IV. Conclusion

For the reasons discussed above, the Commission finds that Amendment No. 2 is appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, and to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act.

IT IS THEREFORE ORDERED, pursuant to Section 11A of the Act,[18] and the rules thereunder, that Amendment No. 2 to the Selection Plan be, and it hereby is, approved.

By the Commission.

Robert W. Errett
Deputy Secretary

[18] 15 U.S.C. 78k-1.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 201

Release No. 34-75976; File No. S7-18-15

RIN 3235-AL87

Amendments to the Commission's Rules of Practice

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing for public comment amendments to update its Rules of Practice to, among other things, adjust the timing of hearings in administrative proceedings; allow for discovery depositions; clarify the rules for admitting hearsay and assertion of affirmative defenses; and make certain related amendments.

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 S7-18-15 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 S7-18-15. 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 of submission. 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; we do not edit personal identifying information in submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Adela Choi, Senior Counsel, and Laura Jarsulic, Associate General Counsel, Office of the General Counsel, (202) 551-5150, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549

SUPPLEMENTARY INFORMATION: The Commission proposes to amend its Rules of Practice. The amendments are being proposed to update its existing rules.

I. Introduction

As it has done from time to time, the Commission proposes to amend its Rules of Practice.[1] The Commission proposes amendments to update the Rules of Practice to adjust the timing of hearings and other deadlines in administrative proceedings and to provide parties in administrative proceedings with the ability to use depositions and other discovery tools. The Commission proposes additional amendments to implement the newly available discovery tools. These proposed Rules are intended to introduce additional flexibility into administrative proceedings, while still providing for the timely and efficient disposition of proceedings. The Commission also proposes amendments to clarify certain other Rules, including the assertion of affirmative defenses in answers and the admissibility of hearsay.

II. Discussion of Proposed Amendments

The proposed amendments are as follows:

A. Proposed Amendments to Rule 360

Rule 360[2] sets forth timing for certain stages of an administrative proceeding. These stages include a prehearing period, a hearing, a period during which parties review hearing transcripts and submit briefs, and then a deadline by which the hearing officer must file an initial decision with the Office of the Secretary. Under current Rule 360, the deadlines for these stages are calculated from the date of service of an order instituting proceedings. Initial decisions must

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[1] *See, e.g., Rules of Practice*, Exchange Act Release No. 35833, 60 FR 32738 (June 9, 1995); *Rules of Practice*, Exchange Act Release No. 40636, 63 FR 63404 (Nov. 4, 1998); *Rules of Practice*, Exchange Act Release No. 48018, 68 FR 35787 (June 11, 2003); *Adoption of Amendments to the Rules of Practice and Delegations of Authority of the Commission*, Exchange Act Release No. 49412, 69 FR 13166 (Mar. 12, 2004); *Adoption of Amendments to the Rules of Practice and Related Provisions and Delegations of Authority of the Commission*, Exchange Act Release No. 52846, 70 FR 72566 (Dec. 5, 2005); *Rules of Practice*, Exchange Act Release No. 63723, 76 FR 4066 (Jan. 24, 2011).

[2] 17 CFR 201.360.

be filed within the number of days prescribed in the order instituting proceedings – 120, 210, or 300 days from the date of service of the order instituting proceedings. Broadly speaking, administrative proceedings instituted pursuant to Section 12(j) of the Exchange Act[3] are designated as 120-day cases, administrative proceedings seeking sanctions as a result of an injunction or conviction[4] are designated as 210-day cases, and administrative proceedings alleging violations of the securities laws are designated as 300-day cases. Because deadlines are calculated from the date of service of the order instituting proceedings, if there are delays early on in the proceeding, the hearing occurs later and the hearing officer then has less time to prepare an initial decision in advance of the Rule 360 deadline.

The amount of time for parties to prepare during the prehearing period may vary from case to case with the number of factual and legal allegations, the complexity of the claims and defenses, and the size of the record. Parties in 300-day cases, for example, have increasingly requested extensions of time to review investigative records and prepare for hearing, citing the volume and time it takes to load and then review electronic productions. Parties in such cases frequently file motions before the hearing officer or the Commission to resolve complicated issues prior to the hearing. In addition, the Chief Administrative Law Judge has sought several extensions of time for hearing officers to file initial decisions in more complicated 300-day cases.[5]

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[3] 15 U.S.C. 78*l*(j).

[4] *See, e.g.*, 15 U.S.C. 78*o*(b)(6); 15 U.S.C. 80b-3(f).

[5] *See, e.g.*, *Natural Blue Resources, Inc., et al.*, Exchange Act Release No. 74891 (May 6, 2015) (order granting extension); *Lawrence M. Labine*, Exchange Act Release No. 74883 (May 6, 2015) (same); *Total Wealth Management, Inc., et al.*, Exchange Act Release No. 74353 (Feb. 23, 2015) (same); *Donald J. Anthony, Jr., et al.*, Exchange Act Release No. 74139 (Jan. 26, 2015) (order granting second motion for extension).

As amended, Rule 360 would include three modifications to address the timing of a proceeding. First, the deadline for filing the initial decision would run from the time that the post-hearing briefing or briefing of dispositive motions or defaults has been completed, rather than the date of service of the order instituting proceedings. This modification would divorce the deadline for the completion of an initial decision from other stages of the proceeding. Under the proposed amendment, the deadlines for initial decisions that would be designated in orders instituting proceedings would be 30, 75, and 120 days from the completion of post-hearing or dispositive briefing. The proposed length of time afforded for the preparation of an initial decision in each type of proceeding would be the same as the amount of time hearing officers are afforded under current Rule 360, if a proceeding actually progresses according to the timeline set out in the current rule.

Second, amended Rule 360 would provide a range of time during which the hearing must begin. For example, in 300-day cases, current Rule 360 states that a hearing should occur within approximately four months. The amended rule would provide that the hearing must be scheduled to begin approximately four months after service of the order instituting proceedings, but not later than eight months after service of the order.[6] Significantly, the amendment doubles the maximum length of the current rule's prehearing period. This is intended to provide additional flexibility during the prehearing phase of a proceeding and afford parties sufficient time to conduct deposition discovery pursuant to new proposed rules, while retaining an outer time limit to ensure the timely and efficient resolution of the proceeding. It also would allow

[6] As amended, Rule 360 would retain the same amount of time as current Rule 360 for parties to obtain the transcript of the hearing and submit post-hearing briefs – approximately two months.

respondents more time to review electronic documents in cases involving an electronic production from the Division.

Third, amended Rule 360 would create a procedure for extending the initial decision deadline by up to thirty days. This extension is intended to complement the Chief Law Judge's ability under current Rule 360 to request extensions of time from the Commission. Under amended Rule 360, the hearing officer may certify to the Commission in writing the need to extend the initial decision deadline by up to thirty days for case management purposes. This certification would need to be issued at least thirty days before the expiration of the initial decision deadline and the proposed extension would take effect if the Commission does not issue an order to the contrary within fourteen days after receiving the certification.

This procedure for extending the initial decision deadline by a thirty-day period is intended to promote effective case management by the hearing officers. For example, for a hearing officer faced with several initial decision deadlines in the same week, a thirty-day extension would provide flexibility to stagger the deadlines. The amended rule would retain the provision allowing the Chief Law Judge to request an extension of any length from the Commission, without regard to whether a hearing officer has already sought to extend the deadline.

We seek comments about the amount of time proposed for each phase of the proceeding, including the eight-month cap on the prehearing period for cases with the longest initial decision deadlines, the time allotted for post-hearing briefing, and the time provided for the hearing officer to prepare an initial decision.

B. Proposed Amendments to Rule 233

Rule 233[7] currently permits parties to take depositions by oral examination only if a witness will be unable to attend or testify at a hearing. The proposed amendment would allow respondents and the Division to file notices to take depositions. If a proceeding involves a single respondent, the proposed amendment would allow the respondent and the Division to each file notices to depose three persons (i.e., a maximum of three depositions per side) in proceedings designated in the proposal as 120-day cases (known as 300-day cases under current Rule 360). If a proceeding involves multiple respondents, the proposed amendment would allow respondents to collectively file notices to depose five persons and the Division to file notices to depose five persons in proceedings designated in the proposal as 120-day cases (i.e., a maximum of five depositions per side).[8] Under the amendment, parties also could request that the hearing officer issue a subpoena for documents in conjunction with the deposition.

The proposed amendment is intended to provide parties with an opportunity to develop arguments and defenses through deposition discovery, which may narrow the facts and issues to be explored during the hearing. Allowing depositions should facilitate the development of the case during the prehearing stage, which may ultimately result in more focused prehearing preparations, with issues distilled for the hearing and post-hearing briefing.

We recognize that additional time during the prehearing stage of the proceeding would facilitate the effective use of depositions for discovery. As a result, we have proposed amendments to Rule 360, discussed above, that provide additional flexibility over deadlines

[7] 17 CFR 201.233.

[8] The provision in current Rule 233 that allows for depositions when a witness is unable to attend or testify at a hearing has been preserved under the amended rule as Rule 233(b). Depositions requested under new Rule 233(b) would not count against the per-side limit on discovery depositions under new Rule 233(a).

during the prehearing discovery period of a proceeding, permitting the hearing to begin up to eight months after service of the order instituting proceedings. We anticipate that four to eight months would be a sufficient amount of time for parties to prepare for the hearing, review documents, and take up to three depositions per side in a single-respondent proceeding, and up to five depositions per side in a multiple-respondent proceeding. In selecting this increased amount of time and number of depositions permitted, we intend to provide parties with the potential benefits of this discovery tool, without sacrificing the public interest in resolving administrative proceedings promptly and efficiently.

We propose additional amendments to Rule 233 to guide the use of depositions for discovery purposes. The amendments would allow the issuance of subpoenas to order a witness to attend a deposition noticed by a party pursuant to Rule 233, and would not preclude the deposition of a witness if the witness testified during an investigation. Notices of depositions also would be served on each party pursuant to Rule 150 and would need to be consistent with the prehearing conference and the hearing officer's scheduling order.

Other proposed amendments to Rule 233 would outline procedures for deposition practice that are consistent with the Federal Rules of Civil Procedure.[9] For example, the amendments would be consistent with federal rules on the location of the depositions; the method of recording; the deposition officer's duties; examination and cross-examination of the witness; forms of objections and waiver of objections; motions to terminate or limit depositions; review of the transcript or recording by the witness; certification and delivery of the deposition;

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[9] *See generally* Federal Rules of Civil Procedure 45(c), 30(b), (d), (e), and (f); *but see* Federal Rule of Civil Procedure 30(c) (limiting depositions to seven hours instead of the six hours proposed in the amendment to Rule 233). While the Federal Rules of Civil Procedure are tailored for use in the federal court system, they represent a well-settled body of procedural rules familiar to practitioners. We have borrowed from those rules, but we have also made changes or declined to follow the Federal Rules of Civil Procedure where appropriate to tailor those rules to our own administrative forum.

attachment of documents and tangible things; and copies of the transcript or recording. We would retain current Rule 233's explicit statement that a witness being deposed may have counsel during the deposition.

We seek comments about the proposed structure of the amendments that provide for depositions, including the number of depositions allowed in single-respondent and multiple-respondent proceedings.

C. Proposed Amendments to Support Amended Rule 233

We also propose amendments to Rules 180,[10] 221,[11] 232,[12] and 234[13] to support the purpose and intent of the proposed amendments to Rule 233. These amendments are based on the expectation that depositions would play an increased role in the prehearing stage of administrative proceedings, and adjust other rules accordingly.

Rule 180 allows the Commission or a hearing officer to exclude a person from a hearing or conference, or summarily suspend a person from representing others in a proceeding, if the person engages in contemptuous conduct before either the Commission or a hearing officer. The exclusion or summary suspension can last for the duration or any portion of a proceeding, and the person may seek review of the exclusion or suspension by filing a motion to vacate with the Commission. We propose to amend Rule 180 to allow the Commission or a hearing officer to exclude or summarily suspend a person for any portion of a deposition, as well as the proceeding, a conference, or a hearing for contemptuous conduct. The person would have the

[10] 17 CFR 201.180.

[11] 17 CFR 201.221.

[12] 17 CFR 201.232.

[13] 17 CFR 201.234.

same right to review of the exclusion or suspension by filing a motion to vacate with the Commission.

Rule 221 sets forth the purposes of a prehearing conference and includes a list of the subjects to be discussed. We propose amendments to Rule 221 to add depositions and expert witness disclosures or reports to the list of subjects to be discussed at the prehearing conference. Under the current rule, the list of subjects for discussion at the prehearing conference covers most other significant aspects of the prehearing period. By adding depositions and the timing of expert witness disclosure to that list, the proposed amendment recognizes the impact that depositions and other discovery tools may have on the development of a schedule that makes efficient use of time during the prehearing period and the proceeding more broadly. It also conforms to the proposed amendment to Rule 233, which would require notices of depositions to be consistent with the prehearing conference and the hearing officer's scheduling order.

Rule 232 sets forth standards for the issuance of subpoenas and motions to quash. With the proposed amendments, Rule 232(a) would make clear that parties may request the issuance of a subpoena in connection with a deposition permitted under Rule 233, and Rule 233(e) would allow any person to whom a notice of deposition is directed to request that the notice of deposition be quashed. This proposed amendment is intended to promote efficiency in the discovery process because it would allow persons who are noticed for depositions to move to quash at the notice stage, rather than waiting for a party to request the issuance of a subpoena to order attendance.

We also propose to amend the standards governing applications to quash or modify subpoenas. Rule 232(e)(2) provides that the hearing officer or the Commission shall quash or modify a subpoena, or order return upon specified conditions, if compliance with the subpoena would be unreasonable, oppressive or unduly burdensome. As amended, Rule 232(e)(2) would provide that the hearing officer or Commission shall quash or modify a subpoena or notice of deposition, or order return upon specified conditions, if compliance with the subpoena would be unreasonable, oppressive, unduly burdensome, or would unduly delay the hearing. This amendment would require the hearing officer or Commission to consider the delaying effect of compliance with a subpoena or notice of deposition as part of the motion to quash standard and is intended to promote the efficient use of time for discovery during the prehearing period.

Finally, we propose to amend Rule 232(e) to add a new provision that specifies an additional standard governing motions to quash depositions noticed or subpoenaed pursuant to Rule 233(a), as amended. Under new Rule 232(e)(3), the hearing officer or Commission would quash or modify a deposition notice or subpoena filed or issued under Rule 233(a) unless the requesting party demonstrates that the deposition notice or subpoena satisfies the requirements under Rule 233(a). This is intended to ensure that parties notice the correct number of depositions pursuant to Rule 233(a) and follow other requirements of that rule.

Rule 232(e)(3) also would require the party requesting the deposition to demonstrate that the proposed deponent is a fact witness,[14] a designated expert witness under Rule 222(b), or a document custodian.[15] This provision is intended to foster use of depositions where appropriate and encourage meaningful discovery, within the limits of the number of depositions provided per side pursuant to Rule 233(a). This provision should encourage parties to focus any requested

[14] Under proposed Rule 232(e)(3), this type of proposed deponent must have witnessed or participated in "any event, transaction, occurrence, act, or omission that forms the basis for any claim asserted by the Division, or any defense asserted by any respondent in the proceeding (this excludes a proposed deponent whose only knowledge of relevant facts about claims or defenses of any party arises from the Division's investigation or litigation)."

[15] This excludes Division of Enforcement or other Commission officers or personnel who have custody of documents or data that was produced from the Division to the respondent. In that circumstance, the Division or Commission officers or personnel were not the original custodian of the documents.

depositions on those persons who are most likely to yield relevant information and thereby make efficient use of time during the prehearing stage of the proceeding.

Rule 232(f) provides for the payment of witness fees and mileage. We propose to add a provision to Rule 232(f) stating that each party is responsible for paying any fees and expenses incurred as a result of deposition or testimony by the expert witness whom that party has designated under Rule 222(b).

Rule 234 contains procedures for taking depositions through the use of written questions. Under Rule 234, a party may make a motion to take a deposition on written questions by filing the questions with the motion. We propose to amend the rule to provide that the moving party may take a deposition on written questions either by stipulation of the parties or by filing a motion demonstrating good cause. This proposed amendment is intended to provide a clear standard under which the hearing officer or Commission would review such a motion, and is consistent with standards for other types of motions articulated under other Rules of Practice.[16] The amendment would replace the standard under the current rule, which references current Rule 233(b)'s limit on depositions to witnesses unable to appear or testify at a hearing.

We seek comments about the proposed amendments to the standards for motions to quash subpoenas and notices for depositions, including the consideration of whether compliance with the subpoena would unduly delay the hearing and the requirement that a proposed deponent must be a fact witness, expert witness under Rule 222(b), or document custodian.

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[16] *See, e.g.,* 17 CFR 201.155(b) (good cause showing to set aside a default); 17 CFR 201.161 (good cause showing for extending or shortening time limits for filings); 17 CFR 201.201(b) (good cause showing for severing a proceeding).

D. Proposed Amendment to Rule 222

Rule 222[17] provides that a party who intends to call an expert witness shall submit a variety of information. The proposed amendment to the rule provides for two exceptions: (1) drafts of any material that is otherwise required to be submitted in final form; and (2) communications between a party's attorney and the party's expert witness who would be required to submit a report under the rules, except under limited circumstances.

The proposed amendment also would require disclosure of a written report for a witness retained or specially employed to provide expert testimony in the case, or an employee of a party whose duties regularly involve giving expert testimony. The proposed amendment would outline the elements that must be contained in that written report, including a complete statement of all opinions the witness will express and the basis and reasons for them, the facts or data considered by the witness in forming them, any exhibits that will be used to summarize or support them, and a statement of the compensation to be paid for the expert's study and testimony in the case. These proposed amendments are consistent with the requirements for expert witness disclosures and expert reports in the Federal Rules of Civil Procedure and we believe they would promote efficiency in both prehearing discovery and the hearing.[18] Moreover, the administrative law judges already have required such expert reports in proceedings before them.[19]

We propose amendments to current Rule 222(b)'s requirement that parties submit a list of other proceedings in which their expert witness has given expert testimony and a list of

[17] 17 CFR 201.222.

[18] *See* Federal Rule of Civil Procedure 26(b)(4), (a)(2), respectively.

[19] *See, e.g., ZPR Investment Management, Inc.*, Admin Proc. Ruling Rel. No. 775 (Aug. 6, 2013), *available at* http://www.sec.gov/alj/aljorders/2013/ap-775.pdf. (general prehearing order stating that "expert reports should be as specific and detailed as those presented in federal district court pursuant to Federal Rule of Civil Procedure 26").

publications authored or co-authored by their expert witness. As amended, Rule 222(b) would limit the list of proceedings to the previous four years, and would limit the list of publications to the previous ten years.

E. Proposed Amendment to Rule 141

Rule 141(a)(2)(iv)[20] specifies the requirements for serving an order instituting proceedings on a person in a foreign country. The proposed amendment would incorporate additional methods of service. The current rule allows for service of an order instituting proceedings on persons in foreign countries by any method specified in the rule, or "by any other method reasonably calculated to give notice, provided that the method of service used is not prohibited by the law of the foreign country."

We propose to amend this rule to state that service reasonably calculated to give notice includes any method authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents; methods prescribed by the foreign country's law for service in that country in an action in its courts of general jurisdiction; or as the foreign authority directs in response to a letter rogatory or letter of request. In addition, under the proposed rules, unless prohibited by the foreign country's law, service may be made by delivering a copy of the order instituting proceedings to the individual personally, or using any form of mail that the Secretary or the interested division addresses and sends to the individual and that requires a signed receipt.

The proposed rule would also allow service by any other means not prohibited by international agreement, as the Commission or hearing officer orders. Like the similar provision in the Federal Rules of Civil Procedure, this provision would cover situations where existing

[20] 17 CFR 201.141(a)(2)(iv).

agreements do not apply, or efforts to serve under such agreements are or would not be successful.

In addition to providing clarification that proper service on persons in foreign countries may be made by any of the above methods, the amended rule would provide some certainty regarding whether service of an order instituting proceedings has been effected properly and would allow the Commission to rely on international agreements in which foreign countries have agreed to accept certain forms of service as valid.

We also propose to amend Rule 141(a)(3),[21] which requires the Secretary to maintain a record of service on parties. In instances where a division of the Commission, rather than the Secretary, serves an order instituting proceedings, the Secretary does not always receive a copy of the service. The proposed amendment would make it clear that a division that serves an order instituting proceedings must file with the Secretary either an acknowledgement of service by the person served or proof of service.

F. Proposed Amendment to Rule 161

Rule 161[22] governs extensions of time, postponements, and adjournments requested by parties. Under the current Rule 161(c)(2), a hearing officer may stay a proceeding pending the Commission's consideration of offers of settlement under certain limited circumstances, but that stay does not affect any of the deadlines in Rule 360. We propose to amend Rule 161(c)(2) to allow a stay pending Commission consideration of settlement offers to also stay the timelines set

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[21] 17 CFR 201.141(a)(3).

[22] 17 CFR 201.161.

forth in Rule 360.[23] All the other requirements for granting a stay that are in the current rule would remain unchanged. This proposed amendment recognizes the important role of settlement in administrative proceedings.

G. Proposed Amendment to Rule 230

Rule 230(a)[24] requires the Division to make available to respondents certain documents obtained by the Division in connection with an investigation prior to the institution of proceedings. Rule 230(b)[25] provides a list of documents that may be withheld from this production. We propose amending Rule 230(b) to provide that the Division may redact certain sensitive personal information from documents that will be made available to respondents, unless the information concerns the person to whom the documents are being produced. Under the amendment, the Division would be able to redact an individual's social-security number, an individual's birth date, the name of an individual known to be a minor, or a financial account number, taxpayer-identification number, credit card or debit card number, passport number, driver's license number, or state-issued identification number other than the last four digits of the number. This proposed amendment is intended to enhance the protection afforded to sensitive personal information.

We also propose to amend Rule 230(b) to clarify that the Division may withhold or redact documents that reflect settlement negotiations with persons or entities who are not respondents in the proceeding at issue. This proposed amendment is intended to preserve the

[23] We also propose a conforming amendment to Rule 360(a)(2)(iii) to include a cross-reference to amended Rule 161(c)(2).

[24] 17 CFR 201.230(a).

[25] 17 CFR 201.230(b).

confidentiality of settlement discussions and safeguard the privacy of potential respondents with whom the Division has negotiated and is consistent with case law that favors the important public policy interest in candid settlement negotiations.[26]

H. Proposed Clarifying Amendments to Rules 220, 235, and 320

Rule 220[27] sets forth the requirements for filing answers to allegations in an order instituting proceedings. Currently, Rule 220 states that a defense of res judicata, statute of limitations, or any other matter constituting an affirmative defense shall be asserted in the answer. We propose amendments to Rule 220 to emphasize that a respondent must affirmatively state in an answer whether the respondent is asserting any avoidance or affirmative defense, including but not limited to res judicata, statute of limitations, or reliance. This proposed amendment would not change the substantive requirement under the current rule to include affirmative defenses in the answer. Instead, it is intended to clarify that any theories for avoidance of liability or remedies, even if not technically considered affirmative defenses, must be stated in the answer as well.[28] Timely assertion of affirmative defenses or theories of avoidance would focus the use of prehearing discovery, foster early identification of key issues and, as a result, make the discovery process more effective and efficient.

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[26] *See, e.g., Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 332 F.3d 976, 980-81 (6th Cir. 2003) ("The public policy favoring secret negotiations, combined with the inherent questionability of the truthfulness of any statements made therein, leads us to conclude that a settlement privilege should exist, and that the district court did not abuse its discretion in refusing to allow discovery.").

[27] 17 CFR 201.220.

[28] For example, some might argue that "reliance on counsel" is not a formal affirmative defense, but a basis for negating liability.

Rule 235[29] provides the standard for granting a motion to introduce a prior sworn statement of a witness who is not a party. Although current Rule 235(a) states that the standard applies to "a witness, not a party," we propose adding new Rule 235(b) to make clear that sworn statements or declarations of a party or agent may be used by an adverse party for any purpose. Further, new Rule 235(b) would clarify that "sworn statements" include a deposition taken pursuant to Rules 233 or 234 or investigative testimony, and allows for the use of declarations pursuant to 28 U.S.C. Section 1746.

Rule 320[30] provides the standard for admissibility of evidence. Under the current rule, the Commission or hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial, or unduly repetitious. We propose to amend the rule to add "unreliable" to the list of evidence that shall be excluded. This amended admissibility standard is consistent with the Administrative Procedure Act.[31] We also propose to add new Rule 320(b) to clarify that hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair. Admitting hearsay evidence if it meets a threshold showing of relevance, materiality, and reliability also is consistent with the Administrative Procedure Act.[32]

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[29] 17 CFR 201.235.

[30] 17 CFR 201.320.

[31] 5 U.S.C. 556(c)(3) (allowing hearing officers to receive relevant evidence); 5 U.S.C. 556(d) (stating that a sanction may not be imposed or rule or order issued except on consideration of the whole record or of those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence).

[32] *See* 5 U.S.C. 556(d) (stating that any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial or unduly repetitious evidence); *see, e.g., J.A.M. Builders, Inc. v. Herman*, 233 F.3d 1350, 1354 (11th Cir. 2000) (hearsay admissible in administrative proceedings if "reliable and credible"); *Calhoun v. Bailar*, 626 F.2d 145, 148 (9th Cir. 1980) (hearsay admissible if "it bear[s] satisfactory indicia of reliability" and is "probative and its use fundamentally fair"). Courts also have held that hearsay can constitute substantial evidence that satisfies the APA requirement. *See, e.g., Echostar Communications Corp. v. FCC*, 292 F.3d 749, 753 (D.C. Cir. 2002) (hearsay evidence is admissible in administrative proceedings if it "bear[s] satisfactory indicia of reliability" and "can constitute substantial evidence if it is reliable and trustworthy"); *see generally Richardson v. Perales*, 402 U.S. 389, 407-08 (1971) (holding that a medical report, though hearsay,

I. Proposed Amendments to Appellate Procedure in Rules 410, 411, 420, 440, and 450

We propose amendments to certain procedures that govern appeals to the Commission. Rule 410(b)[33] outlines the procedure for filing a petition for review of an initial decision and directs a party to set forth in the petition the specific findings and conclusions of the initial decision as to which exception is taken, together with supporting reasons for each exception. Rule 410(b) also states that an exception may be deemed to have been waived by the petitioner if the petitioner does not include the exception in the petition for review or a previously filed proposed finding made pursuant to Rule 340.

We propose to amend Rule 410(b) to eliminate both the requirement that a petitioner set forth all the specific findings and conclusions of the initial decision to which exception is taken, and the provision stating that if an exception is not stated, it may be deemed to have been waived by the petitioner. Instead, under amended Rule 410(b), a petitioner would be required to set forth only a summary statement of the issues presented for review. We also propose to add new Rule 410(c) to limit the length of petitions for review to three pages. Incorporation of pleadings or filings by reference would not be permitted.

This proposed amendment is intended to address timing issues and potential inequities in the number of briefs each party is permitted to submit to the Commission. The timing issues arise out of the requirement under Rule 410 that a party must file its petition for review within 21 days after service of the initial decision or 21 days from the date of the hearing officer's order resolving a motion to correct manifest error in an initial decision. This means that during the

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could constitute substantial evidence in social security disability claim hearing); *cf.* Federal Rule of Evidence 403 (stating that relevant, material, and reliable evidence shall be admitted).

[33] 17 CFR 201.410(b).

three-week period immediately following the issuance of the initial decision, a party must decide whether to file a motion to correct manifest error and, if not, whether to appeal. If the party decides to file a petition to appeal, then the petitioner is required under the current rule to quickly determine every exception the petitioner takes with the findings and conclusions in the initial decision, along with supporting reasons. Requiring the petitioner to submit a petition that includes all exceptions and supporting reasons, which may be deemed waived if not raised in the petition, encourages petitioners to file lengthy petitions that provide lists of exceptions with little refinement of the arguments or narrowing of issues to those most significant to the Commission's review. As a result, petitions for review often have exceeded the length of opening briefs later filed in support of a petition for review. In addition, petitions often list exceptions that are later abandoned or unsupported in the opening brief.

The proposed amendment would address these issues by allowing a party to file a petition for review that provides only a brief summary of the issues presented for review under Rule 411(b), which refers to prejudicial errors, findings or conclusions of material fact that are clearly erroneous, conclusions of law that are erroneous, or exercises of discretion or decisions of law or policy that the Commission should review.[34] After filing a petition for review that gives the Commission summary notice of the issues presented by the case, the petitioner would then be able to focus on the brief that develops the reasoned arguments in support of the petition. This practice is consistent with the Commission's routine grant of appeals, without allowing parties to

[34] This is consistent with the Commission's current rules governing appeals to the Commission from determinations by self-regulatory organizations pursuant to Rule 420. Under Rule 420, an application for review of a determination of a self-regulatory organization must set forth in summary form a brief statement of the alleged errors in the determination and supporting reasons, and must not exceed two pages. Rule 420 does not contain a waiver provision.

file oppositions to petitions.[35] Providing for a summary petition would also be consistent with the Federal Rules of Appellate Procedure, which requires only notice filing if a petitioner may appeal as of right.[36]

Allowing parties to file only a summary statement of the issues on appeal also would address potential briefing inequities in the current rule. As described above, a petitioner often files a lengthy petition for review that is followed, in the typical case, by an opening brief limited to 14,000 words. Essentially, petitioners are afforded two opportunities under the current rule to brief the issues in the case, while under current Rule 450, the opposing party typically may submit only a brief in opposition that is limited to 14,000 words. As a practical matter, that brief in opposition must address not only the arguments explained in the petitioner's opening brief, but also each exception listed in the petition for review. This has the potential to place opposing parties at a disadvantage. The proposed amendment to Rule 410(b) would correct this apparent inequity by requiring a petitioner to make arguments in its opening brief rather than in the petition for review. This also has the benefit of encouraging a petitioner to narrow the issues and

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[35] *Proposed Amendments to the Rules of Practice and Related Provisions*, Exchange Act Release No. 48832, 68 FR 68185, 68191 (Dec. 5, 2003) ("In the Commission's experience, the utility of such oppositions has been quite limited, given that the Commission has long had a policy of granting petitions for review, believing that there is a benefit to Commission review when a party takes exception to a decision."); *Adoption of Amendments to the Rules of Practice and Delegations of Authority of the Commission*, Exchange Act Release No. 49412, 69 FR 13166, 13167 (Mar. 12, 2004) (deleting the provision for oppositions to petitions for review). The Commission issues a scheduling order within approximately three weeks of granting a petition for review. Pursuant to Rule 450, the scheduling order generally provides the petitioner with thirty days to submit a brief in support of the petition of no more than 14,000 words.

[36] Federal Rule of Appellate Procedure 3(c) (stating that a notice of appeal when there is an appeal as of right must specify the parties taking appeal, designate the judgment, order, or part thereof being appeals, and name the court to which the appeal is taken); *cf.* Federal Rule of Appellate Procedure 5 (stating that a petition for appeal when an appeal is within the court's discretion must include the facts necessary to understand the question presented, the question itself, the relief sought, the reasons why the appeal should be allowed and is authorized by statute or rule, and a copy of the order, decree, or judgment complained of and any related opinion or memorandum, and any order stating the district court's permission to appeal or finding that the necessary conditions are met).

explain supporting arguments, while allowing opposing parties to address only those arguments asserted in the petitioner's opening brief.

We propose an amendment to Rule 411(d)[37] to effect the amendments to Rule 410(b). Rule 411(b) states that Commission review of an initial decision is limited to the issues specified in the petition for review and any issues specified in the order scheduling briefs.[38] We propose to amend Rule 411(b) to state that Commission review of an initial decision is limited to the issues specified in an opening brief and that any exception to an initial decision not supported in an opening brief may be deemed to have been waived by the petitioner.

We propose amendments to Rule 450[39] to provide additional support for a structure in which opening briefs are the primary vehicles for arguments on appeal. Rule 450(b) states that reply briefs are confined to matters in opposition briefs of other parties. We propose amendments to Rule 450(b) to make clear that any argument raised for the first time in a reply brief shall be deemed to have been waived by the petitioner.

We also propose amendments to Rule 450(c) to prohibit parties from incorporating pleadings or filings by reference. Under current Rule 450(c), parties are permitted to incorporate pleadings or filings by reference, although the number of words in documents incorporated by reference count against Rule 450(c)'s word limit for briefs. As a practical matter, it is difficult to enforce a word count that allows for incorporation by reference, and the rule has encouraged parties to rely on pleadings or filings from the hearing below, which already are in the record,

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[37] 17 CFR 201.411(d).

[38] Rule 411(d) also states that on notice to all parties, the Commission may, at any time prior to issuance of its decision, raise and determine any other matters that it deems material, with opportunity for oral or written argument thereon by the parties.

[39] 17 CFR 201.450.

rather than addressing the relevant evidence or developing the arguments central to the appeal before the Commission. Prohibiting incorporation by reference is intended to sharpen the arguments and require parties to provide specific support for each assertion, rather than non-specific support through incorporation of other briefs or filings.

We propose amendments to Rule 450(d) to conform to the proposed amendments to Rule 450(c). Rule 450(d) requires parties to certify compliance with the length limitations set forth in Rule 450(c). As amended, Rule 450(d) would no longer refer to pleadings incorporated by reference, and would require parties to certify compliance with the requirements set forth in Rule 450(c), instead of certifying only compliance with the length limitations in Rule 450(c).

Finally, we propose amendments to Rules 420(c)[40] and 440(b)[41] to make them consistent with the proposed amendments to Rules 410(b) and 450(b). Rule 420 governs appeals of determinations by self-regulatory organizations and Rule 440 governs appeals of determinations by the Public Company Accounting Oversight Board. Current Rule 420(c) is similar to proposed amended Rule 410(b) in that it limits the length of an application for review and requires that applicants set forth in summary form only a brief statement of alleged errors in the determination and supporting reasons. We propose to amend Rule 420(c) to include a provision stating that any exception to a determination that is not supported in an opening brief may be deemed to have been waived by the applicant. Likewise, current Rule 440(b) is similar to proposed amendments to Rule 410(b) because it requires that an applicant set forth in summary form only a brief statement of alleged errors in the determination and supporting reasons. We propose to amend Rule 440(b) to include a page limit for the application (two pages, which is consistent

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[40] 17 CFR 201.420(c).

[41] 17 CFR 201.440(b).

with current Rule 420(c)) and a provision stating that any exception to a determination that is not supported in an opening brief may be deemed to have been waived by the applicant. These proposed amendments would align appeals from determinations by the Public Company Accounting Oversight Board with appeals from determinations by self-regulatory organizations and appeals from initial decisions issued by hearing officers.

J. Proposed Amendments to Rule 900 Guidelines

We propose amendments to Rule 900,[42] which sets forth guidelines for the timely completion of proceedings, provides for confidential status reports to the Commission on pending cases, and directs the publication of summary information concerning the pending case docket. Rule 900(a) states that the guidelines will be examined periodically and, if necessary, readjusted in light of changes in the pending caseload and the available level of staff resources. Consistent with that provision, we propose to amend Rule 900(a) to state that a decision by the Commission with respect to an appeal from the initial decision of a hearing officer, a review of a determination by a self-regulatory organization or the Public Company Accounting Oversight Board, or a remand of a prior Commission decision by a court of appeals ordinarily will be issued within eight months from the completion of briefing on the petition for review, application for review, or remand order, and, if the Commission determines that the complexity of the issues presented in an appeal warrant additional time, the decision of the Commission may be issued within ten months of the completion of briefing. We also propose to amend Rule 900(a) to provide that if the Commission determines that a decision by the Commission cannot be issued within the eight or ten-month periods, the Commission may extend that period by

[42] 17 CFR 201.900.

orders as it deems appropriate in its discretion. Finally, we propose to amend Rule 900(c) to include additional information in the published report concerning the pending case docket. Specifically, we propose to amend the rule to include, in addition to what is already included, the median number of days from the completion of briefing of an appeal to the time of the Commission's decision for the cases completed in the given time period.

K. Effective Date and Transition

We are proposing that the amended Rules govern any proceeding commenced after the effective date of the amended Rules. We seek comments about whether the amended Rules should be applied, in whole or in part, to proceedings that are pending or have been docketed before or on the effective date, and, if so, the standard for applying any amended Rules to such pending proceedings.

III. Request for Public Comment

We request and encourage any interested person to submit comments regarding: (1) the time periods for each stage of the proceeding under proposed amendments to Rule 360, (2) the structure and number of depositions provided under proposed amendments to Rule 233, (3) the standards governing an application to quash deposition notices or subpoenas under proposed amendments to Rule 232, (4) the standards governing the admission of evidence, including hearsay, under Rule 320, (5) the assertion of affirmative defenses under Rule 220, (6) the effective date and whether and how any amended rules should apply to proceedings pending on the effective date, (7) the other proposed changes that are the subject of this release, (8) additional or different changes, or (9) other matters that may have an effect on the proposals contained in this release.

IV. Administrative Procedure Act, Regulatory Flexibility Act, and Paperwork Reduction Act

The Commission finds, in accordance with Section 553(b)(3)(A) of the Administrative Procedure Act,[43] that these revisions relate solely to agency organization, procedure, or practice. They are therefore not subject to the provisions of the Administrative Procedure Act requiring notice, opportunity for public comment, and publication. The Regulatory Flexibility Act[44] therefore does not apply.[45] Nonetheless, we have determined that it would be useful to publish these proposed rules for notice and comment before adoption. Because these rules relate to "agency organization, procedure or practice that does not substantially affect the rights or obligations of non-agency parties," they are not subject to the Small Business Regulatory Enforcement Fairness Act.[46] To the extent these rules relate to agency information collections during the conduct of administrative proceedings, they are exempt from review under the Paperwork Reduction Act.[47]

V. Economic Analysis

We are mindful of the costs and benefits of our rules. In proposing these amendments, we seek to enhance flexibility in the conduct of administrative proceedings while maintaining the facility to efficiently resolve individual matters.

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[43] 5 U.S.C. 553(b)(3)(A).

[44] 5 U.S.C. 601- 612.

[45] *See* 5 U.S.C. 603.

[46] 5 U.S.C. 804(3)(C).

[47] *See* 44 U.S.C. 3518(c)(1)(B)(ii); 5 CFR 1320.4 (exempting collections during the conduct of administrative proceedings or investigations).

The current rules governing administrative proceedings serve as the baseline against which we assess the economic impacts of these proposed amendments. At present, Commission rules set the prehearing period of a proceeding at approximately four months for a 300-day proceeding and do not permit parties to take depositions solely for the purpose of discovery. Rules governing the testimony of expert witnesses have not been formalized, but the administrative law judges already have required expert reports in proceedings before them.

The scope of the benefits and costs of the proposed rules depends on the expected volume of administrative proceedings. In fiscal year 2014, 230 new administrative proceedings were initiated and not settled immediately. New proceedings initiated and not immediately settled in fiscal years 2013 and 2012 totaled 202 and 207 respectively.[48]

The amendments to Rule 233 and Rule 360, as well as the supporting amendments, may benefit respondents and the Division of Enforcement by providing them with additional time and tools to discover relevant facts and information. The proposed amendment to Rule 233 and supporting amendments would permit respondents and the Division of Enforcement to take depositions by oral examination, permitting a more efficient discovery period. We preliminarily believe that the proposed amendments regarding depositions will provide parties with an opportunity to further develop arguments and defenses, which may narrow the facts and issues to be explored during the hearing. The proposed amendments to Rule 360 would alter the timeline to allow for expanded discovery. We anticipate that the potential for a longer discovery period would allow respondents additional time to review investigative records and to load and then

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[48] The total number of administrative proceedings initiated and not immediately settled each fiscal year encompasses a variety of types of proceedings, including proceedings instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 seeking to determine whether it is necessary and appropriate for the protection of investors to suspend or revoke the registration of an issuer's securities and proceedings instituted under Section 15(b) of the Exchange Act or Section 203(f) of the Investment Advisers Act of 1940 seeking to determine what, if any, remedial action is appropriate in the public interest.

review electronic productions. Together, allowing depositions and providing time for additional discovery should facilitate the information acquisition during the prehearing stage, and may ultimately result in more focused hearings. Furthermore, we preliminarily believe that more information acquisition at the prehearing stage may lead to cost savings to respondents and the Division of Enforcement stemming from the earlier resolution of cases through settlement or shorter, more focused, hearings. We are unable to quantify these benefits, however, as the potential savings would depend on multiple factors, including the complexity of actions brought to administrative proceedings and the impact that the change to discovery may have on settlement terms, which are unknown.

We preliminarily believe that the costs of the proposed amendments will be borne by the Commission as well as respondents in administrative proceedings and witnesses who provide deposition testimony. These costs will primarily stem from the cost of depositions and the additional length of administrative proceedings.

Costs stemming from depositions depend on whether respondents and the Division of Enforcement take depositions for the purpose of discovery and how they choose to participate in these depositions. Costs of depositions include the expenses of travel, attorney's fees, and reporter and transcription expenses. Based on staff experience, we preliminarily estimate the cost to a respondent of conducting one deposition could be approximately $36,840.[49] However,

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[49] This estimate is comprised of the following expenses: (i) travel expenses: $4,000; (ii) reporter/videographer: $7,000; and (iii) professional costs for two attorneys (including reasonable preparation for the deposition): 34 hours x $460/hr and 34 hours x $300/hr = $25,840. The hourly rates for the attorneys are based on the 2014-2015 Laffey Matrix. The Laffey Matrix is a matrix of hourly rates for attorneys of varying experience levels that is prepared annually by the Civil Division of the United States Attorney's Office for the District of Columbia. *See* Laffey Matrix – 2014-2015, *available at* http://www.justice.gov/sites/default/files/usao-dc/legacy/2014/07/14/Laffey%20Matrix_2014-2015.pdf (last visited Sept. 10, 2015) (the "Laffey Matrix"); *see Save Our Cumberland Mountains v. Hodel,* 857 F.2d 1516, 1525 (D.C. Cir. 1988) (en banc); *Covington v. District of Columbia*, 57 F.3d 1101, 1105 & n.14, 1109 (D.C. Cir. 1995). We have applied different estimates of the outside legal costs in connection with public company reporting, but believe that the Laffey Matrix is an appropriate

we recognize that respondents and the Division of Enforcement play a large role in managing their own costs by determining whether to take or attend depositions, managing attorney costs, including the number of attorneys attending each deposition, contracting with a competitively-priced reporter, arranging for less expensive travel, and choosing the location of depositions. We note that determinations regarding the approach to depositions will likely reflect parties' beliefs regarding the potential benefits they expect to realize from participation in depositions. However we recognize that although respondents and the Division of Enforcement can choose the extent and manner in which they request depositions, the costs of depositions are borne not only by the party choosing to conduct a deposition, but also by other parties who choose to attend the deposition, the witness, and other entities in time, travel, preparation, and attorney costs.[50]

The longer potential discovery period permitted by the proposed amendment to Rule 360, while intended to provide sufficient time for parties to engage in discovery, may impose costs on respondents and the Commission. We preliminarily estimate that potentially lengthening the overall administrative proceedings timeline by up to four months to allow more time for discovery may result in additional costs to respondents in a single matter of up to $462,400.[51]

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measure for calculating reasonable attorneys fees in litigation. *Compare Pay Ratio Disclosure*, Exchange Act Release No. 75610, 80 FR 50103 (Aug. 5, 2015) (applying a $400 per hour estimate of professional costs for Paperwork Reduction Act calculations).

[50] Some witnesses who are deposed might bear little if any out-of-pocket cost if, for example, the deposition is conducted in the city in which they live or work, and they choose not be represented by counsel at the deposition. Moreover, the party seeking the deposition might under the rules reimburse the witness for mileage or other travel costs. On the other hand, if the witness is required to pay for his or own travel to the deposition, and chooses to retain counsel to represent him or her at the deposition, we preliminary estimate that the deposition cost to the witness could be approximately $19,640 ($4000 in travel expenses for the witness and an attorney, and attorney time of 34 hours (preparation and attendance at the deposition) x $460 per hour). The hourly rate for the attorney is based on the Laffey Matrix.

[51] This estimate is comprised of the following expenses: (i) 1 senior attorney x 40 hours per week x 16 weeks x $460/hr = $294,400; (ii) 1 mid-level attorney x 20 hours per week x 16 weeks x $300/hr = $96,000; (iii) 1 paralegal x 30 hours per week x 16 weeks x $150/hr = $72,000. The hourly rates for the attorneys and paralegal are based on the Laffey Matrix.

Again, however, we recognize that while parties are likely to incur these costs only to the extent that they expect to receive benefits from engaging in depositions and additional discovery, the costs imposed by the additional time for discovery may be incurred by all parties, not just the party advocating for additional time for discovery. Further, to the extent that the proposed rules may result in the earlier resolution of cases through settlement or shorter, more focused, hearings, some of these costs may potentially be offset.

The proposed amendments related to discovery may also affect efficiency in certain cases. To the extent that the proposed amendments facilitate the discovery of relevant facts and information through depositions and extending the time for discovery, they may lead to more expeditious resolution of administrative proceedings, which could enhance the overall efficiency of the Commission's processes. For example, for complex cases that may benefit significantly from the additional information there could be efficiency gains from the proposed rules if the costs associated with the use of depositions are smaller than the value of the information gained from depositions. However, we note that because parties may not take into account the costs that depositions may impose on other entities, a potential consequence of the proposed amendments to Rule 233 and Rule 360 is that parties may engage in more discovery than is efficient. For example, for simple cases which may not benefit significantly from the additional information gained from a deposition, requesting depositions may result in inefficiency by imposing costs on all parties and witnesses involved without any significant informational benefit. However, we preliminarily believe that the supporting proposed amendments to Rule 232 and 233 may mitigate the risk of this efficiency loss by setting forth standards for the issuance of subpoenas and motions to quash depositions and setting a limit on the maximum number of depositions each side may request.

As an alternative to the proposed rules, we could continue to permit depositions only when a witness is unable to testify at a hearing, or propose other limited discovery tools, such as the use of interrogatories or requests for admissions in lieu of depositions. Although alternatives such as interrogatories or admissions may reduce some of the costs of the discovery process (i.e., the cost of depositions), they might increase other costs (resulting from the time attorneys and parties need to prepare responses) and also may yield less useful information for the administrative proceeding given the limited nature of questioning these forms permit. Relative to these alternatives, we believe that the proposed amendments would achieve the benefits of discovery in a cost-efficient manner.

The proposed amendments to Rule 222 specify the requirements for parties requesting to call expert witnesses. To the extent that the requirements specified in Rule 222 are identical to the current practices of administrative law judges, we do not anticipate any significant economic effects. However, the proposed amendments to Rule 222 may impose costs on parties involved in proceedings before administrative law judges whose current practices differ in any way from the requirements specified in Rule 222.

We preliminarily do not expect any significant economic consequences to stem from proposed amendments to Rules 141, 161, 220, 230, 235, 320, 410, 411, 420, 440, 450, and 900. For Rule 233 and its supporting amendments and Rule 360, we expect that these proposed amendments will have an impact on the efficiency of administrative proceedings but do not expect them to significantly affect the efficiency, competition, or capital formation of securities markets. We also do not expect the proposed amendments to impose a significant burden on competition.[52]

We request comment on all aspects of the economic effects of the proposal, including any anticipated impacts that are not mentioned here. We are particularly interested in comments regarding the expected benefits and costs of the proposed rules, including the specific benefits and costs parties expect to result from the proposed amendments. We are also interested in comments regarding how the amendments may affect the overall length and outcomes of administrative proceedings, and how parties approach administrative proceedings. Additionally, we request quantitative estimates of the benefits and costs on respondents in administrative proceedings and witnesses who provide deposition testimony, in general or for particular types of proceedings. We also request comment on reasonable alternatives to the proposed rules and on any effect the proposed rules may have on efficiency, competition, and capital formation.

VI. Statutory Basis and Text of Proposed Amendments

These amendments to the Rules of Practice are being proposed pursuant to statutory authority granted to the Commission, including section 3 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7202; section 19 of the Securities Act, 15 U.S.C. 77s; sections 4A, 19, and 23 of the Exchange Act, 15 U.S.C. 78d-1, 78s, and 78w; section 319 of the Trust Indenture Act of 1939, 15 U.S.C. 77sss; sections 38 and 40 of the Investment Company Act, 15 U.S.C. 80a-37 and 80a-39; and section 211 of the Investment Advisers Act, 15 U.S.C. 80b-11.

List of Subjects

17 CFR Part 201

Administrative practice and procedure.

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[52] *See* 15 U.S.C. 78w(a)(2).

Text of the Amendments

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:

PART 201 – RULES OF PRACTICE

1. The authority citation for part 201, subpart D, continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77h-1, 77j, 77s, 77u, 77sss, 77ttt, 78c(b), 78d-1, 78d-2, 78*l*, 78m, 78n, 78o(d), 78o-3, 78s, 78u-2, 78u-3, 78v, 78w, 80a-8, 80a-9, 80a-37, 80a-38, 80a-39, 80a-40, 80a-41, 80a-44, 80b-3, 80b-9, 80b-11, 80b-12, 7202, 7215, and 7217.

2. § 201.141 is amended by revising paragraphs (a)(2)(iv), (a)(2)(v), and (a)(3) to read as follows:

§201.141 Orders and decisions: Service of orders instituting proceedings and other orders and decisions.

(a) * * *

(2) * * *

(iv) *Upon persons in a foreign country.* Notice of a proceeding to a person in a foreign country may be made by any of the following methods:

(A) Any method specified in paragraph (a)(2) of this section that is not prohibited by the law of the foreign country; or

(B) By any internationally agreed means of service that is reasonably calculated to give notice, such as those authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents; or

(C) Any method that is reasonably calculated to give notice

(1) As prescribed by the foreign country's law for service in that country in an action in its courts of general jurisdiction; or

(2) As the foreign authority directs in response to a letter rogatory or letter of request; or

(3) Unless prohibited by the foreign country's law, by delivering a copy of the order instituting proceedings to the individual personally, or using any form of mail that the Secretary or the interested division addresses and sends to the individual and that requires a signed receipt; or

(D) By any other means not prohibited by international agreement, as the Commission or hearing officer orders.

(v) *In stop order proceedings*. Notwithstanding any other provision of paragraph (a)(2) of this section, in proceedings pursuant to Sections 8 or 10 of the Securities Act of 1933, 15 U.S.C. 77h or 77j, or Sections 305 or 307 of the Trust Indenture Act of 1939, 15 U.S.C. 77eee or 77ggg, notice of the institution of proceedings shall be made by personal service or confirmed telegraphic notice, or a waiver obtained pursuant to paragraph (a)(4) of this section.

* * * * *

(3) *Record of service*. The Secretary shall maintain a record of service on parties (in hard copy or computerized format), identifying the party given notice, the method of service, the date of service, the address to which service was made, and the person who made service. If a division serves a copy of an order instituting proceedings, the division shall file with the Secretary either an acknowledgement of service by the person served or proof of service consisting of a statement by the person who made service certifying the date and manner of service; the names of the persons served; and their mail or electronic addresses, facsimile numbers, or the addresses of the places of delivery, as appropriate for the manner of service. If service is made in person, the certificate of service shall state, if available, the name of the individual to whom the order was given. If service is made by U.S. Postal Service certified or

Express Mail, the Secretary shall maintain the confirmation of receipt or of attempted delivery, and tracking number. If service is made to an agent authorized by appointment to receive service, the certificate of service shall be accompanied by evidence of the appointment.

* * * * *

3. § 201.161 is amended by revising paragraph (c)(2)(iii) to read as follows:

§201.161 Extensions of time, postponements and adjournments.

* * * * *

(c) * * *

(2) * * *

(iii) The granting of any stay pursuant to this paragraph (c) shall stay the timeline pursuant to §201.360(a).

4. § 210.180 is amended by revising paragraphs (a)(1), (a)(1)(i), and (a)(2).

The revisions read as follows:

§201.180 Sanctions.

(a) * * *(1) *Subject to exclusion or suspension.* Contemptuous conduct by any person before the Commission or a hearing officer during any proceeding, including at or in connection with any conference, deposition or hearing, shall be grounds for the Commission or the hearing officer to:

(i) Exclude that person from such deposition, hearing or conference, or any portion thereof; and/or

* * * * *

(2) *Review procedure.* A person excluded from a deposition, hearing or conference, or a counsel summarily suspended from practice for the duration or any portion of a proceeding, may seek review of the exclusion or suspension by filing with the Commission, within three days of the exclusion or suspension order, a motion to vacate the order. The Commission shall consider such motion on an expedited basis as provided in §201.500.

* * * * *

5. Revise section 201.220 to read as follows:

§201.220 Answer to allegations.

(a) *When required.* In its order instituting proceedings, the Commission may require any respondent to file an answer to each of the allegations contained therein. Even if not so ordered, any respondent in any proceeding may elect to file an answer. Any other person granted leave by the Commission or the hearing officer to participate on a limited basis in such proceedings pursuant to §201.210(c) may be required to file an answer.

(b) *When to file.* Except where a different period is provided by rule or by order, a respondent shall do so within 20 days after service upon the respondent of the order instituting proceedings. Persons granted leave to participate on a limited basis in the proceeding pursuant to §201.210(c) may file an answer within a reasonable time, as determined by the Commission or the hearing officer. If the order instituting proceedings is amended, the Commission or the hearing officer may require that an amended answer be filed and, if such an answer is required, shall specify a date for the filing thereof.

(c) *Contents; effect of failure to deny.* Unless otherwise directed by the hearing officer or the Commission, an answer shall specifically admit, deny, or state that the party does not have, and is unable to obtain, sufficient information to admit or deny each allegation in the order instituting proceedings. When a party intends in good faith to deny only a part of an allegation, the party shall specify so much of it as is true and shall deny only the remainder. A statement of a lack of information shall have the effect of a denial. A respondent must affirmatively state in the answer any avoidance or affirmative defense, including but not limited to res judicata, statute of limitations or reliance. Any allegation not denied shall be deemed admitted.

(d) *Motion for more definite statement.* A respondent may file with an answer a motion for a more definite statement of specified matters of fact or law to be considered or determined. Such motion shall state the respects in which, and the reasons why, each such matter of fact or law should be required to be made more definite. If the motion is granted, the order granting such motion shall set the periods for filing such a statement and any answer thereto.

(e) *Amendments.* A respondent may amend its answer at any time by written consent of each adverse party or with leave of the Commission or the hearing officer. Leave shall be freely granted when justice so requires.

(f) *Failure to file answer: default.* If a respondent fails to file an answer required by this section within the time provided, such respondent may be deemed in default pursuant to § 201.155(a). A party may make a motion to set aside a default pursuant to § 201.155(b).

6. § 201.221 is amended by revising paragraph (c) to read as follows.

§201.221 Prehearing conference.

* * * * *

(c) *Subjects to be discussed.* At a prehearing conference consideration may be given and action taken with respect to any and all of the following:

(1) Simplification and clarification of the issues;

(2) Exchange of witness and exhibit lists and copies of exhibits;

(3) Timing of disclosure of expert witness disclosures and reports, if any;

(4) Stipulations, admissions of fact, and stipulations concerning the contents, authenticity, or admissibility into evidence of documents;

(5) Matters of which official notice may be taken;

(6) The schedule for exchanging prehearing motions or briefs, if any;

(7) The method of service for papers other than Commission orders;

(8) Summary disposition of any or all issues;

(9) Settlement of any or all issues;

(10) Determination of hearing dates;

(11) Amendments to the order instituting proceedings or answers thereto;

(12) Production of documents as set forth in § 201.230, and prehearing production of documents in response to subpoenas duces tecum as set forth in § 201.232;

(13) Specification of procedures as set forth in § 201.202;

(14) Depositions to be conducted, if any, and date by which depositions shall be completed; and

(15) Such other matters as may aid in the orderly and expeditious disposition of the proceeding.

* * * * *

7. § 201.222 is amended by:

a. revising the heading; and

b. revising paragraph (b).

The revisions read as follows:

§201.222 Prehearing submissions and disclosures.

* * * * *

(b) *Expert witnesses.*--

(1) *Information to be supplied; reports.* Each party who intends to call an expert witness shall submit, in addition to the information required by paragraph (a)(4) of this section, a statement of the expert's qualifications, a listing of other proceedings in which the expert has given expert testimony during the previous 4 years, and a list of publications authored or co-authored by the expert in the previous 10 years. Additionally, if the witness is one retained or specially employed to provide expert testimony in the case or one whose duties as the party's employee regularly involve giving expert testimony, then the party must include in the disclosure a written report—prepared and signed by the witness. The report must contain:

(i) A complete statement of all opinions the witness will express and the basis and reasons for them;

(ii) The facts or data considered by the witness in forming them;

(iii) Any exhibits that will be used to summarize or support them; and

(iv) A statement of the compensation to be paid for the study and testimony in the case.

(2) *Drafts and communications protected.*--

(i) Drafts of any report or other disclosure required under this section need not be furnished regardless of the form in which the draft is recorded.

(ii) Communications between a party's attorney and the party's expert witness who is identified under this section need not be furnished regardless of the form of the communications, except if the communications relate to compensation for the expert's study or testimony, identify facts or data that the party's attorney provided and that the expert considered in forming the opinions to be expressed, or identify assumptions that the party's attorney provided and that the expert relied on in forming the opinions to be expressed.

8. § 201.230 is amended by:

a. Revising paragraph (b) introductory text;

b. Redesignating paragraph (b)(1)(iv) as paragraph (b)(1)(v) and adding new paragraph (b)(1)(iv);

c. Redesignating paragraph (b)(2) as paragraph (b)(3) and adding new paragraph (b)(2); and

d. In paragraph (c), removing the term "(b)(1)(iv)" and adding in its place "(b)(1)(v)" wherever it occurs.

The revision and additions read as follows:

§201.230 Enforcement and disciplinary proceedings: Availability of documents for inspection and copying.

* * * * *

(b) *Documents that may be withheld or redacted.* * * *

(iv) The document reflects only settlement negotiations between the Division of Enforcement and a person or entity who is not a respondent in the proceeding; or

* * * * *

(2) Unless the hearing officer orders otherwise upon motion, the Division of Enforcement may redact information from a document if:

(i) The information is among the categories set forth in paragraphs (b)(1)(i) through (v) of this section; or

(ii) The information consists of the following with regard to a person other than the respondent to whom the information is being produced:

(A) An individual's social-security number;

(B) An individual's birth date;

(C) The name of an individual known to be a minor; or

(D) A financial account number, taxpayer-identification number, credit card or debit card number, passport number, driver's license number, or state-issued identification number other than the last four digits of the number.

* * * * *

9. § 201.232 is amended by revising paragraphs (a), (c), (d), (e), and (f) to read as follows:

§201.232 Subpoenas.

(a) *Availability; procedure.* In connection with any hearing ordered by the Commission or any deposition permitted under §201.233, a party may request the issuance of subpoenas requiring the attendance and testimony of witnesses at such depositions or at the designated time and place of hearing, and subpoenas requiring the production of documentary or other tangible evidence returnable at any designated time or place. Unless made on the record at a hearing, requests for issuance of a subpoena shall be made in writing and served on each party pursuant to §201.150. A person whose request for a subpoena has been denied or modified may not request that any other person issue the subpoena.

* * * * *

(c) *Service.* Service shall be made pursuant to the provisions of §201.150 (b) through (d). The provisions of this paragraph (c) shall apply to the issuance of subpoenas for purposes of investigations, as required by 17 CFR 203.8, as well as depositions and hearings.

(d) *Tender of fees required.* When a subpoena ordering the attendance of a person at a hearing or deposition is issued at the instance of anyone other than an officer or agency of the

United States, service is valid only if the subpoena is accompanied by a tender to the subpoenaed person of the fees for one day's attendance and mileage specified by paragraph (f) of this section.

* * * * *

(e) *Application to quash or modify.* (1) Any person to whom a subpoena or notice of deposition is directed, or who is an owner, creator or the subject of the documents that are to be produced pursuant to a subpoena, or any party may, prior to the time specified therein for compliance, but in no event more than 15 days after the date of service of such subpoena or notice, request that the subpoena or notice be quashed or modified. Such request shall be made by application filed with the Secretary and served on all parties pursuant to §201.150. The party on whose behalf the subpoena or notice was issued may, within five days of service of the application, file an opposition to the application. If a hearing officer has been assigned to the proceeding, the application to quash shall be directed to that hearing officer for consideration, even if the subpoena or notice was issued by another person.

(2) *Standards governing application to quash or modify.* If compliance with the subpoena or notice of deposition would be unreasonable, oppressive, unduly burdensome or would unduly delay the hearing, the hearing officer or the Commission shall quash or modify the subpoena or notice, or may order a response to the subpoena, or appearance at a deposition, only upon specified conditions. These conditions may include but are not limited to a requirement that the party on whose behalf the subpoena was issued shall make reasonable compensation to the person to whom the subpoena was addressed for the cost of copying or transporting evidence to the place for return of the subpoena.

(3) *Additional standards governing application to quash deposition notices or subpoenas filed pursuant to § 201.233(a).* The hearing officer or the Commission shall quash or modify a

deposition notice or subpoena filed or issued pursuant to §201.233(a) unless the requesting party demonstrates that the deposition notice or subpoena satisfies the requirements of §201.233(a), and:

(i) The proposed deponent was a witness of or participant in any event, transaction, occurrence, act, or omission that forms the basis for any claim asserted by the Division of Enforcement, or any defense asserted by any respondent in the proceeding (this excludes a proposed deponent whose only knowledge of relevant facts about claims or defenses of any party arises from the Division of Enforcement's investigation or the proceeding);

(ii) The proposed deponent is a designated as an "expert witness" under §201.222(b); provided, however, that the deposition of an expert who is required to submit a written report under §201.222(b) may only occur after such report is served; or

(iii) The proposed deponent has custody of documents or electronic data relevant to the claims or defenses of any party (this excludes Division of Enforcement or other Commission officers or personnel who have custody of documents or data that was produced by the Division to the respondent).

* * * * *

(f) *Witness fees and mileage.* Witnesses summoned before the Commission shall be paid the same fees and mileage that are paid to witnesses in the courts of the United States, and witnesses whose depositions are taken and the persons taking the same shall severally be entitled to the same fees as are paid for like services in the courts of the United States. Witness fees and mileage shall be paid by the party at whose instance the witnesses appear. Except for such witness fees and mileage, each party is responsible for paying any fees and expenses of the expert witnesses whom that party designates under § 201.222(b), for appearance at any deposition or hearing.

10. § 201.233 is revised to read as follows:

§201.233 Depositions upon oral examination.

(a) *Depositions upon written notice.* In any proceeding under the 120-day timeframe under §201.360(a)(2), except as otherwise set forth in these rules, and consistent with the prehearing conference and hearing officer's scheduling order:

(1) If the proceeding involves a single respondent, the respondent may file written notices to depose no more than three persons, and the Division of Enforcement may file written notices to depose no more than three persons. No other depositions shall be permitted, except as provided in paragraph (b) of this section;

(2) If the proceeding involves multiple respondents, the respondents collectively may file joint written notices to depose no more than five persons, and the Division of Enforcement may file written notices to depose no more than five persons. The depositions taken under this paragraph (a)(2) shall not exceed a total of five depositions for the Division of Enforcement, and five depositions for all respondents collectively. No other depositions shall be permitted except as provided in paragraph (b) of this section;

(3) A deponent's attendance may be ordered by subpoena issued pursuant to the procedures in §201.232; and

(4) The Commission or hearing officer may rule on a motion by a party that a deposition shall not be taken upon a determination under §201.232(e). The fact that a witness testified during an investigation does not preclude the deposition of that witness.

(b) *Depositions when witness is unavailable.* In addition to depositions permitted under paragraph (a) of this section, the Commission or the hearing officer may grant a party's request to file a written notice of deposition if the requesting party shows that the prospective witness will likely give testimony material to the proceeding; that it is likely the prospective witness, who is then within the United States, will be unable to attend or testify at the hearing because of age, sickness, infirmity, imprisonment, other disability, or absence from the United States, unless it appears that the absence of the witness was procured by the party requesting the deposition; and that the taking of a deposition will serve the interests of justice.

(c) *Service and contents of notice.* Notice of any deposition pursuant to this section shall be made in writing and served on each party pursuant to §201.150, and shall be consistent with the prehearing conference and hearing officer's scheduling order. A notice of deposition shall designate by name a deposition officer. The deposition officer may be any person authorized to administer oaths by the laws of the United States or of the place where the deposition is to be held. A notice of deposition also shall state:

(1) The name and address of the witness whose deposition is to be taken;

(2) The scope of the testimony to be taken;

(3) The time and place of the deposition; provided that a subpoena for a deposition may command a person to attend a deposition only as follows:

(A) Within 100 miles of where the person resides, is employed, or regularly transacts business in person;

(B) Within the state where the person resides, is employed, or regularly transacts business in person, if the person is a party or a party's officer;

(C) At such other location that the parties and proposed deponent stipulate; or

(D) At such other location that the hearing officer or the Commission determines is appropriate; and

(4) The manner of recording and preserving the deposition.

(d) *Producing documents.* In connection with any deposition pursuant to §201.233(a), a party may request the issuance of a subpoena duces tecum under §201.232. The party conducting the deposition shall serve upon the deponent any subpoena duces tecum so issued. The materials designated for production, as set out in the subpoena, must be listed in the notice of deposition or in an attachment.

(e) *Method of recording.*

(1) *Method stated in the notice.* The party who notices the deposition must state in the notice the method for recording the testimony. Unless the hearing officer or Commission orders otherwise, testimony may be recorded by audio, audiovisual, or stenographic means. The noticing party bears the recording costs. Any party may arrange to transcribe a deposition.

(2) *Additional method.* With prior notice to the deponent and other parties, any party may designate another method for recording the testimony in addition to that specified in the original notice. That party bears the expense of the additional record or transcript unless the hearing officer or the Commission orders otherwise.

(f) *By remote means.* The parties may stipulate—or the hearing officer or Commission may on motion order—that a deposition be taken by telephone or other remote means. For the purpose of this section, the deposition takes place where the deponent answers the questions.

(g) *Deposition officer's duties.*

(1) *Before the deposition.* The deposition officer designated pursuant to paragraph (c) of this section must begin the deposition with an on-the-record statement that includes:

(i) The deposition officer's name and business address;

(ii) The date, time, and place of the deposition;

(iii) The deponent's name;

(iv) The deposition officer's administration of the oath or affirmation to the deponent; and

(v) The identity of all persons present.

(2) *Conducting the deposition*; *Avoiding distortion.* If the deposition is recorded non-stenographically, the deposition officer must repeat the items in paragraphs (g)(1)(i) through (iii) of this section at the beginning of each unit of the recording medium. The deponent's and attorneys' appearance or demeanor must not be distorted through recording techniques.

(3) *After the deposition.* At the end of a deposition, the deposition officer must state on the record that the deposition is complete and must set out any stipulations made by the attorneys about custody of the transcript or recording and of the exhibits, or about any other pertinent matters.

(h) *Order and record of the examination.*

(1) *Order of examination.* The examination and cross-examination of a deponent proceed as they would at the hearing. After putting the deponent under oath or affirmation, the deposition officer must record the testimony by the method designated under paragraph (e) of this section. The testimony must be recorded by the deposition officer personally or by a person acting in the presence and under the direction of the deposition officer. The witness being deposed may have counsel present during the deposition.

(2) *Form of objections stated during the deposition.* An objection at the time of the examination—whether to evidence, to a party's conduct, to the deposition officer's qualifications, to the manner of taking the deposition, or to any other aspect of the deposition—

must be noted on the record, but the examination still proceeds and the testimony is taken subject to any objection. An objection must be stated concisely in a nonargumentative and nonsuggestive manner. A person may instruct a deponent not to answer only when necessary to preserve a privilege, to enforce a limitation ordered by the hearing officer or the Commission, or to present a motion to the hearing officer or the Commission for a limitation on the questioning in the deposition.

(i) *Waiver of objections.*

(1) *To the notice.* An objection to an error or irregularity in a deposition notice is waived unless promptly served in writing on the party giving the notice.

(2) *To the deposition officer's qualification.* An objection based on disqualification of the deposition officer before whom a deposition is to be taken is waived if not made:

(i) Before the deposition begins; or

(ii) Promptly after the basis for disqualification becomes known or, with reasonable diligence, could have been known.

(3) *To the taking of the deposition.*

(i) *Objection to competence, relevance, or materiality.* An objection to a deponent's competence—or to the competence, relevance, or materiality of testimony—is not waived by a failure to make the objection before or during the deposition, unless the ground for it might have been corrected at that time.

(ii) *Objection to an error or irregularity.* An objection to an error or irregularity at an oral examination is waived if:

(A) It relates to the manner of taking the deposition, the form of a question or answer, the oath or affirmation, a party's conduct, or other matters that might have been corrected at that time; and

(B) It is not timely made during the deposition.

(4) *To completing and returning the deposition.* An objection to how the deposition officer transcribed the testimony—or prepared, signed, certified, sealed, endorsed, sent, or otherwise dealt with the deposition—is waived unless a motion to suppress is made promptly after the error or irregularity becomes known or, with reasonable diligence, could have been known.

(j) *Duration; cross-examination; motion to terminate or limit.*

(1) *Duration.* Unless otherwise stipulated or ordered by the hearing officer or the Commission, a deposition is limited to one day of 6 hours, including cross-examination as provided in this subsection. In a deposition conducted by or for a respondent, the Division of Enforcement shall be allowed a reasonable amount of time for cross-examination of the deponent. In a deposition conducted by the Division, the respondents collectively shall be allowed a reasonable amount of time for cross-examination of the deponent. The hearing officer or the Commission may allow additional time if needed to fairly examine the deponent or if the deponent, another person, or any other circumstance impedes or delays the examination.

(2) *Motion to terminate or limit.*

(i) *Grounds.* At any time during a deposition, the deponent or a party may move to terminate or limit it on the ground that it is being conducted in bad faith or in a manner that unreasonably annoys, embarrasses, or oppresses the deponent or party. If the objecting deponent or party so demands, the deposition must be suspended for the time necessary to present the motion to the hearing officer or the Commission.

(ii) *Order.* The hearing officer or the Commission may order that the deposition be terminated or may limit its scope. If terminated, the deposition may be resumed only by order of the hearing officer or the Commission.

(k) *Review by the witness; changes.* (1) *Review; statement of changes.* On request by the deponent or a party before the deposition is completed, and unless otherwise ordered by the hearing officer or the Commission, the deponent must be allowed 14 days after being notified by the deposition officer that the transcript or recording is available, unless a longer time is agreed to by the parties or permitted by the hearing officer, in which:

(i) To review the transcript or recording; and

(ii) If there are changes in form or substance, to sign a statement listing the changes and the reasons for making them.

(2) *Changes indicated in the deposition officer's certificate.* The deposition officer must note in the certificate prescribed by paragraph (*l*)(1) of this section whether a review was requested and, if so, must attach any changes the deponent makes during the 14-day period.

(*l*) *Certification and delivery; exhibits; copies of the transcript or recording.*

(1) *Certification and delivery.* The deposition officer must certify in writing that the witness was duly sworn and that the deposition accurately records the witness's testimony. The certificate must accompany the record of the deposition. Unless the hearing officer orders otherwise, the deposition officer must seal the deposition in an envelope or package bearing the title of the action and marked "Deposition of [witness's name]" and must promptly send it to the

attorney or party who arranged for the transcript or recording. The attorney or party must store it under conditions that will protect it against loss, destruction, tampering, or deterioration.

(2) *Documents and tangible things.*

(i) *Originals and copies.* Documents and tangible things produced for inspection during a deposition must, on a party's request, be marked for identification and attached to the deposition. Any party may inspect and copy them. But if the person who produced them wants to keep the originals, the person may:

(A) Offer copies to be marked, attached to the deposition, and then used as originals—after giving all parties a fair opportunity to verify the copies by comparing them with the originals; or

(B) Give all parties a fair opportunity to inspect and copy the originals after they are marked—in which event the originals may be used as if attached to the deposition.

(ii) *Order regarding the originals.* Any party may move for an order that the originals be attached to the deposition pending final disposition of the case.

(3) *Copies of the transcript or recording.* Unless otherwise stipulated or ordered by the hearing officer or Commission, the deposition officer must retain the stenographic notes of a deposition taken stenographically or a copy of the recording of a deposition taken by another method. When paid reasonable charges, the deposition officer must furnish a copy of the transcript or recording to any party or the deponent.

11. § 201.234 is amended by revising paragraphs (a) and (c) to read as follows:

§201.234 Depositions upon written questions.

(a) *Availability.* Any deposition permitted under §201.232 may be taken and submitted on written questions upon motion of any party, for good cause shown, or as stipulated by the parties.

* * * * *

(c) *Additional requirements.* The order for deposition, filing of the deposition, form of the deposition and use of the deposition in the record shall be governed by paragraphs (c) through (l) of §201.233, except that no cross-examination shall be made.

12. § 201.235 is amended by:

a. Revising the heading;

b. Revising paragraphs (a), (a)(2), and (a)(5); and

c. Adding paragraph (b).

The revisions and addition read as follows:

§201.235 Introducing prior sworn statements or declarations.

(a) At a hearing, any person wishing to introduce a prior, sworn deposition taken pursuant to §201.233 or §201.234, investigative testimony, or other sworn statement or a declaration pursuant to 28 U.S.C. 1746, of a witness, not a party, otherwise admissible in the proceeding, may make a motion setting forth the reasons therefor. If only part of a statement or declaration is offered in evidence, the hearing officer may require that all relevant portions of the statement or declaration be introduced. If all of a statement or declaration is offered in evidence, the hearing officer may require that portions not relevant to the proceeding be excluded. A motion to introduce a prior sworn statement or declaration may be granted if:

* * * * *

(2) The witness is out of the United States, unless it appears that the absence of the witness was procured by the party offering the prior sworn statement or declaration;

* * * * *

(5) In the discretion of the Commission or the hearing officer, it would be desirable, in the interests of justice, to allow the prior sworn statement or declaration to be used. In making this determination, due regard shall be given to the presumption that witnesses will testify orally in an open hearing. If the parties have stipulated to accept a prior sworn statement or declaration in lieu of live testimony, consideration shall also be given to the convenience of the parties in avoiding unnecessary expense.

(b) *Sworn statement or declaration of party or agent.* An adverse party may use for any purpose a deposition taken pursuant to §201.233 or §201.234, investigative testimony, or other sworn statement or a declaration pursuant to 28 U.S.C. 1746, of a party or anyone who, when giving the sworn statement or declaration, was the party's officer, director, or managing agent.

13. § 201.320 is revised to read as follows:

§201.320 Evidence: Admissibility.

(a) Except as otherwise provided in this section, the Commission or the hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial, unduly repetitious, or unreliable.

(b) Subject to §201.235, evidence that constitutes hearsay may be admitted if it is relevant, material, and bears satisfactory indicia of reliability so that its use is fair.

14. § 201.360 is amended by revising paragraphs (a)(2), (a)(3), and (b) to read as follows:

§201.360 Initial decision of hearing officer.

(a) * * *

(2) *Time period for filing initial decision and for hearing.*

(i) *Initial decision.* In the order instituting proceedings, the Commission will specify a time period in which the hearing officer's initial decision must be filed with the Secretary. In the Commission's discretion, after consideration of the nature, complexity, and urgency of the subject matter, and with due regard for the public interest and the protection of investors, this time period will be either 30, 75, or 120 days from the completion of post-hearing briefing, or if there is no in-person hearing, the completion of briefing on a dispositive motion (including but not limited to a motion for summary disposition or default) or the occurrence of a default under §201.155(a).

(ii) *Hearing.* Under the 120-day timeline, the hearing officer shall issue an order scheduling the hearing to begin approximately 4 months (but no more than 8 months) from the date of service of the order instituting the proceeding, allowing parties approximately 2 months from the conclusion of the hearing to obtain the transcript and submit post-hearing briefs, and no more than 120 days after the completion of post-hearing or dispositive motion briefing for the hearing officer to file an initial decision. Under the 75-day timeline, the hearing officer shall issue an order scheduling the hearing to begin approximately 2-1/2 months (but no more than 6 months) from the date of service of the order instituting the proceeding, allowing parties approximately 2 months from the conclusion of the hearing to obtain the transcript and submit post-hearing briefs, and no more than 75 days after the completion of post-hearing or dispositive motion briefing for the hearing officer to file an initial decision. Under the 30-day timeline, the hearing officer shall issue an order scheduling the hearing to begin approximately 1 month (but no more than 4 months) from the date of service of the order instituting the proceeding, allowing parties approximately 2 months from the conclusion of the hearing to obtain the transcript and submit post-hearing briefs, and no more than 30 days after the completion of post-hearing or dispositive motion briefing for the hearing officer to file an initial decision. These deadlines confer no substantive rights on respondents. If a stay is granted pursuant to §201.161(c)(2)(i) or §201.210(c)(3), the time period specified in the order instituting proceedings in which the hearing officer's initial decision must be filed with the Secretary, as well as any other time limits established in orders issued by the hearing officer in the proceeding, shall be automatically tolled during the period while the stay is in effect.

(3) *Certification of extension; motion for extension.* (i) In the event that the hearing officer presiding over the proceeding determines that it will not be possible to file the initial decision within the specified period of time, the hearing officer may certify to the Commission in writing the need to extend the initial decision deadline by up to 30 days for case management purposes. The certification must be issued no later than 30 days prior to the expiration of the time specified for the issuance of an initial decision and be served on the Commission and all parties in the proceeding. If the Commission has not issued an order to the contrary within fourteen days after receiving the certification, the extension set forth in the hearing officer's certification shall take effect.

(ii) Either in addition to a certification of extension, or instead of a certification of extension, the Chief Administrative Law Judge may submit a motion to the Commission requesting an extension of the time period for filing the initial decision. First, the hearing officer presiding over the proceeding must consult with the Chief Administrative Law Judge. Following such consultation, the Chief Administrative Law Judge may determine, in his or her discretion, to submit a motion to the Commission requesting an extension of the time period for filing the initial decision. This motion may request an extension of any length but must be filed no later than 15 days prior to the expiration of the time specified in the certification of extension, or if there is no certification of extension, 30 days prior to the expiration of the time specified in the order instituting proceedings. The motion will be served upon all parties in the proceeding, who may file with the Commission statements in support of or in opposition to the motion. If the Commission determines that additional time is necessary or appropriate in the public interest, the Commission shall issue an order extending the time period for filing the initial decision.

(iii) The provisions of this paragraph (a)(3) confer no rights on respondents.

(b) *Content*. An initial decision shall include findings and conclusions, and the reasons or basis therefor, as to all the material issues of fact, law or discretion presented on the record and the appropriate order, sanction, relief, or denial thereof. The initial decision shall also state the time period, not to exceed 21 days after service of the decision, except for good cause shown, within which a petition for review of the initial decision may be filed. The reasons for any extension of time shall be stated in the initial decision. The initial decision shall also include a statement that, as provided in paragraph (d) of this section:

* * * * *

15. § 201.410 is amended by:

a. Revising paragraph (b);

b. Redesignating paragraph (c) as paragraph (d); and

c. Adding new paragraph (c).

The revision and addition read as follows:

§201.410 Appeal of initial decisions by hearing officers.

* * * * *

(b) *Procedure.* The petition for review of an initial decision shall be filed with the Commission within such time after service of the initial decision as prescribed by the hearing officer pursuant to §201.360(b) unless a party has filed a motion to correct an initial decision with the hearing officer. If such correction has been sought, a party shall have 21 days from the date of the hearing officer's order resolving the motion to correct to file a petition for review. The petition shall set forth a statement of the issues presented for review under §201.411(b). In the event a petition for review is filed, any other party to the proceeding may file a cross-petition for review within the original time allowed for seeking review or within ten days from the date that the petition for review was filed, whichever is later.

(c) *Length limitation.* Except with leave of the Commission, the petition for review shall not exceed three pages in length. Incorporation of pleadings or filings by reference is not permitted. Motions to file petitions in excess of those limitations are disfavored.

* * * * *

16. § 201.411 is amended by revising paragraph (d) to read as follows:

§201.411 Commission consideration of initial decisions by hearing officers.

* * * * *

(d) *Limitations on matters reviewed.* Review by the Commission of an initial decision shall be limited to the issues specified in an opening brief that complies with §201.450(b), or the issues, if any, specified in the briefing schedule order issued pursuant to §201.450(a). Any exception to an initial decision not supported in an opening brief that complies with §201.450(b) may, at the discretion of the Commission, be deemed to have been waived by the petitioner. On notice to all parties, however, the Commission may, at any time prior to issuance of its decision, raise and determine any other matters that it deems material, with opportunity for oral or written argument thereon by the parties.

* * * * *

17. § 201.420 is amended by adding a new last sentence to paragraph (c) to read as follows:

§201.420 Appeal of determinations by self-regulatory organizations.

* * * * *

(c) *Application.* * * * Any exception to a determination not supported in an opening brief that complies with §201.450(b) may, at the discretion of the Commission, be deemed to have been waived by the applicant.

* * * * *

18. § 201.440 is amended by revising paragraph (b) to read as follows:

§201.440 Appeal of determinations by the Public Company Accounting Oversight Board.

* * * * *

(b) *Procedure.* An aggrieved person may file an application for review with the Commission pursuant to §201.151 within 30 days after the notice filed by the Board of its determination with the Commission pursuant to 17 CFR 240.19d-4 is received by the aggrieved person applying for review. The applicant shall serve the application on the Board at the same time. The application shall identify the determination complained of, set forth in summary form a brief statement of alleged errors in the determination and supporting reasons therefor, and state an address where the applicant can be served. The application should not exceed two pages in length. The notice of appearance required by §201.102(d) shall accompany the application. Any exception to a determination not supported in an opening brief that complies with §201.450(b) may, at the discretion of the Commission, be deemed to have been waived by the applicant.

* * * * *

19. § 201.450 is amended by revising paragraphs (b), (c) and (d) to read as follows.

§201.450 Briefs filed with the Commission.

* * * * *

(b) *Contents of briefs*. Briefs shall be confined to the particular matters at issue. Each exception to the findings or conclusions being reviewed shall be stated succinctly. Exceptions shall be supported by citation to the relevant portions of the record, including references to the specific pages relied upon, and by concise argument including citation of such statutes, decisions and other authorities as may be relevant. If the exception relates to the admission or exclusion of evidence, the substance of the evidence admitted or excluded shall be set forth in the brief, or by citation to the record. Reply briefs shall be confined to matters in opposition briefs of other parties; except as otherwise determined by the Commission in its discretion, any argument raised for the first time in a reply brief shall be deemed to have been waived.

(c) *Length limitation*. Except with leave of the Commission, opening and opposition briefs shall not exceed 14,000 words and reply briefs shall not exceed 7,000 words, exclusive of pages containing the table of contents, table of authorities, and any addendum that consists solely of copies of applicable cases, pertinent legislative provisions or rules, and exhibits. Incorporation of pleadings or filings by reference is not permitted. Motions to file briefs in excess of these limitations are disfavored.

(d) *Certificate of compliance*. An opening or opposition brief that does not exceed 30 pages in length, exclusive of pages containing the table of contents, table of authorities, and any addendum that consists solely of copies of applicable cases, pertinent legislative provisions, or rules and exhibits, is presumptively considered to contain no more than 14,000 words. A reply brief that does not exceed 15 pages in length, exclusive of pages containing the table of contents, table of authorities, and any addendum that consists solely of copies of applicable cases, pertinent legislative provisions, or rules and exhibits is presumptively considered to contain no more than 7,000 words. Any brief that exceeds these page limits must include a certificate by the party's representative, or an unrepresented party, stating that the brief complies with the requirements set forth in §201.450(c) and stating the number of words in the brief. The person preparing the certificate may rely on the word count of the word-processing system used to prepare the brief.

20. § 201.900 is revised to read as follows:

§ 201.900 Informal Procedures and Supplementary Information Concerning Adjudicatory Proceedings.

(a) *Guidelines for the timely completion of proceedings.* (1) Timely resolution of adjudicatory proceedings is one factor in assessing the effectiveness of the adjudicatory program in protecting investors, promoting public confidence in the securities markets and assuring respondents a fair hearing. Establishment of guidelines for the timely completion of key phases of contested administrative proceedings provides a standard for both the Commission and the public to gauge the Commission's adjudicatory program on this criterion. The Commission has directed that:

(i) To the extent possible, a decision by the Commission on review of an interlocutory matter should be completed within 45 days of the date set for filing the final brief on the matter submitted for review.

(ii) To the extent possible, a decision by the Commission on a motion to stay a decision that has already taken effect or that will take effect within five days of the filing of the motion, should be issued within five days of the date set for filing of the opposition to the motion for a stay. If the decision complained of has not taken effect, the Commission's decision should be issued within 45 days of the date set for filing of the opposition to the motion for a stay.

(iii) Ordinarily, a decision by the Commission with respect to an appeal from the initial decision of a hearing officer, a review of a determination by a self-regulatory organization or the Public Company Accounting Oversight Board, or a remand of a prior Commission decision by a court of appeals will be issued within eight months from the completion of briefing on the petition for review, application for review, or remand order. If the Commission determines that the complexity of the issues presented in a petition for review, application for review, or remand order warrants additional time, the decision of the Commission in that matter may be issued within 10 months of the completion of briefing.

(iv) If the Commission determines that a decision by the Commission cannot be issued within the period specified in paragraph (a)(1)(iii), the Commission may extend that period by orders as it deems appropriate in its discretion. The guidelines in this paragraph (a) confer no rights or entitlements on parties or other persons.

(2) The guidelines in this paragraph (a) do not create a requirement that each portion of a proceeding or the entire proceeding be completed within the periods described. Among other reasons, Commission review may require additional time because a matter is unusually complex or because the record is exceptionally long. In addition, fairness is enhanced if the Commission's deliberative process is not constrained by an inflexible schedule. In some proceedings, deliberation may be delayed by the need to consider more urgent matters, to permit the preparation of dissenting opinions, or for other good cause. The guidelines will be used by the Commission as one of several criteria in monitoring and evaluating its adjudicatory program. The guidelines will be examined periodically, and, if necessary, readjusted in light of changes in the pending caseload and the available level of staff resources.

(b) *Reports to the Commission on pending cases.* The administrative law judges, the Secretary and the General Counsel have each been delegated authority to issue certain orders or adjudicate certain proceedings. See 17 CFR 200.30-1 et seq. Proceedings are also assigned to the General Counsel for the preparation of a proposed order or opinion which will then be recommended to the Commission for consideration. In order to improve accountability by and to the Commission for management of the docket, the Commission has directed that confidential status reports with respect to all filed adjudicatory proceedings shall be made periodically to the Commission. These reports will be made through the Secretary, with a minimum frequency established by the Commission. In connection with these periodic reports, if a proceeding pending before the Commission has not been concluded within 30 days of the guidelines established in paragraph (a) of this section, the General Counsel shall specifically apprise the Commission of that fact, and shall describe the procedural posture of the case, project an estimated date for conclusion of the proceeding, and provide such other information as is necessary to enable the Commission to make a determination under paragraph (a)(1)(iv) of this section or to determine whether additional steps are necessary to reach a fair and timely resolution of the matter.

(c) *Publication of information concerning the pending case docket.* Ongoing disclosure of information about the adjudication program caseload increases awareness of the importance of the program, facilitates oversight of the program and promotes confidence in the efficiency and fairness of the program by investors, securities industry participants, self-regulatory organizations and other members of the public. The Commission has directed the Secretary to publish in the first and seventh months of each fiscal year summary statistical information about the status of pending adjudicatory proceedings and changes in the Commission's caseload over the prior six months. The report will include the number of cases pending before the administrative law judges and the Commission at the beginning and end of the six-month period. The report will also show increases in the caseload arising from new cases being instituted, appealed or remanded to the Commission and decreases in the caseload arising from the disposition of proceedings by issuance of initial decisions, issuance of final decisions issued on appeal of initial decisions, other dispositions of appeals of initial decisions, final decisions on review of self-regulatory organization determinations, other dispositions on review of self-regulatory organization determinations, and decisions with respect to stays or interlocutory motions. For each category of decision, the report shall also show the median age of the cases at the time of the decision, the number of cases decided within the guidelines for the timely completion of adjudicatory proceedings, and, with respect to appeals from initial decisions, reviews of determinations by self-regulatory organizations or the Public Company Accounting Oversight Board, and remands of prior Commission decisions, the median days from the completion of briefing to the time of the Commission's decision.

By the Commission.

Dated: September 24, 2015

Brent J. Fields
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 201

Release No. 34-75977; File No. S7-19-15

RIN 3235-AL87

Amendments to the Commission's Rules of Practice

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing for public comment amendments to its Rules of Practice that would require persons involved in administrative proceedings to submit all documents and other items electronically. The proposed amendments are intended to enhance the accessibility of administrative proceedings by ensuring that filings and other information concerning administrative proceedings are more readily available to the public.

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 S7-19-15 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 S7-19-15. 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 of submission. The Commission will post all comments on the Commission's Internet Web site (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; we do not edit personal identifying information in submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Adela Choi, Senior Counsel, and Laura Jarsulic, Associate General Counsel, Office of the General Counsel, (202) 551-5150, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission proposes to amend its Rules of Practice. The amendments are being proposed as a result of the Commission's experience with its existing rules.

I. Introduction

The Commission proposes to make targeted amendments to its Rules of Practice that would automate and modernize aspects of the filing process in administrative proceedings to facilitate the flow of information to the public. The Commission recognizes the need to ensure that public administrative proceeding records are made available to the public as quickly as possible. Roughly 100 requests for records related to administrative proceedings were made each year over the last three years, and certain records were requested by multiple members of the public.

The Commission currently is developing a comprehensive Internet-based electronic system that would, among other things, allow persons in administrative proceedings to file and serve documents electronically and facilitate the prompt distribution of public information regarding administrative proceedings. In conjunction with the development of this system, the Commission proposes to require electronic submissions. The Commission believes that electronic submissions will enhance the transparency of administrative proceedings by providing a quicker way for the Commission to make records available to the public. In addition, the Commission believes that the electronic system will increase its ability to efficiently process filings, and may decrease costs for parties who may file and serve submissions electronically, rather than in paper format.[1]

There are three main components to the proposed approach. First, persons involved in administrative proceedings who currently are required to file documents under Rules 151 and

[1] As part of the ongoing effort to make records available to the public promptly, the Commission now posts on its website more types of documents associated with administrative proceedings, such as significant pleadings filed by parties. Previously, only documents issued by the Commission and Administrative Law Judges, such as adjudicatory initial decisions, opinions, and orders, were posted on the website.

152 of the Commission's Rules of Practice would be required to file such documents electronically through a secure system on the Commission's website at www.sec.gov that is designed to receive uploads of documents and attachments. Filing by facsimile and in paper format would no longer be permitted absent the filing of a certification that the person reasonably cannot comply with the electronic filing requirement. However, as discussed further below, for the first 90 days after the proposed amendments become final, the Commission intends to administer a phase-in period that would require all filings to be made both electronically and in paper format. Second, parties that are required to serve documents under Rule 150 would be required to serve each other electronically in the form and manner that is prescribed in the guidance posted on the Commission's website.

The third component would require filers to exclude or redact sensitive personal information from electronic filings and submissions in accordance with the Commission's obligation to protect such information under the Privacy Act of 1974, as amended.[2] Sensitive personal information would be defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued identification number, home address (other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any sensitive health information identifiable by individual, such as an individual's medical

[2] 5 U.S.C. 552a. Federal courts and certain federal agencies require the exclusion or redaction of certain sensitive personal information contained in filings. *See, e.g.*, Fed. R. Civ. P. 5.2 (Privacy Protection for Filings Made with the Court); Consumer Financial Protection Bureau, Rules of Practice for Adjudication Proceedings, Rule 112, 12 CFR 1081.112 (Formal Requirements as to Papers Filed); National Labor Relations Board, E-Filing Terms for Selected Documents in Unfair Labor Practice and Representation Cases, *available at* http://www.nlrb.gov/sites/default/files/attachments/basic-page/node-1673/electronic_filings.pdf (last visited Sept. 10, 2015). The electronic filings and submissions discussed herein are systems of records that the Commission has previously identified as covered by the Privacy Act.

records. There are exceptions to this proposed definition. Specifically, persons need not redact the last four digits of a taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number. Nor would persons need to redact home addresses and telephone numbers of parties and persons filing documents with the Commission; business telephone numbers; and copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website. The definition of sensitive personal information would not include a personal e-mail address. We seek comments about whether the disclosure of personal e-mail addresses generally and home addresses of parties and persons filing documents with the Commission could have an adverse effect on persons or parties, and whether, as a result, these terms should be included in the definition of sensitive personal information that must be excluded or redacted.

If the person making a filing believes that sensitive personal information is necessary to the proceeding, the person would need to file a motion for a protective order in accordance with Rule 322 to limit disclosure of the sensitive personal information. In accordance with the proposed amendments to Rule 322, and only if review of the documents is necessary to a ruling on the motion, the person would be required to file an unredacted version of the submission to be used by the hearing officer and the Commission for purposes of the proceeding, and a redacted version to be used for distribution to the public. A redacted version would not need to be filed if the submission would be redacted in its entirety. This reflects current practice when parties file motions for protective orders pursuant to the Rules of Practice.

As a corollary to incorporating electronic filings into the Rules of Practice, self-regulatory organizations and the Public Company Accounting Oversight Board ("PCAOB") would be required to file electronically with the Commission a copy of a record that is the subject of an appeal.

II. Discussion of Proposed Amendments

The proposed amendments are as follows:

A. Proposed Amendments to Rule 140

Rule 140[3] requires the Secretary or other authorized person to sign Commission orders and decisions. The proposed amendment would clarify that the signature may be an electronic signature. An electronic signature could consist of an "/s/" notation or any other digital signature.

B. Proposed Amendments to Rule 151

Rule 151(a)[4] currently sets forth the procedural requirements for filing papers with the Commission. The proposed amendment would require a person to make filings electronically pursuant to the requirements of Rule 152(a).[5] Filing by facsimile and in paper format would no longer be permitted absent a certification filed under Rule 152(a)(1) that explains why the person reasonably cannot comply with the electronic filing requirement. During a 90-day phase-in period after adoption, filings would have to be made in both paper and electronic format.

Rule 151(d)[6] would be amended to include an e-mail address in the certificate of service for those parties served by e-mail.

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[3] 17 CFR 201.140.

[4] 17 CFR 201.151(a).

[5] 17 CFR 201.152(a).

[6] 17 CFR 201.151(d).

Proposed new Rule 151(e)[7] would require persons to exclude or redact sensitive personal information, which would be defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued identification number, home address (other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any sensitive health information identifiable by individual, such as an individual's medical records. There would be three exceptions to the definition. First, persons may, but would not be required to, exclude or redact the last four digits of a taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number. Second, persons would not be required to redact home addresses and telephone numbers of parties and persons filing documents with the Commission. Third, persons would not be required to redact any information from copies of filings by regulated entities or registrants that are available on the Commission's public website. All filings must include a certification that any sensitive personal information has been excluded or redacted from the filing or, if necessary to the filing, has been filed under seal pursuant to Rule 322.

If the person making a filing believes that sensitive personal information is necessary to the proceeding, the person would need to file a motion for a protective order in accordance with Rule 322[8] to limit disclosure of the sensitive personal information. If review of the documents that are the subject of a motion for a protective order is necessary to a ruling on the motion, the proposed amendment to Rule 322 would require a person to file an unredacted version of the

[7] 17 CFR 201.151(e).

[8] 17 CFR 201.322.

submission to be used by the hearing officer and the Commission for purposes of the proceeding, and a redacted version to be used for distribution to the public. The unredacted version would be required to have the confidential information marked and include the words "Under Seal" on the first page of the document. The redacted version would be required to be identical in all other respects to the unredacted version. A person would not be required to file a redacted version if the submission would be redacted in its entirety. This process would be required for all kinds of motions for protective orders made pursuant to Rule 322, *i.e.*, not just those motions filed regarding sensitive personal information.

C. Proposed Amendments to Rule 152

Like Rule 151, the proposed amendments to Rule 152(a) would make clear that all filings shall be made electronically. Rule 152(a) would direct persons to follow guidance issued by the Secretary on the Commission's website at www.sec.gov. For example, the guidance would provide instructions on how to file electronically through a secure system on the Commission's website or other means; information about the Commission's Privacy Act obligations, including information about a filer's responsibilities to redact sensitive personal information; and the terms and conditions of using the website. Generally speaking, persons would use the secure system on the Commission's website pursuant to Rule 152 to file documents, such as briefs and motions and their attachments, petitions for review, and applications for review. Under Rule 152(a), papers would need to be filed on the secure system before midnight Eastern Time, as opposed to 5:30 p.m. Eastern Time, the current deadline for filing papers.

The Commission recognizes that a person involved in an administrative proceeding may be unable to submit documents electronically during either the entire proceeding or a portion thereof. For example, a person who is incarcerated at the time of the proceeding may not have access to the Internet or other electronic media necessary to file documents through the Commission's secure system. There may be other reasons why a person reasonably cannot comply with the electronic filing requirement.

A person who reasonably cannot comply with the requirement must file a certification under Rule 152(a)(1) that explains why the person reasonably cannot comply. The filing also must indicate the expected duration of the person's reasonable inability to comply, such as whether the certification is intended to apply to a solitary filing or all filings made during the proceeding. The certification is immediately effective. Upon filing the certification, it will be part of the record of the proceeding, and the person may file paper documents by any additional method listed in Rule 152(d).

Rule 152(a) would be amended to provide additional methods of filing if a person reasonably cannot comply with the electronic filing requirements. Filers should take note that the Commission would need to receive mailed, couriered, or hand-delivered filings by 5:30 p.m. Eastern Time because the Commission is unable to accept such filings after that time. The Commission would need to receive facsimile transmissions by midnight Eastern Time.

The proposed amendment also would provide that electronic filings that require a signature pursuant to Rule 153[9] may be signed with an "/s/" notation, which shall be deemed the signature of the person making the filing for purposes of Rule 153.

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[9] 17 CFR 201.153.

D. Proposed Amendments to Rule 351

Rule 351[10] currently sets forth the requirements regarding the transmittal of documents to the Secretary and the preparation, issuance, and certification of a record index. Rule 351(b)[11] requires the hearing officer to transmit to the Secretary an index of the originals of any motions, exhibits or any other documents filed with or accepted into evidence by the hearing officer that have not been previously transmitted to the Secretary. The Secretary then shall prepare a record index and transmit it to the hearing officer and serve a copy on each party. Any person may file proposed corrections to the record index with the hearing officer within fifteen days of service of the record index. The proposed amendment to Rule 351(b) would reduce that amount of time to three days but would provide persons who oppose the proposed corrections three days to file an opposition.

Proposed new Rule 351(c)[12] would state that, no later than five days after the Secretary serves a final record index, the parties shall submit electronically, through the same secure system used for filings under Rules 151 and 152, copies of all exhibits that were admitted, or offered and not admitted, during the hearing, and any other exhibits that were admitted after the hearing. The parties shall submit such evidence in the form and manner that is prescribed in the guidance posted on the Commission's website and shall certify that exhibits and other documents or items submitted to the Secretary are true and accurate copies of exhibits that were admitted, or offered and not admitted, during the hearing. Generally speaking, parties would follow Rule 351 to submit record exhibits and other documents or items that are not attached to filings, *i.e.*,

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[10] 17 CFR 201.351.

[11] 17 CFR 201.351(b).

[12] 17 CFR 201.351(c).

materials accepted into evidence by a hearing officer under Rule 351 in connection with an in-person hearing. As under Rule 151(a), the submission deadline depends on the method of delivery that is used.

As under Rule 151(e), the proposed amendment to Rule 351(c) would set forth the same definition of sensitive personal information, require its redaction or omission from all submissions under Rule 351, provide a process for seeking a protective order under Rule 322 with respect to sensitive personal information that is necessary to the proceeding, and require a certification that sensitive personal information has been excluded or redacted or filed under seal. A person who reasonably cannot submit exhibits electronically must file a certification under Rule 351(c)(2) that explains why the person reasonably cannot comply. The filing also must indicate the expected duration of the person's reasonable inability to comply, such as whether the certification is intended to apply to a solitary submission or all submissions made during the proceeding. The certification is immediately effective. Upon filing the certification, it will be part of the record of the proceeding, and the person shall submit originals of any exhibits that have not already been submitted to the Secretary by other means. Rule 351(c) also would state that electronic submissions that require a signature pursuant to Rule 153 may be signed with an "/s/" notation, which shall be deemed the signature of the person making the filing for purposes of Rule 153.

E. Phase-In Period

For the first 90 days after the proposed amendments become final, the Commission intends to administer a phase-in period that would require all filings to be made both electronically and in paper format. The Commission preliminarily believes that a 90-day phase-in period is a reasonable amount of time for persons to become proficient in the electronic filing procedures while ensuring that the Commission receives the filing should there be an electronic transmission failure. However, it may be appropriate to extend the phase-in period if persons are experiencing substantial difficulties with the electronic filing.

F. Other Proposed Amendments

Rule 150(c)[13] would be amended to require parties to serve each other electronically in the form and manner that is prescribed in the guidance posted on the Commission's website. Electronic service by e-mail is a practice that appears to occur already in administrative proceedings. Electronic service would need to occur contemporaneously with filing, and the timing of service would therefore differ depending on the filing method. As with electronic filing, a party who reasonably cannot comply with the electronic service requirement must file a certification under Rule 150(c)(1) that explains why the person reasonably cannot comply. The filing also must indicate the expected duration of the person's reasonable inability to comply, such as whether the certification is intended to apply to a solitary instance of service or all instances of service made during the proceeding. The certification is immediately effective. Upon filing the certification, it will be part of the record of the proceeding, and the person may serve paper documents by any additional method listed in Rule 150(d). Rule 150(d) would be amended to provide additional methods of service if a person reasonably cannot comply with the electronic service requirements, or if service is of an investigative subpoena pursuant to 17

[13] 17 CFR 201.150(c).

C.F.R. 203.8. Under Rule 150(e),[14] electronic service would be deemed complete upon transmission.

Rule 141(b)[15] would be amended to allow the Secretary to serve orders and decisions, other than an order instituting proceedings, electronically.

Currently, Rule 102(d)[16] requires a person to provide to the Commission certain contact information that may be used during an administrative proceeding. The proposed amendment clarifies that a mailing address and an e-mail address shall be provided under paragraphs (d)(1), (d)(2), and (d)(4).[17]

Rule 193[18] currently provides that an original and three copies of an application shall be filed under Rules 151, 152, and 153, and that such application shall be supported by a manually signed affidavit. The proposed amendment would delete the term "manually," delete the reference to one original and three copies, and leave the cross reference to Rules 151, 152, and 153 to account for electronic filing.

Rule 420[19] sets forth the requirements regarding appeals of determinations by self-regulatory organizations. Currently, Rule 420(e)[20] requires a self-regulatory organization to certify and file with the Commission one copy of the record upon which the action complained

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[14] 17 CFR 201.150(e).

[15] 17 CFR 201.141(b).

[16] 17 CFR 201.102(d).

[17] 17 CFR 201.102(d)(1), (d)(2), (d)(4).

[18] 17 CFR 201.193.

[19] 17 CFR 201.420.

[20] 17 CFR 201.420(e).

of was taken, to file with the Commission three copies of an index to such record, and to serve upon each party one copy of the index within fourteen days after receiving an application for review or a Commission order for review. The proposed amendment would require the self-regulatory organization to file such information electronically. Further, if such information contains sensitive personal information, the self-regulatory organization would be required to file electronically a copy of the record and index that redacts or omits the sensitive personal information and to certify that any sensitive personal information has been excluded or redacted. The requirements for filing and serving would continue to be governed by Rules 150-152.

Rule 440[21] sets forth the requirements regarding appeals of determinations by the PCAOB. Rule 440(d)[22] currently requires the PCAOB to certify and file with the Commission one copy of the record upon which it took the complained of action, to file with the Commission three copies of an index to such record, and to serve upon each party one copy of the index within fourteen days after receiving an application for review. The proposed amendment would require the PCAOB to file such information electronically. Further, if such information contains sensitive personal information, the PCAOB would be required to file electronically a redacted copy of the record and index that redacts or omits the sensitive personal information and to certify that any sensitive personal information has been excluded or redacted. The requirements for filing and serving would continue to be governed by Rules 150-152.

The United States Postal Service changed the name of the product known as Express Mail to Priority Mail Express. Rule 141(a)(2)(i), (ii), (iii), (vi), (a)(3) and Rule 150(a)(2), (d) would be amended to refer generically to "express mail."

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[21] 17 CFR 201.440.

[22] 17 CFR 201.440(d).

III. Request for Public Comment

We request and encourage any interested person to submit comments regarding: (1) the definition of sensitive personal information, (2) the potential adverse effects, if any, of disclosing personal e-mail addresses and home addresses of parties and persons filing documents with the Commission, (3) alternative approaches to handling personal e-mail addresses and home addresses of parties and persons filing documents with the Commission, (4) the other proposed changes that are the subject of this release, (5) additional or different changes, or (6) other matters that may have an effect on the proposals contained in this release.

IV. Administrative Procedure Act, Regulatory Flexibility Act, and Paperwork Reduction Act

The Commission finds, in accordance with Section 553(b)(3)(A) of the Administrative Procedure Act,[23] that these revisions relate solely to agency organization, procedure, or practice. They are therefore not subject to the provisions of the Administrative Procedure Act requiring notice, opportunity for public comment, and publication. The Regulatory Flexibility Act[24] therefore does not apply.[25] Nonetheless, the Commission has determined that it would be useful to publish these proposed rules for notice and comment before adoption. Because these rules relate to "agency organization, procedure or practice that does not substantially affect the rights or obligations of non-agency parties," they are not subject to the Small Business Regulatory Enforcement Fairness Act.[26] To the extent these rules relate to agency information collections

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[23] 5 U.S.C. 553(b)(3)(A).

[24] 5 U.S.C. 601- 612.

[25] *See* 5 U.S.C. 603.

[26] 5 U.S.C. 804(3)(C).

during the conduct of administrative proceedings, they are exempt from review under the Paperwork Reduction Act.[27]

V. Economic Analysis

The Commission is sensitive to the costs and benefits of its rules. The current processes and filing requirements for administrative proceedings serve as the baseline against which the economic impacts of the proposed rules are measured. At present, submissions are permitted to be filed with the Commission in paper format or by facsimile followed by a paper submission. The Commission's current Rules of Practice do not identify sensitive personal information that must be redacted from these documents by those who file them. Instead, such redaction is undertaken by the Commission when necessary in responding to document requests from the public or posting documents on the Commission's public website. Service by e-mail is already generally an accepted practice by parties to administrative proceedings who mutually agree to it, although it is not expressly permitted by rule.

The scope of the benefits and costs of the proposed rules depends on the expected volume of administrative proceedings and the number of filed documents and document requests associated with these proceedings. In fiscal year 2014, 230 new administrative proceedings were initiated and not settled immediately. New proceedings initiated and not immediately settled in fiscal years 2013 and 2012 totaled 202 and 207 respectively.[28] From 2011 to 2013, an average of

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[27] *See* 44 U.S.C. 3518(c)(1)(B)(ii); 5 CFR 1320.4 (exempting collections during the conduct of administrative proceedings or investigations).

[28] The total number of administrative proceedings initiated and not immediately settled each fiscal year encompasses a variety of types of proceedings, including proceedings instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 seeking to determine whether it is necessary and appropriate for the protection of investors to suspend or revoke the registration of an issuer's securities and proceedings instituted under Section 15(b) of the

approximately 1,900 filings were submitted per fiscal year in relation to litigated proceedings, including filings by outside parties as well as Commission staff. These filings consist of one or more documents, such as motions, briefs, and record exhibits, and the length of the filings generally ranges from one page to a few thousand pages. The Commission also received numerous requests from the public to release documents related to these proceedings. Requests for records related to administrative proceedings (both settled and litigated) numbered 127, 83, and 100 for fiscal years 2013, 2012, and 2011 respectively.

The implementation of electronic filing and the related proposed rules are intended to improve the efficiency and transparency of the Commission's operations and to modernize the document management process to be consistent with common practice in other tribunals. Benefits of the proposed rules are anticipated to accrue to the public and outside parties to administrative proceedings as well as the Commission.

Specifically, the proposed rules may benefit members of the public with an interest in the Commission's administrative proceedings by permitting the Commission to more quickly make public the documents relating to these proceedings. The proposed rules may increase the speed at which information from administrative proceedings is transmitted as well as the overall transparency of these proceedings. Additionally, parties to administrative proceedings may benefit from the increased flexibility enabled by the changes, such as the Commission's acceptance of electronic and facsimile submissions until midnight rather than the close of business on a given day. These parties may also benefit from savings on printing and mailing costs because, after the phase-in period, filing paper copies generally will not be required. In

Exchange Act or Section 203(f) of the Investment Advisers Act of 1940 seeking to determine what, if any, remedial action is appropriate in the public interest.

addition, the changes expressly require service by electronic means, which may increase further the savings in printing and mailing. The Commission's response to document requests is expected to be more time- and cost-effective due to the efficiency of electronic retrieval and the fact that sensitive information will have been redacted in advance. However, the magnitude of the above benefits is difficult to quantify due to the limitations of existing data.

The costs of the proposal will be borne by the Commission as well as the outside parties to administrative proceedings. The proposed rules place the primary burden of redacting sensitive personal information on the parties submitting documents in administrative proceedings—either outside parties or Commission staff—following common practice in federal courts. The Commission believes that parties filing documents are well positioned to redact the documents—or initially draft documents to avoid the use of sensitive personal information—and that the proposed narrow definition of sensitive personal information will limit the burden on parties required to redact documents. The Commission recognizes, however, that the costs of reviewing and editing the content to protect sensitive information might be significant for some parties. Additionally, when sensitive personal information is necessary to the proceedings, outside parties or the Commission may expend additional resources filing a motion for a protective order in accordance with Rule 322 to limit disclosure of the sensitive information and to prepare a redacted and unredacted version of the documents.

Parties to administrative proceedings will also bear any incremental burden of electronic filings over the current practice of facsimile or paper transmissions. The magnitude of costs will depend primarily on whether the original format of the documents to be submitted is electronic or whether they must be scanned or otherwise converted to an electronic format. Other factors that may affect these costs include the ease of access the party has to the internet and to any hardware and software that may be involved in processing the documents. For most parties, we do not expect these costs to be significant because, among other things, most parties already are subject to similar requirements in other kinds of legal proceedings or have access to the Internet and conversion programs at a reasonable cost. Further, these potential burdens may be mitigated for some parties as the proposed rules provide for relief from the electronic filing requirements in situations in which a party certifies a reasonable inability to comply with the electronic filing requirements.

As an alternative to the proposed rules, the Commission could implement electronic filing with different requirements. In particular, the Commission could continue to allow the filing of unredacted documents—requiring that redaction be undertaken by Commission staff when necessary—or could permit electronic filing on a voluntary, rather than mandatory, basis. Relative to these alternatives, or to the existing paper format and facsimile document submission and management system for administrative proceedings, the Commission believes that the proposed changes achieve the benefits described above in a cost-efficient manner. The Commission does not expect significant effects on efficiency, competition, or capital formation to result from the proposed changes. And to the extent that the changes impose any burden on competition, the Commission believes that such burden would be necessary and appropriate in furtherance of the purposes of the Exchange Act.[29]

The Commission requests comment on all aspects of the economic effects of the proposal, including any anticipated impacts that are not mentioned here. We are particularly

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[29] *See* 15 U.S.C. 78w(a)(2).

interested in quantitative estimates of the benefits and costs, in general or for particular types of participants in administrative proceedings, including smaller entities. We also request comment on reasonable alternatives to the proposed rules and on any effect the proposed rules may have on efficiency, competition, and capital formation.

VI. Statutory Basis and Text of Proposed Amendments

These amendments to the Rules of Practice are being proposed pursuant to statutory authority granted to the Commission, including section 3 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7202; section 19 of the Securities Act, 15 U.S.C. 77s; sections 4A, 19, and 23 of the Exchange Act, 15 U.S.C. 78d-1, 78s, and 78w; section 319 of the Trust Indenture Act of 1939, 15 U.S.C. 77sss; sections 38 and 40 of the Investment Company Act, 15 U.S.C. 80a-37 and 80a-39; and section 211 of the Investment Advisers Act, 15 U.S.C. 80b-11.

List of Subjects

17 CFR Part 201

Administrative practice and procedure.

Text of the Amendments

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:

PART 201 – RULES OF PRACTICE

4. The authority citation for Part 201, subpart D, is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77h-1, 77j, 77s, 77u, 78c(b), 78d-1, 78d-2, 78*l*, 78m, 78n, 78o(d), 78o-3, 78s, 78u-2, 78u-3, 78v, 78w, 77sss, 77ttt, 80a-8, 80a-9, 80a-37, 80a-38, 80a-39, 80a-40, 80a-41, 80a-44, 80b-3, 80b-9, 80b-11, 80b-12, 7202, 7215, and 7217.

5. § 201.102 is amended by revising paragraphs (d), (d)(2) and (d)(4) to read as follows:

§ 201.102 Appearance and practice before the Commission.

* * * * *

(d) *Designation of address for service; notice of appearance; power of attorney; withdrawal*—(1) *Representing oneself.* When an individual first makes any filing or otherwise appears on his or her own behalf before the Commission or a hearing officer in a proceeding as defined in § 201.101(a), he or she shall file with the Commission, or otherwise state on the record, and keep current, a mailing address and e-mail address at which any notice or other written communication required to be served upon him or her or furnished to him or her may be sent and a telephone number where he or she may be reached during business hours.

(2) *Representing others.* When a person first makes any filing or otherwise appears in a representative capacity before the Commission or a hearing officer in a proceeding as defined in § 201.101(a), that person shall file with the Commission, and keep current, a written notice stating the name of the proceeding; the representative's name, business address, e-mail address, and telephone number; and the name, e-mail address, and address of the person or persons represented.

* * * * *

(4) *Withdrawal.* Any person seeking to withdraw his or her appearance in a representative capacity shall file a notice of withdrawal with the Commission or the hearing officer. The notice shall state the name, mailing address, e-mail address, and telephone number of the withdrawing representative; the name, address, and telephone number of the person for whom the appearance was made; and the effective date of the withdrawal. If the person seeking

to withdraw knows the name, mailing address, e-mail address, and telephone number of the new representative, or knows that the person for whom the appearance was made intends to represent him- or herself, that information shall be included in the notice. The notice must be served on the parties in accordance with § 201.150. The notice shall be filed at least five days before the proposed effective date of the withdrawal.

* * * * *

6. § 201.140 is amended by revising paragraph (a).

The revisions read as follows:

§ 201.140 Commission Orders and Decisions: Signature and Availability.

* * * * *

(a) *Signature required.* All orders and decisions of the Commission shall be signed by the Secretary or any other person duly authorized by the Commission. The signature may be an electronic signature that consists of an "/s/" notation or any other digital signature.

* * * * *

7. § 201.141 is amended by:

a. Removing each time they appear the words "Express Mail" and, in their place, adding the words "express mail"; and

b. Revising the first sentence of paragraph (b).

The revisions read as follows:

§ 201.141 Orders and decisions: Service of orders instituting proceedings and other orders and decisions.

* * * * *

(b) *Service of Orders or Decisions Other than an Order Instituting Proceedings*. Written orders or decisions issued by the Commission or by a hearing officer shall be served promptly on each party pursuant to any method of service authorized under paragraph (a) of this Rule or Rule 150(c) and (d). * * *

8. § 201.150 is amended by:

a. Redesignating paragraphs (c) and (d) as paragraphs (d) and (e);

b. Adding new paragraph (c);

c. Revising new paragraphs (d) and (d)(4);

d. Revising new paragraph (e); and

e. Removing each time they appear the words "Express Mail" and, in their place, adding the words "express mail".

The revisions read as follows:

§ 201.150 Service of papers by parties.

* * * * *

(c) *How Made*. Service shall be made electronically in the form and manner that is prescribed in the guidance posted on the Commission's website. Persons serving each other shall have provided the Commission and the parties with notice of an e-mail address.

(1) *Certification of Inability to Serve Electronically*. If a person reasonably cannot serve electronically, due to a lack of access to electronic transmission devices (due to incarceration or otherwise), the person promptly shall file a certification under this paragraph that explains why

the person reasonably cannot comply. The filing also must indicate the expected duration of the person's reasonable inability to comply, such as whether the certification is intended to apply to a solitary instance of service or all instances of service made during the proceeding. The certification is immediately effective. Upon filing the certification, it will be part of the record of the proceeding, and the person may serve paper documents by any additional method listed in Rule 150(d).

(d) *Additional methods of service*. If a person reasonably cannot serve electronically, or if service is of an investigative subpoena pursuant to 17 C.F.R. 203.8, service may be made by delivering a copy of the filing. *Delivery* means:

* * * * *

(4) Transmitting the papers by facsimile transmission to the person required to be served. The persons so serving each other shall have provided the Commission and the parties with notice of a facsimile machine telephone number.

(e) *When service is complete.* Electronic service is complete upon transmission. Personal service, service by U.S. Postal Service express mail or service by a commercial courier or express delivery service is complete upon delivery. Service by mail is complete upon mailing. Service by facsimile is complete upon confirmation of transmission.

9. § 201.151 is amended by:

a. Revising paragraph (a);

b. Revising paragraph (d); and

c. Adding paragraph (e).

The revisions read as follows:

§ 201.151 Filing of papers with the Commission: Procedure.

(a) *When to file.* All papers required to be served upon any person shall also be filed contemporaneously with the Commission electronically pursuant to the requirements of § 201.152(a). The person making such filing is responsible for ensuring that the Commission receives a complete and legible filing within the time limit set for such filing. Documents that are attached to filings shall be filed in accordance with this Rule. Documents or items that are not attached to filings (*i.e.*, are admitted by the hearing officer at an in-person hearing), shall be submitted in accordance with § 201.351.

* * * * *

(d) *Certificate of service.* Papers filed with the Commission or a hearing officer shall be accompanied by a certificate stating the name of the person or persons served, the date of service, the method of service, and the mailing address or e-mail address to which service was made, if not made in person.

(e) *Sensitive personal information.* Sensitive personal information is defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued identification number, home address (other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any sensitive health information identifiable by individual, such as an individual's medical records. Sensitive personal information shall not be included in, and must be redacted or omitted from, all filings subject to:

(1) *Exceptions*. The following information may be included and is not required to be redacted from filings:

(i) The last four digits of a taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number;

(ii) Home addresses and telephone numbers of parties and persons filing documents with the Commission;

(iii) Business telephone numbers; and

(iv) Copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website.

(2) *Confidential treatment of information.* If the person making any filing believes that sensitive personal information (as defined above) contained therein is necessary to the proceeding, the person shall file unredacted documents, along with a motion for a protective order in accordance with § 201.322 to limit disclosure of unredacted sensitive personal information.

(3) *Certification.* Any filing must include a certification that any sensitive personal information as defined in § 201.151(e) has been excluded or redacted from the filing or, if necessary to the filing, has been filed under seal pursuant to § 201.322.

10. § 201.152 is amended by:

a. Redesignating paragraph (a) as paragraph (b);

b. Removing new paragraph (b)(6);

c. Adding new paragraph (a);

d. Removing paragraph (d);

e. Redesignating paragraphs (b) and (c) as paragraphs (c) and (d);

f. Revising new paragraph (b); and

g. Revising new paragraph (c);

h. Removing the phrase "or microfilming" from paragraph (d).

The revisions read as follows:

§ 201.152 Filing of papers: Form.

(a) *Electronic filing.* Papers filed in connection with any proceeding as defined in §201.101(a) shall be filed electronically in the form and manner that is prescribed in the guidance posted on the Commission's website. Papers filed electronically must be received by the Commission by midnight Eastern Time on the date the filing is due.

(1) *Certification of Inability to File Electronically.* If a person reasonably cannot comply with the requirements of this Rule, due to a lack of access to electronic transmission devices (due to incarceration or otherwise), the person promptly shall file a certification under this paragraph that explains why the person reasonably cannot comply. The filing also must indicate the expected duration of the person's reasonable inability to comply, such as whether the certification is intended to apply to a solitary filing or all filings made during the proceeding. The certification is immediately effective. Upon filing the certification, it will be part of the record of the proceeding, and the person may file paper documents by any additional method listed in § 201.152(a)(2).

(2) *Additional methods of filing.* If a person reasonably cannot file electronically, filing may be made by hand delivering the filing by 5:30 p.m. Eastern Time through a commercial courier service or express delivery service; mailing the filing through the U.S Postal Service by first class, certified, registered, or express mail delivery so that it is received by the Commission

by 5:30 p.m. Eastern Time; or transmitting the filing by facsimile transmission so that it is received by the Commission by midnight Eastern Time.

(b) *Form.* Papers filed in connection with any proceeding as defined in § 201.101(a) shall:

(1) Reflect a page, electronically or otherwise, that measures 8½ × 11 inches when printed, except that, to the extent that the reduction of larger documents would render them illegible when printed, such documents may be filed on larger paper;

(2) Use 12-point or larger typeface;

(3) Include at the head of the paper, or on a title page, the name of the Commission, the title of the proceeding, the names of the parties, the subject of the particular paper or pleading, and the file number assigned to the proceeding;

(4) Be paginated with left hand margins at least 1 inch wide, and other margins of at least 1 inch; and

(5) Be double-spaced, with single-spaced footnotes and single-spaced indented quotations.

(c) *Signature required.* All papers must be dated and signed as provided in § 201.153. Electronic filings that require a signature pursuant to § 201.153 may be signed with an "/s/" notation, which shall be deemed the signature of the person making the filing for purposes of § 201.153.

(d) *Suitability for recordkeeping.* Documents which, in the opinion of the Commission, are not suitable for computer scanning may be rejected.

* * * * *

11. § 201.193 is amended by revising the introductory text of paragraph (b).

The revisions read as follows:

§ 201.193 Applications by barred individuals for consent to associate.

* * * * *

(b) *Form of application.* Each application shall be supported by an affidavit, signed by the applicant, that addresses the factors set forth in paragraph (d) of this section. The application shall be filed pursuant to §§ 201.151, 201.152 and 201.153. Each application shall include as exhibits:

* * * * *

12. § 201.322 is amended by:

a. Revising paragraph (a);

b. Redesignating paragraphs (b), (c), and (d) as paragraphs (c), (d), and (e); and

c. Adding new paragraph (b).

§ 201.322 Evidence: Confidential information, protective orders.

(a) *Procedure.* In any proceeding as defined in § 201.101(a), a party, any person who is the owner, subject or creator of a document subject to subpoena or which may be introduced as evidence, or any witness who testifies at a hearing may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that contain confidential information. The motion should include a general summary or extract of the documents without revealing confidential details.

(b) If review of the documents that are the subject of a request for a protective order is necessary to a ruling on the motion and the information as to which a protective order is sought is available to the movant, the motion shall be accompanied by:

(1) A complete, sealed copy of the materials containing the information as to which a protective order is sought, with the allegedly confidential information marked as such, and with the first page of the document labeled "Under Seal." If the movant seeks a protective order against disclosure to other parties as well as the public, copies of the documents shall not be served on other parties; and

(2) A redacted copy of the materials containing the information as to which a protective order is sought, with the allegedly confidential information redacted. The redacted version shall indicate any omissions with brackets or ellipses, and its pagination and depiction of text on each page shall be identical to that of the sealed version. A redacted copy need not accompany a motion requesting a protective order if the materials would be redacted in their entirety.

* * * * *

13. § 201.351 is amended by:

a. Revising paragraph (b);

b. Redesignating paragraph (c) as paragraph (d); and

c. Adding new paragraph (c).

The revisions read as follows:

§ 201.351 Transmittal of documents to Secretary; record index; electronic copy of exhibits; certification.

* * * * *

(b) *Preparation, certification of record index.* Promptly after the close of the hearing, the hearing officer shall transmit to the Secretary an index of the originals of any motions, exhibits or any other documents filed with or accepted into evidence by the hearing officer that have not been previously transmitted to the Secretary, and the Secretary shall prepare a record index. Prior to issuance of an initial decision, or if no initial decision is to be prepared, within 30 days of the close of the hearing, the Secretary shall transmit the record index to the hearing officer and serve a copy of the record index on each party. Any person may file proposed corrections to the record index with the hearing officer within three days of service of the record index. Any opposition to the proposed corrections shall be filed within three days of service of the proposed corrections. The hearing officer shall, by order, direct whether any corrections to the record index shall be made. The Secretary shall make such corrections, if any, and issue a revised record index. If an initial decision is to be issued, the initial decision shall include a certification that the record consists of the items set forth in the record index or revised record index issued by the Secretary.

(c) *Electronic exhibits*. Within two weeks after the close of a hearing, the parties shall submit electronically to the Secretary a copy of all exhibits that were admitted, or offered and not admitted, during the hearing, and any other exhibits that were admitted after the hearing. The parties shall submit such evidence in the form and manner that is prescribed in the guidance posted on the Commission's website.

(1) *Sensitive personal information.* Sensitive personal information is defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued identification number, home address (other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any sensitive health information identifiable by individual, such as an individual's medical records. Sensitive personal information shall not be included in, and must be redacted or omitted from, all filings subject to:

(i) *Exceptions*. The following information may be included and is not required to be redacted from filings:

(A) The last four digits of a taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number;

(B) Home addresses and telephone numbers of parties and persons filing documents with the Commission;

(C) Business telephone numbers; and

(D) Copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website.

(ii) *Confidential treatment of information.* If the person submitting record exhibits and other documents or items that are not attached to filings believes that sensitive personal information (as defined above) contained therein is necessary to the proceeding, the person shall file unredacted documents, along with a motion for a protective order in accordance with § 201.322 to limit disclosure of unredacted sensitive personal information.

(2) *Certification of Inability to Submit Exhibits Electronically.* A person who reasonably cannot submit exhibits electronically must file a certification under § 201.351(c)(2) that explains why the person reasonably cannot comply. The filing also must indicate the expected duration of the person's reasonable inability to comply, such as whether the certification is intended to apply to a solitary submission or all submissions made during the proceeding. The certification is immediately effective. Upon filing the certification, it will be part of the record of the proceeding, and the person shall submit originals of any exhibits that have not already been submitted to the Secretary by other means.

(3) *Signature requirement.* Electronic submissions that require a signature pursuant to § 201.153 may be signed with an "/s/" notation, which shall be deemed the signature of the person making the submission for purposes of § 201.153.

(4) *Certification.* The parties shall certify that exhibits and other documents or items submitted to the Secretary under this rule:

(i) are true and accurate copies of exhibits that were admitted, or offered and not admitted, during the hearing; and

(ii) that any sensitive personal information as defined in § 201.351(c) has been excluded or redacted, or, if necessary, has been filed under seal pursuant to § 201.322

(d) *Final transmittal of record items to the Secretary.* * * * * *

14. § 201.420 is amended by revising paragraph (e).

The revisions read as follows:

§ 201.420 Appeal of determinations by self-regulatory organizations.

* * * * *

(e) *Certification of the record; service of the index.* Fourteen days after receipt of an application for review or a Commission order for review, the self-regulatory organization shall certify and file electronically in the form and manner that is prescribed in the guidance posted on the Commission's website one unredacted copy of the record upon which the action complained of was taken. If such record contains any sensitive personal information, as defined in paragraph (e)(1) of this Rule, the self-regulatory organization also shall file electronically with the Commission one redacted copy of such record, subject to the following:

(1) *Sensitive personal information.* Sensitive personal information is defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued identification number, home address (other than city and state), telephone number, date of birth (other than year), names and

initials of minor children, as well as any sensitive health information identifiable by individual, such as an individual's medical records. Sensitive personal information shall not be included in, and must be redacted or omitted from, all filings subject to:

(i) *Exceptions.* The following information may be included and is not required to be redacted from filings:

(A) The last four digits of a taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number;

(B) Home addresses and telephone numbers of parties and persons filing documents with the Commission;

(C) Business telephone numbers; and

(D) Copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website.

(2) The self-regulatory organization also shall file electronically with the Commission one copy of an index to such record, and shall serve upon each party one copy of the index. If such index contains any sensitive personal information, as defined in paragraph (e)(1) of this Rule, the self-regulatory organization also shall file electronically with the Commission one redacted copy of such index, subject to the requirements of paragraphs (e)(1) and (e)(1)(i).

(3) *Certification.* Any filing made pursuant to this Rule must include a certification that any sensitive personal information as defined in § 201.420(e)(1) has been excluded or redacted from the filing.

15. § 201.440 is amended by revising paragraph (d).

§ 201.440 Appeal of determinations by the Public Company Accounting Oversight Board.

* * * * *

(d) *Certification of the record; service of the index.* Within fourteen days after receipt of an application for review, the Board shall certify and file electronically in the form and manner that is prescribed in the guidance posted on the Commission's website one unredacted copy of the record upon which it took the complained-of action. If such record contains any sensitive personal information, as defined in paragraph (d)(1) of this Rule, the Board also shall file electronically with the Commission one redacted copy of such record, subject to the following:

(1) *Sensitive personal information.* Sensitive personal information is defined as a Social Security number, taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, state-issued identification number, home address (other than city and state), telephone number, date of birth (other than year), names and initials of minor children, as well as any sensitive health information identifiable by individual, such as an individual's medical records. Sensitive personal information shall not be included in, and must be redacted or omitted from, all filings subject to:

(i) *Exceptions.* The following information may be included and is not required to be redacted from filings:

(A) The last four digits of a taxpayer identification number, financial account number, credit card or debit card number, passport number, driver's license number, and state-issued identification number;

(B) Home addresses and telephone numbers of parties and persons filing documents with the Commission;

(C) Business telephone numbers; and

(D) Copies of unredacted filings by regulated entities or registrants that are available on the Commission's public website.

(2) The Board shall file electronically with the Commission one copy of an index of such record, and shall serve one copy of the index on each party. If such index contains any sensitive personal information, as defined in paragraph (d)(1) of this Rule, the Board also shall file electronically with the Commission one redacted copy of such index, subject to the requirements of paragraphs (d)(1) and (d)(1)(i).

(3) *Certification.* Any filing made pursuant to this Rule must include a certification that any sensitive personal information as defined in § 201.440(d)(1) has been excluded or redacted from the filing.

By the Commission.

Brent J. Fields
Secretary

September 24, 2015

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75989 / September 25, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16832

In the Matter of **Advanced Battery Technologies, Inc., Chauvin Enterprises, Inc. (a/k/a Internet Solutions for Business, Inc., a/k/a International Solutions for Business, Inc.), and Oilsands Quest 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 Advanced Battery Technologies, Inc., Chauvin Enterprises, Inc. (a/k/a Internet Solutions for Business, Inc., a/k/a International Solutions for Business, Inc.), and Oilsands Quest Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Advanced Battery Technologies, Inc. (CIK No. 745651) is a delinquent Delaware corporation located in Shuangcheng, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Battery Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for June 30, 2011. As of September 8, 2015, the company's stock (symbol "ABAT") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link").

2. Chauvin Enterprises, Inc. (a/k/a Internet Solutions for Business, Inc., a/k/a International Solutions for Business, Inc.) (CIK No. 1097394) is a merged Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Chauvin Enterprises is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB on January 31, 2000.

3. Oilsands Quest Inc. (CIK No. 1096791) is a Colorado corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Oilsands Quest is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q on January 31, 2012, which reported a net loss of $733,669,000 from the company's April 3, 1998 inception through January 31, 2012.

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's Rules of Practice.

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

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

By the Commission.

Brent J. Fields
Secretary

By: Robert W. Errett
Deputy Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75990 / September 28, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4210 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16833

In the Matter of

Marcello Trebitsch,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND 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 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Marcello Trebitsch (a/k/a Yair Trebitsch) ("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 Section III.2. below, and consents to the entry of this Order Instituting

Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940 and 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. During the relevant time period, Respondent acted as an unregistered broker and held himself out as an investment adviser in connection with his ownership and control of Allese Capital, an unregistered limited liability company, through which Respondent solicited investors, provided investment advice, executed trades, and obtained compensation. Respondent is 37 and is a resident of Brooklyn, New York.

2. On July 13, 2015, Respondent entered a plea of guilty to one count of securities fraud in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated thereunder before the United States District Court for the Southern District of New York in United States v. Marcello Trebitsch, Case No. 15-cr-00450-VSB.

3. The count of the criminal information to which Respondent pled guilty alleged, inter alia, that Respondent willfully and knowingly defrauded investors and obtained money and property by soliciting more than $8 million from investors based on false and misleading representations that he would use the money to invest on their behalf when, in fact, Respondent used only a portion of the investors' money to invest as promised and used the remainder for his own personal benefit and the benefit of others, including to repay other investors.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act and Section 15(b)(6) of the Exchange Act that Respondent Trebitsch 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 Trebitsch 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. 76002 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16840

In the Matter of **The Money Tree Lending Group, Inc., PEP Management Corp., Pop Starz Ventures 2, Inc., and Primo World Markets 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 The Money Tree Lending Group, Inc., PEP Management Corp., Pop Starz Ventures 2, Inc., and Primo World Markets Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The Money Tree Lending Group, Inc. ("The Money Tree") (CIK No. 1294605) is a void Delaware corporation located in Port Charlotte, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). The Money Tree is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended February 28, 2005, which reported a net loss of $1,600 from the company's June 7, 2004 inception to February 28, 2005.

2. PEP Management Corp. ("PEP Management") (CIK No. 1111907) is an inactive Florida corporation located in Clearwater, Florida with a class of securities

registered with the Commission pursuant to Exchange Act Section 12(g). PEP Management is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on April 21, 2000.

3. Pop Starz Ventures 2, Inc. ("Pop Starz") (CIK No. 1441637) is a void Delaware corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pop Starz 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, 2009, which reported a net loss of $9,870 for the prior nine months.

4. Primo World Markets Ltd. ("Primo World") (CIK No. 1507629) is a void Delaware corporation located in Dade City, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Primo World is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on December 13, 2010.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76003 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16841

In the Matter of Paygard, Inc., Quantum Companies, Inc., and Reidco Acquisition I, 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 Paygard, Inc., Quantum Companies, Inc., and Reidco Acquisition I, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Paygard, Inc. (CIK No. 1106976) is a permanently revoked Nevada corporation located in London, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Paygard 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, 2003, which reported a net loss of over $15.9 million for the prior twelve months.

2. Quantum Companies, Inc. (CIK No. 1106599) is a Nevada corporation located in Santa Monica, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Quantum Companies 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, 2006, which reported a net loss of $26,692 for the prior twelve months.

3. Reidco Acquisition I, Inc. (CIK No. 1378044) is a void Delaware corporation located in Henderson, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Reidco is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2009, which reported a net loss of $13,648 for the prior nine months.

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

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75992 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16835

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

I.

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

II.

In anticipation of the institution of these proceedings, Credit Suisse has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Credit Suisse admits the facts set forth in Section III below, acknowledges that its conduct violated the federal securities laws, admits the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

It is a fundamental obligation of broker-dealers to provide complete and accurate blue sheet data when requested by representatives of the Commission to do so. The submission of complete and accurate blue sheet data is critical to many aspects of the Commission's operations and its ability to discharge its enforcement and regulatory mandates. The failure of a broker-dealer to provide complete and accurate blue sheet information in response to a Commission request can impact the Commission's ability to discharge its statutory obligations, undermine the integrity of its investigations and examinations, and ultimately interfere with the Commission's ability to protect investors.

This action results from Credit Suisse's violation of the recordkeeping and reporting requirements of Section 17(a) of the Exchange Act and Rules 17a-4(j) and 17a-25 thereunder. From January 2012 to January 2014 (the "relevant period"), Credit Suisse failed to provide required accurate and complete blue sheet submissions to the Commission, resulting in at least 593 deficient blue sheet submissions to the Commission by the firm, thereby omitting more than 553,400 reportable trades representing 1.3 billion shares.[1]

Section 17 of the Exchange Act imposes on broker-dealers recordkeeping and reporting requirements that are essential to the Commission's ability to enforce the federal securities laws and to protect investors. To ensure the continued effectiveness of the Commission's enforcement and regulatory programs, broker-dealers must comply with, among other things: Rule 17a-25, requiring that broker-dealers submit electronically securities transaction information upon request by the Commission; and Rule 17a-4(j), requiring broker-dealers to furnish promptly legible, true, complete, and current copies of required records upon request by a representative of the Commission. Credit Suisse failed to comply with these requirements, as described below.

Respondent

1. **Credit Suisse Securities (USA) LLC** ("Credit Suisse") is a Delaware limited liability company with headquarters in New York, New York. Credit Suisse is a broker-dealer registered with the Commission. Credit Suisse is a wholly-owned subsidiary of Credit Suisse (USA), Inc., which is an indirect wholly-owned subsidiary of Credit Suisse Group AG.

Facts

A. Credit Suisse's Blue Sheet Discrepancies

Discovery of the Blue Sheet Discrepancies

2. In connection with a related investigation, the staff compared the blue sheet submissions from certain broker-dealers to equity cleared data from the National Securities

[1] Blue sheets are electronic forms that are generated by market makers, brokers and/or clearing firms in response to requests by the Commission and/or securities industry self-regulatory organizations ("SROs"), that provide detailed information about trades performed by a firm and its customers.

Clearing Corporation ("NSCC") for the same broker-dealers and the same period of time. If accurate, the reported transactions reflected on the broker-dealer's blue sheet submissions should have matched the transactions set forth in NSCC's equity cleared data. Through this analysis, the staff discovered apparent discrepancies in Credit Suisse's blue sheet submissions.

3. On March 28, 2013, the staff contacted Credit Suisse concerning the apparent discrepancies. Independently, on February 21, 2013, more than one month earlier, Credit Suisse disclosed to FINRA certain blue sheet discrepancies. In response to the staff's inquiry, Credit Suisse acknowledged blue sheet data discrepancies, advised the staff of the disclosure to FINRA, and maintained that it was in the process of correcting the issues. As part of this disclosure, Credit Suisse identified certain technological and human errors as the root cause of the deficient blue sheet submissions to the Commission and FINRA.

4. Credit Suisse notified the Commission staff on July 13, 2015, that it had corrected and fully remediated the errors responsible for its deficient blue sheet submissions.

Causes of the Blue Sheet Discrepancies

Migration to New Blue Sheets Reporting System

5. In November of 2012, Credit Suisse migrated to a new blue sheets reporting system and experienced a number of processing problems that resulted in a total of approximately 347 deficient blue sheet submissions to the Commission and approximately 163 deficient blue sheet submissions to FINRA.

6. In December 2012 and January 2013, another migration issue resulting from a coding error caused 51 additional deficient submissions to the Commission and 98 deficient submissions to FINRA.

7. Further, from November of 2013 to January of 2014, certain trades were not uploaded into the blue sheets reporting system as a result of the inadvertent failure to remove a "dry run" flag following certain testing procedures of the then-new system, which impacted an additional 42 blue sheet submissions to the Commission and 116 blue sheet submissions to FINRA.

Order Management System Errors

8. During the relevant period, Credit Suisse employed an order management system. One of the functions of the order management system was to interact with the blue sheets reporting system and provide the underlying data for the blue sheet submissions.

9. In August 2012, when Credit Suisse launched the next generation of the order management system, the blue sheets reporting system utilized by the company at the time failed to properly extract blue sheet data, which impacted a total of 70 blue sheet submissions to the Commission and 79 blue sheet submissions to FINRA.

10. Further, from September 2012 through January 2013, Credit Suisse's blue sheets reporting system was unable to properly recognize otherwise reportable transactions because of a coding error in one of the order management system's applications. This error resulted in Credit Suisse omitting trades in 83 blue sheet submissions to the Commission and 190 blue sheet submissions to FINRA.

Inadequate System for Validating Accuracy of Blue Sheets

11. The technological and human errors that caused Credit Suisse's blue sheet reporting failures persisted for an extended period due in part to Credit Suisse's system for validating the accuracy of its blue sheet submissions, which spread the responsibility for overseeing the accuracy and completeness of blue sheet reporting across multiple departments in different geographic locations. Further, the selection of testing criteria to validate the accuracy of blue sheet submissions, such as sample size, was not uniform but, rather, left to the discretion of a front line manager.

12. In April 2013, Credit Suisse retained an information technology consulting firm to assist it in diagnosing and remediating the problems with its blue sheets reporting system and to analyze the flow of data through the system to strengthen its reliability. In November 2013, Credit Suisse retained a consulting firm that specialized in regulatory compliance to review its blue sheets reporting system.

13. In February 2015, Credit Suisse notified the Commission staff that it had implemented several changes to ensure the accuracy of its blue sheets including measures designed to prevent, detect, and correct any possible blue sheet data errors. These changes included, among other things, installation of controls designed to detect incomplete data transfers and the implementation of enhancements to its validation procedures.

Additional Data Discrepancies Reported by Credit Suisse

14. On June 25, 2015, Credit Suisse notified the staff that it had discovered four additional issues that impacted 502 blue sheet submissions to the Commission and 260 blue sheet submissions to FINRA. All four of the issues were discovered as a result of Credit Suisse's recent modifications to its blue sheets reporting system architecture, controls, and oversight.

15. Three of the problems were caused by legacy issues relating to the transfer of data between the firm's trade capture system for processing prime brokerage services activity and the firm's blue sheets reporting system. These issues occurred before Credit Suisse completed the installation of its new system modifications and were detected by the firm's modified validation procedures.

16. The fourth issue was due to human error in manually uploading data to the archival data repository from which Credit Suisse generates its blue sheet submissions. This

problem was also detected by Credit Suisse's modified validation procedures. Credit Suisse has made additional changes to its front office order management system that are designed to reduce the risk of such errors.

B. Violations of the Federal Securities Laws

17. As described above, Credit Suisse failed to furnish complete records to the Commission staff that were requested by the Commission staff in its blue sheet requests. Therefore, Credit Suisse willfully violated Section 17(a) of the Exchange Act and Exchange Act Rule 17a-4(j), which require a broker-dealer to "furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the [broker-dealer] that are required to be preserved under [Rule 17a-4], or any other records of the [broker-dealer] subject to examination under section 17(b) of the [Exchange Act] that are requested by the representative of the Commission."[2]

18. Additionally, Credit Suisse willfully violated Section 17(a) of the Exchange Act and Exchange Act Rule 17a-25 by failing to electronically submit certain securities transaction information to the Commission upon request through the blue sheets reporting system.

C. Credit Suisse's Remedial Efforts

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

IV.

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

Accordingly, pursuant to Sections 15(b)(4) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Credit Suisse shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rules 17a-4(j) and 17a-25 thereunder.

B. Respondent Credit Suisse is censured.

C. Respondent Credit Suisse shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $4,250,000 ($4.25 million) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act

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

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 Credit Suisse 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 Sharon B. Binger, Regional Director, Philadelphia Regional Office, Securities and Exchange Commission, One Penn Center, 1617 John F. Kennedy Blvd., Suite 520, Philadelphia, Pennsylvania 19103-1844.

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

By the Commission.

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. 75996 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16836

In the Matter of **STEVEN J. MUEHLER, ALTERNATIVE SECURITIES MARKETS GROUP CORP., AND BLUE COAST SECURITIES CORP., dba GLOBALCROWDTV, INC., AND BLUE COAST BANC,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO 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 Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Steven J. Muehler, Alternative Securities Markets Group Corp. ("ASMG"), and Blue Coast Securities Corp. ("Blue Coast"), dba GlobalCrowdTV, Inc. and Blue Coast Banc (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Steven J. Muehler ("Muehler"), age 40, resides in Marina Del Rey, California. He is not registered with the Commission in any capacity and is not associated with a registered broker-dealer. He founded ASMG and Blue Coast and was fully responsible for their operations at all relevant times. In April 2009, the Minnesota Department of Commerce issued a cease-and-desist order against Muehler and a Muehler-controlled company, ordering them to cease and desist from fraudulent conduct in the offer of unregistered securities and from acting as an unregistered broker-dealer in Minnesota. In August 2010, the California Department of Corporations found that Muehler and a Muehler-controlled entity had offered unregistered securities to at least one investor in California and ordered them to desist and refrain from doing so.

2. Alternative Securities Markets Group Corporation, also known as Alternative Securities Markets Group, is a California corporation located in Marina Del Rey, California. It is not registered with the Commission in any capacity and was owned, operated, and controlled by Muehler at all relevant times. Although ASMG was incorporated in October 2014, Muehler used the name to do business as early as April 2014.

3. Blue Coast Securities Corp., dba GlobalCrowdTV, Inc. and Blue Coast Banc, is a California corporation located in Marina Del Rey, California. It is not registered with the Commission in any capacity and was owned, operated, and controlled by Muehler at all relevant times.

B. RESPONDENTS' FRAUDULENT SCHEME AND UNLAWFUL BROKER-DEALER ACTIVITY

SUMMARY

1. Since at least August 2013, Muehler and his companies, Blue Coast and ASMG, have offered to help small businesses raise money from investors. The Respondents offer to structure and prepare securities offerings, shepherd the offerings through the Commission review process, and then market the securities to the investing public. Although none of them was registered as a broker-dealer, and Muehler was not associated with a registered broker-dealer, during this time, they have offered and agreed to effect securities transactions for customers over the Internet, primarily under Regulation A in connection with proposed securities offerings.

2. To persuade small businesses to sign up for their services, Respondents falsely claim they have helped other small businesses raise millions of dollars from investors, and that they work with securities counsel to ensure the offerings are lawful. They have also failed to disclose sanctions imposed against Muehler by state securities regulators for acting as an unregistered broker-dealer and defrauding small business customers in past iterations of Muehler's fraudulent scheme. Through their scheme, Respondents have signed more than thirty small businesses as customers, collected

more than $50,000 in fees, and acquired common stock from their customers as part of payment for their services.

3. Upon signing issuer customers, Respondents take significant steps to offer and sell securities to investors, including filing Regulation A offering statements with the Commission and marketing the offerings to investors. Commission staff have notified Respondents that there are significant deficiencies in the offering statements filed by Muehler, many of which Muehler has not meaningfully addressed. Nonetheless, Respondents continue to operate their scheme and to lull issuer customers by assuring them that they are on the verge of qualifying under Regulation A and raising investor funds.

FACTS

IDENTIFICATION AND SOLICITATION OF ISSUER CUSTOMERS

4. Since at least August 2013, Muehler has been in the business of offering to help small business customers raise money from investors through Blue Coast and ASMG. Prior to April 2014, Muehler marketed his services using Blue Coast, which, at times, he operated using the names "GlobalCrowdTV, Inc." and "Blue Coast Banc." Muehler began marketing his services under the name of ASMG in approximately April 2014. Blue Coast and ASMG, however, are merely the most recent iterations of Muehler's unregistered broker-dealer business, which he has operated using various entity names since at least 2008.

5. Muehler identifies potential customers on crowdfunding websites and sends unsolicited emails offering to help them raise money from investors. Small business owners who express interest receive marketing materials and follow-up calls from Muehler. Respondents also market themselves to prospective customers through Internet posts, web-based press releases, and sophisticated-looking websites they control, such as www.alternativesecuritiesmarket.com (the "Website"). The Website describes the "Alternative Securities Market" as the "First Primary and Secondary Market for Regulation A, Regulation S and Regulation D Securities," and Muehler has used the Website to advertise the "financial services" that ASMG offers to issuers and investors, including "Initial Public Offerings" and "ASM Listing Broker" services.

BROKER-DEALER SERVICES OFFERED TO SMALL BUSINESSES

6. Although none of the Respondents was registered as a broker-dealer, and Muehler was not associated with a registered broker-dealer, during the relevant period of misconduct, Respondents have held themselves out as broker-dealers that provide broker-dealer services and other "issuer services." For the stated purpose of helping customers raise capital from investors, Respondents have offered to:

- list securities for sale on the "Alternative Securities Market" and "BlueCoastBanc.com";
- structure the terms of proposed offerings;

- prepare offering memoranda and registration statements;
- help customers qualify to sell securities under Regulation A;
- ensure proposed offerings comply with all applicable laws;
- market the offered securities to potential investors, including registered investment advisers and venture capitalists;
- identify and screen potential investors;
- provide an online portal for investors to purchase customers' securities;
- handle investor payments online;
- transfer and hold digital stock certificates;
- purchase customers' securities not sold to investors; and
- provide a secondary market for customers' securities.

ADDITIONAL BROKER-DEALER ACTIVITY

7. In addition to offering broker-dealer services to prospective customers, Respondents have undertaken significant efforts to effect securities transactions between their issuer customers and investors, including helping issuers structure the terms of proposed offerings.

8. Respondents have advertised the proposed offerings as well, including on the Website and through Internet-based press releases. A press release that Muehler circulated on the Internet in July 2014, for instance, lists twenty-seven "IPOs" scheduled for the Alternative Securities Market in August and September 2014, and states that ASMG "expects the securities of Companies listed on the Alternative Securities Market to become quoted on the OTCQB, OTCQX or the NASDAQ Capital Markets within approximately one to four years of IPO or Listing on the Alternative Securities Market." The version of the Website that was available to the public in July 2014, and which Muehler marketed to investors over the Internet, provided a webpage for each customer that listed the terms of the proposed offering, included a link to the customer's offering statement, and included an "INVEST" button that led to an investor login page. As of at least June 2015, the Website listed eighteen companies as purportedly available for "trading" on the Alternative Securities Market.

9. Respondents have also marketed their customers' securities in promotional videos made available to the public on the Website and YouTube, in which

Muehler recommended specific offerings to potential investors and directed them to the Website to invest. In a video for at least one customer, Muehler stated that the customer's securities were already available for sale on the Alternative Securities Market to accredited investors and would be available to all investors upon qualification under Regulation A.

10. Respondents also solicit potential investors to participate on the Alternative Securities Market and have taken steps to register and screen investors for appropriate investments. For example, in one promotional video for the Alternative Securities Market, Muehler explained to potential investors that they can trade securities through ASMG as they could on "e*trade." As of August 2014, Muehler estimated that a hundred potential investors had expressed interest in participating on the Alternative Securities Market, including by signing up on the Website and contacting ASMG via email. Respondents also received accreditation information from investors they solicited.

CUSTOMER AGREEMENTS AND TRANSACTION-BASED COMPENSATION

11. Through "Listing & Direct Public Offering And Marketing Agreements" with customers (the "Customer Agreements"), Respondents offer their broker-dealer services in return for up-front fees, monthly fees, a percentage of the funds raised, and an equity stake in each issuer, the size of which depends on the offering's success. In some instances, Respondents have received a vested right to common stock from a customer upon signing a Customer Agreement, along with the right to receive more common stock if the offering is successful. In some instances, Respondents have taken an additional stake in an offering's success by agreeing to purchase any of the customer's newly issued securities not sold to investors.

RESPONDENTS' FALSE AND FRAUDULENT STATEMENTS, OMISSIONS AND DECEITFUL CONDUCT

12. To encourage small business owners to sign with them and, thus, to obtain fees, common stock, and other compensation, Respondents have made false and misleading statements and omissions, and engaged in other deceptive practices, including misrepresentations that Muehler made personally in telephone conversations and emails. Examples include:

- falsely stating that Respondents have helped customers raise millions of dollars from investors;

- falsely stating that ASMG is a registered broker-dealer firm;

- falsely stating that Respondents were working with securities counsel to ensure the lawfulness of the proposed offerings;

- using "Legal@asmmarketsgroup.com" and references to ASMG's "Legal Dept." to create the false impression that ASMG has in-house counsel;

- falsely describing ASMG as an established financial services company with the ability to make multi-million-dollar loans;

- agreeing to use investment funds controlled by Muehler to purchase securities not sold to investors without disclosing that the funds had neither assets nor a reasonable expectation of having assets to satisfy the guarantees;

- falsely stating that customer fees are used to pay SEC filing fees and that the SEC plans to dramatically increase its filing fees; and

- assuring issuer customers that Regulation A qualification for their offerings is forthcoming despite notice of significant deficiencies in the offering statements on file.

13. Respondents also misled prospective customers by emphasizing their experience raising millions of dollars for small businesses through exempt offerings, and promising to do the same for prospective customers, without disclosing that Muehler's experience includes being disciplined by state securities regulators for promoting unregistered securities and defrauding the issuers of those securities. In April 2009, the Minnesota Department of Commerce ordered Muehler and a Muehler-controlled company to cease and desist from engaging in fraudulent conduct in offering securities and from acting as an unregistered broker-dealer in Minnesota. The order states that Muehler offered to solicit investors for customers who were attempting to start new businesses; offered unregistered securities to investors; acted as an unregistered broker-dealer; and "engaged in fraudulent and deceptive practices by failing to return advance fees that were obtained from customers under the premise that the fees were refundable." In August 2010, the California Department of Corporations concluded that Muehler and another Muehler-controlled entity had offered unregistered securities to at least one investor in California and ordered them to desist and refrain from doing so.

C. VIOLATIONS

1. As a result of the conduct described above, Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful to employ any manipulative or deceptive devices in connection with the purchase or sale of securities.

2. As a result of the conduct described above, Respondents willfully violated Section 15(a)(1) of the Exchange Act, which makes it unlawful for any broker or dealer to use the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security"

unless that broker or dealer is registered with the Commission in accordance with Section 15(b) 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. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b)(6) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder; whether Muehler should be prohibited, conditionally or unconditionally, and permanently or for such period of time as shall be determined, 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; whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act; and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act.

IV.

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

IT IS FURTHER ORDERED that 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 any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him/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 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. 75999 / September 28, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3708 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16839

In the Matter of **Daniel R. Bartholomew and** **Karl I. Hjelvik,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND NOTICE OF HEARING**

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 Daniel R. Bartholomew and Karl I. Hjelvik (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 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Notice of Hearing ("Order"), as set forth below.

III.

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

Summary

As the New Mexico economy declined during the financial crisis, Trinity Capital Corporation and its wholly-owned subsidiary, Los Alamos National Bank (collectively, "Trinity" or "the Bank"), experienced an increase in problem loans and a decrease in the collateral values supporting its loan portfolio and other real estate owned ("OREO"). In response, certain former members of the Bank's management caused the Bank to engage in false and misleading accounting and reporting that concealed the Bank's delinquencies and declining collateral values and to hide the true nature of its loan and OREO portfolio. This conduct resulted in the Bank materially misstating its provision for loan losses and its allowance for loan and lease losses ("ALLL"), included in quarterly and annual filings with the Commission during 2010, 2011 and the first two quarters of 2012. This conduct by certain former members of the Bank's management was aided by the Bank's deficient internal accounting controls over loan and OREO accounting, as well as the circumventing internal accounting controls by certain employees and former members of management.

While serving as the Bank's Chief Financial Officer, Daniel Bartholomew failed to implement adequate internal controls over, among other areas, impaired loan loss calculations, troubled debt restructurings ("TDRs"), subsequent events, OREO, and appraisals. In some instances, Bartholomew was also a cause of Trinity's false books and records and the submission of inaccurate reports because he was on notice of certain transactions that failed to comply with generally accepted accounting principles ("GAAP"), but he failed to correct the accounting errors.

While serving as the Bank's head of Internal Audit, Karl Hjelvik was directly responsible for testing the Bank's internal accounting controls and compliance with GAAP. When Hjelvik became aware of issues in the way in which loans were accounted for under the direction of the Bank's management, he failed to report his concerns to the Bank's audit committee, and in some instances, he failed to take action to remedy inaccurate reports and books and records as required by the Bank's policies and procedures. Hjelvik also failed to ensure that effective internal controls were in place over impaired loan loss calculations, TDRs, subsequent events, OREO, and appraisals.

Respondents

1. <u>Daniel Bartholomew</u> is a 49-year-old resident of Los Alamos, New Mexico. Bartholomew served as the Bank's chief financial officer ("CFO") from 2003 until September 2014. He has never been a certified public accountant.

[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.

2. Karl Hjelvik is a 53-year-old resident of Los Alamos, New Mexico. Hjelvik has served as the Bank's head of internal audit since 1997 and has held the title of Vice President of Internal Audit since 2007. Hjelvik has never been a certified public accountant.

Related Entity

3. Trinity Capital Corporation is a New Mexico corporation headquartered in Los Alamos, New Mexico. Trinity is the holding company of Los Alamos National Bank, a national banking organization with $1.4 billion in assets. Trinity's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act; however, its stock is not listed on any automated quotation system or securities exchange and no firm makes a market in its stock. In 2010, Trinity issued common stock under a registration statement filed on Form S-8 (Registration No. 333-126980, filed July 28, 2005). In 2012, Trinity awarded Restricted Stock Units to certain personnel under the same registration statement. The registration statement incorporated by reference subsequent filings, including Trinity's 2010 Forms 10-Q and 10-K, 2011 Forms 10-Q and 10-K, and 2012 Forms 10-Q.

Facts

4. During 2010, 2011 and the first two quarters of 2012 (the "Relevant Periods"), Trinity failed to properly account for the Bank's loan portfolio and failed to properly account for its OREO in 2011. As a result, the Bank filed inaccurate periodic reports with the Commission in 2010, 2011, and the first two quarters of 2012.

5. On December 12, 2014, Trinity filed its Form 10-K for the year ended December 31, 2013, which included the restatement of Trinity's consolidated financial data for the year ended December 31, 2011 and the quarterly periods ended March 31, 2012 and June 30, 2012, and the restated, unaudited, selected consolidated financial data for the year ended December 31, 2010. According to its restatement, Trinity's provision for loan losses was understated by $6.8 million (25%) in 2010, $22.3 million (73%) in 2011, and $4.5 million (68%) in the first quarter of 2012. Trinity overstated its provision for loan losses for the second quarter of 2012 by $2.3 million (31%). Additionally, in 2011, Trinity's OREO losses were understated by $364,000 (10%). The restatement also noted that these failures were caused in part by the override of controls by certain former members of management because of Trinity's insufficient internal accounting controls, including controls in the loan department, internal audit, and loan accounting. The restatement also identified material weaknesses in Trinity's internal control over financial reporting.

6. Certain former members of the Bank's management, directly and through instructions to lower-level employees, caused the Bank to materially misstate its ALLL and loan loss provision by: (1) failing to downgrade troubled loans; (2) failing to identify loans as individually impaired – including hundreds of TDRs; (3) failing to measure the impairment on impaired loans properly; and (4) making various misrepresentations to the Respondents and other third parties. In 2011, certain former members of the Bank's management also caused the Bank to improperly value its OREO.

7. In furtherance of the scheme, and to avoid downgrading loans to special mention or substandard, certain former members of the Bank's management established a practice, followed by loan department employees, of using a variety of "extend and pretend" tactics to ignore and hide a borrower's troubled financial situation, such as extending additional credit to troubled borrowers so that interest payments could be made and borrowers would remain off the past due list; instructing employees to keep certain borrowers "off the radar" of the Office of the Comptroller of the Currency ("OCC") and other third parties; and delaying, ignoring, and improperly rejecting appraisals. The scheme was motivated, at least in part, by a desire to have the Bank released from a Formal Agreement with the OCC, which was in place from January 2010 to April 2012.

8. Hjelvik and the internal audit department he headed were directly responsible for ensuring: that risk was assessed, monitored and managed; that internal accounting controls existed and functioned properly; that GAAP was followed; that an effective internal audit program was developed and maintained; that audit results were reported to the audit committee each quarter; and that internal audit's independence was maintained. However, the Bank's internal audit department was not independent from management, internal controls either did not exist or did not function properly, GAAP was not always followed, an effective internal audit program was not maintained, and the Bank's audit committee was not always provided with complete and independent audit findings. The Bank's internal audit department also lacked a formalized risk assessment process and, as a result, did not sufficiently consider risks in financial reporting in establishing audit procedures.

9. During the Relevant Periods, the Bank lacked sufficient internal accounting controls for the periodic review of loans to ensure loans were accurately graded and to identify troubled and impaired loans. Bartholomew and Hjelvik reviewed all internal control flow charts annually and were aware that they lacked sufficient controls over identification of loans for impairment and collateral fair value determination. Bartholomew and Hjelvik also repeatedly saw quarterly grade change reports that indicated loans were not being downgraded timely.

10. In one specific instance, Hjelvik informed management within the loan department that a loan should be impaired; however, the loan department refused to impair the loan and Hjelvik never reported the incorrect loan classification to the audit committee or outside auditors. In another example, a borrower's loans were downgraded from pass to substandard by the internal audit department in late March 2011, were then upgraded to pass at the direction of former members of management in early April 2011, and were then again downgraded to substandard in May 2011 when the borrower appeared on a list of loans to be reviewed by a third party. Other than flagging these loans for testing by the third party reviewer, Hjelvik did not report the loan department's attempted override of internal controls or bank policies to the audit committee though Hjelvik was required by the Bank's policies and procedures to report such problems to the audit committee, and once a year was asked by the audit committee in executive session to report his concerns.

11. In response to another red flag, Bartholomew took no action when he was "dis-invited" from attending loan department meetings where problem loans were discussed, even though he suspected that he was dis-invited because he thought the loan department wanted to keep

information from the accounting department. Hjelvik was also aware that senior members of the accounting department were dis-invited from these meetings but took no action in response.

12. The Bank also lacked sufficient internal accounting controls over the use of overdraft loans and the analysis of TDRs. For example, the Bank's internal loan approval and credit review documents failed to require an analysis of whether a loan or a modification was a TDR. Bartholomew and Hjelvik were both aware that the Bank might not be identifying all TDRs and that the Bank's systems were not able to run reports that would identify TDRs. Similarly, in some instances, feedback and working papers from independent, third-party loan reviews indicated that a TDR analysis should be performed on specific loans; however, there were no controls in place to confirm that this feedback was reviewed, noted, and acted upon. Bartholomew and Hjelvik were aware that none of Trinity's internal control flow charts addressed TDRs and they failed to take action to put sufficient controls in place.

13. The Bank failed to devise and maintain internal accounting controls sufficient to provide reasonable assurances that its accounting for impaired loans was in conformity with GAAP. Bartholomew, Hjelvik, and loan department personnel involved in calculating and reviewing the impaired loan loss calculations did not possess sufficient accounting expertise. As a result, errors occurred in the calculation of impaired loan losses by the loan department that were not remediated by Bartholomew or Hjelvik during their review of the calculations. For example, Bartholomew and Hjelvik were aware of loans that relied upon stale appraisals and collateral values improperly based on "as-stabilized" valuations. They were also aware of other indications of value – including listing agreements and negotiated sales prices – that suggested fair value was substantially below the Bank's dated appraised value used for its impairment calculation. Nevertheless, Bartholomew and Hjelvik failed to take action to ensure that the impairment measurements considered updated and accurate "as-is" values or to notify the audit committee of any concerns. Further, in one example, neither of them followed up to ensure that an appraisal was being handled properly when they were made aware that the appraisal had been deleted out of a Bank database.

14. The Bank also lacked sufficient processes and controls over appraisals. While the appraisal process was to be separate and independent from the loan department, in practice, loan department employees were charged with determining when appraisals would be ordered on classified loans and OREO properties. Further, at the direction of certain former members of the Bank's management and loan department, appraisals were sometimes not ordered timely, delayed, or ordered without the standard request for an "as-is" fair value. Neither the internal audit nor accounting departments were automatically notified when appraisals were received, which meant that they were not always aware of appraisals relevant to impairment measurements or OREO write downs. During the Relevant Periods, Bartholomew and Hjelvik were both aware of these appraisal irregularities in connection with loans and yet they took no action to increase controls over the appraisal process.

15. Additionally, appraisals received in the subsequent event period were not always considered, as required by GAAP, in the Bank's loan and OREO impairment accounting. Bartholomew and Hjelvik were aware of this by at least 2009 when the Bank's outside auditor found a material accounting error. They were also aware of instances of the loan department

failing to properly account for subsequent events throughout 2010 and 2011. Nonetheless, Bartholomew and Hjelvik failed to implement controls to adequately address this issue and, throughout the Relevant Periods, the Bank's internal audit and accounting departments continued to stumble across appraisals received in the subsequent event period that had not been considered in the Bank's accounting.

16. Bartholomew and Hjelvik were also aware that sufficient controls were lacking over the Bank's processes and computerized systems that housed appraisals and loan information. Controls were inadequate to ensure all received appraisals were preserved in the Bank's database. Numerous employees, including loan officers, had edit rights to these systems allowing them to alter or delete data about loans, appraisals, collateral values, and customers. Because of these internal control weaknesses, employees could delete appraisals or change collateral values without documenting why the alterations were made. When appraisals and collateral values were deleted, the result was that information was not made available to the OCC and other third parties, as well as other Bank employees.

17. Bartholomew signed Trinity's 10-K and 10-Q filings, including certifications, as well as management representation letters to the outside auditors that included representations on GAAP, internal controls, and any suspected fraud. Hjelvik signed Trinity's 2011 internal control representation letter to the external auditor and signed sub-certifications to Trinity's 2010 Form 10-K, 2011 Form 10-K, and the 2012 first quarter 10-Q, knowing that their purpose was to bring up issues that could affect the filings. Notwithstanding the facts described above, Bartholomew and Hjelvik signed these representations, while also failing to adequately address concerns raised by Bank employees about how certain significant loans were being risk rated and accounted for by the Bank.

Violations

18. As a result of the conduct described above, Bartholomew and Hjelvik were a cause of Trinity's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

19. As a result of the conduct described above, Bartholomew and Hjelvik were a cause of Trinity's violations of 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 reflect their transactions and dispositions of their assets.

20. As a result of the conduct described above, Bartholomew and Hjelvik were a cause of Trinity's violations of Section 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; and prohibit persons from knowingly circumventing or knowingly failing to implement a system of internal accounting

controls, knowingly falsifying any book, record, or account, and directly or indirectly falsifying or causing to be falsified any book, record, or account.

IV.

Respondents acknowledge that the Commission is not at this time imposing a civil penalty based upon their agreement to cooperate in a related enforcement action. However, pursuant to this Order, Respondents agree to additional proceedings in this proceeding to determine what, if any, civil penalties pursuant to Section 21B(a) of the Exchange Act against Respondents are in the public interest. In connection with such additional proceedings: (a) Respondents agree that they will be precluded from arguing that they did not violate the federal securities laws described in this Order; (b) Respondents agree that they may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the findings of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondents Bartholomew and Hjelvik 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.

B. IT IS FURTHER ORDERED pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party, that a public hearing for the purpose of taking evidence on the questions set forth in Section IV hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110, following the entry of a final judgment against the last remaining defendant(s) in *Securities and Exchange Commission v. Jill D. Cook and Mark C. Pierce*, Civil Action No. 15-cv-00864 (D.N.M., filed September 28, 2015 (the "Related Actions").

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

The Order shall be served forthwith upon Respondents personally or by certified mail.

C. IT IS FURTHER ORDERED pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party, that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of the entry of a final judgment in the Related Actions.

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

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 76000 / September 28, 2015

WHISTLEBLOWER AWARD PROCEEDING

File No. 2015-7

In the Matter of the Claim for Award

in connection with

Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On June 5, 2015, the Claims Review Staff issued a Preliminary Determination related to Notice of Covered Action Redacted (the "Covered Action"). The Preliminary Determination recommended that Claimant 1 and Claimant 2 each receive a whistleblower award because they voluntarily provided original information to the Commission that led to the successful enforcement of the Covered Action pursuant to Section 21F(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-6(b)(1), and Rule 21F-3(a) thereunder, 17 C.F.R. § 240.21F-3(a). Further, the Claims Review Staff recommended that such award be set in the amount of twenty percent (20%), in total, with eleven percent (11%) to Claimant 1 and nine percent (9%) to Claimant 2 of the monetary sanctions collected or to be collected in the Covered Action. In arriving at this recommendation, the Claims Review Staff considered the factors set forth in Rule 21F-6, 17 C.F.R. § 240.21F-6, in relation to the facts and circumstances of Claimant 1 and Claimant 2 applications.

On July 16, 2015 and June 11, 2015, Claimant 1 and Claimant 2 respectively, provided written notice to the Commission of their 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 1 shall receive an award of eleven percent (11%) and Claimant 2 shall receive an award of nine percent (9%) 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 ACT OF 1933
Release No. 9931 / September 28, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75998 / September 28, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3707 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16838

In the Matter of **William C. Enloe,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND PENALTIES**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against William C. Enloe ("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 in Section V herein, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Penalties ("Order"), as set forth below.

III.

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

Summary

This proceeding resulted from the failure of Trinity Capital Corporation and its wholly-owned subsidiary, Los Alamos National Bank (collectively, "Trinity" or "the Bank"), to account properly for the Bank's loan portfolio during 2010, 2011 and the first two quarters of 2012 (the "Relevant Periods"), and to account properly for its real estate held as a result of foreclosures (referred to as "other real estate owned" or "OREO") in 2011.

By 2009, as the New Mexico economy declined during the financial crisis, the Bank experienced an increase in delinquent and problem loans and a decrease in the collateral values supporting its loan and OREO portfolio, requiring the Bank to record loan and OREO losses. Enloe and other former members of Trinity's management caused the Bank to engage in false and misleading accounting and reporting that concealed the Bank's loan delinquencies and declining collateral values and to hide the true value of its loan and OREO portfolio. This conduct resulted in the Bank materially misstating its provision for loan losses on its income statement and its allowance for loan and lease losses ("ALLL") on its balance sheet during the Relevant Periods, including in its quarterly and annual filings with the Commission during 2010, 2011, and the first two quarters of 2012, and understating its OREO losses in 2011. This conduct by Enloe and other former members of the Bank's management was aided by the Bank's deficient internal accounting controls over loan and OREO accounting, as well as the overriding of internal accounting controls by Enloe and other employees and former members of management.

While serving as the CEO of the Bank, Enloe facilitated the false and misleading accounting by pressuring loan officers to engage in improper conduct that kept the Bank from properly recording losses on its financial statements. Specifically, Enloe instructed and encouraged loan officers and others: (1) not to downgrade loans that were delinquent; (2) to make delinquent loans appear to be paying on time; (3) not to identify loans for which the Bank was not going to be paid in full; and (4) not to accurately value the Bank's collateral. In addition, Enloe circumvented the Bank's internal controls by, among other things: (a) permitting the extension of additional credit to delinquent borrowers without the appropriate financial analysis or supervisory approval; (b) improperly rejecting appraisals that evidenced declining values for real estate that collateralized loans; and (c) continuing to act as a loan officer when he had no lending authority. The fraudulent conduct was also aided by Enloe's failure to implement sufficient internal controls over financial reporting at the Bank.

Respondent

1. William C. Enloe is a 66-year-old resident of Los Alamos, New Mexico. Enloe worked at the Bank from 1971 until his employment concluded on February 1, 2013. From 1979

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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.

until 1994 he was the President of Trinity, and from 1994 to February 1, 2013, Enloe served as Trinity's CEO. Enloe is now employed by a private company.

Related Entity

2. Trinity Capital Corporation is a New Mexico corporation headquartered in Los Alamos, New Mexico. Trinity is the holding company of Los Alamos National Bank, a national banking organization with $1.4 billion in assets. Trinity's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act; however, its stock is not listed on any automated quotation system or securities exchange and no firm makes a market in its stock. In 2010, Trinity issued common stock under a registration statement filed on Form S-8 (Registration No. 333-126980, filed July 28, 2005). In 2012, Trinity awarded Restricted Stock Units to certain personnel under the same registration statement. The registration statement incorporated by reference subsequent filings, including Trinity's 2010 Forms 10-Q and 10-K, 2011 Forms 10-Q and 10-K, and 2012 Forms 10-Q.

Facts

3. During 2010, 2011, and the first two quarters of 2012 (the "Relevant Periods"), Trinity failed to properly account for the Bank's loan portfolio and OREO. As a result, the Bank filed inaccurate periodic reports with the Commission in 2010, 2011, and the first two quarters of 2012.

4. On December 12, 2014, Trinity filed its Form 10-K for the year ended December 31, 2013, which included the restatement of Trinity's consolidated financial data for the year ended December 31, 2011 and the quarterly periods ended March 31, 2012 and June 30, 2012, and the restated, unaudited, selected consolidated financial data for the year ended December 31, 2010. According to its restatement, Trinity's provision for loan losses was understated by $6.8 million (25%) in 2010, $22.3 million (73%) in 2011, and $4.5 million (68%) in the first quarter of 2012. Trinity overstated its provision for loan losses for the second quarter of 2012 by $2.3 million (31%). Additionally, in 2011, Trinity's OREO losses were understated by $364,000 (10%). The restatement noted that these failures were caused in part by the override of controls by certain former members of management because of Trinity's insufficient internal accounting controls, including controls in the loan department, internal audit, and loan accounting. The restatement also identified material weaknesses in Trinity's internal controls over financial reporting.

5. During the time period at issue, the Bank's loan policies required that loans be assigned one of seven descending grades based on the decreasing likelihood that the loan principal and interest would be collected. As discussed herein, the Bank was thereafter required under relevant accounting principles to recognize and/or reserve against likely loan losses. Enloe, directly and through instructions to lower-level employees, caused the Bank to materially misstate its ALLL and loan loss provision by: (1) pressuring loan officers not to downgrade troubled loans; (2) instructing and encouraging loan officers and others to modify loan terms and extend additional credit to delinquent borrowers to make unpaid loans falsely appear to be current; (3) failing to identify loans that were not going to be paid in full – including loans where the Bank granted concessions to the borrowers through restructured terms, known as troubled debt restructurings

("TDRs"); and (4) failing to utilize accurate collateral valuations on impaired loans. In 2011, the Bank and Enloe failed properly to value and account for impairments to its OREO by not using appraisals that indicated that the value of OREO properties had decreased and that OREO write-downs were required.

Failure To Downgrade Loans

6. During the Relevant Periods, the Bank's loan department operated under a culture that discouraged downgrading loans to special mention or substandard since the downgrading would lead to the recording of additional losses. Loans were to be graded special mention when they had potential weaknesses that deserved management's close attention. Loans were to be graded substandard when they demonstrated a well-defined weakness. Loan officers were under pressure from Enloe and other members of management to avoid having "bad loans" in their loan portfolios, including any loans that were graded below pass and loans that were more than 30 days past due. As a result, the Bank's loan department ignored and hid loan weaknesses that required downgrades and waited as long as possible to downgrade loans below pass, which sometimes included waiting until the loan was at or over 90 days past due, or until the loan was selected for review by a third party and was therefore at risk for being identified as a grade "miss." These grading errors resulted in the Bank understating its ALLL because its lower graded loans carried a higher historical loss rate, which would have required additional losses and increased the ALLL.

7. Enloe and the Bank's loan department undertook steps to prevent downgrades on certain loan relationships, including authorizing checking account overdrafts and the extension of additional credit to borrowers who were unable to make their required principal and interest payments on their existing debt. Sometimes this additional credit would be granted using loans referred to as "ABC Loans," which stood for "Additional Balance Club Loans." The additional credit was used to make required payments on the existing debt, which would result in the borrower appearing current on loan payments when, in fact, the Bank was not actually making any collections from the borrower.

8. Enloe, other former members of the Bank's management, and loan department employees circumvented and ignored internal accounting controls by failing to downgrade troubled loan relationships. For example, in one instance, Enloe extended credit to a borrower without the required credit analyses being completed. In another instance, a borrower's loans were first downgraded from pass to substandard by the internal audit department in late March 2011, were then updated to pass at Enloe's direction in early April 2011, and were then again downgraded to substandard in May 2011 when the borrower appeared on a list of loans to be reviewed by a third party.

9. In the case of one borrower and his associated entities, approximately $8.8 million in loans were improperly graded as pass during nearly all of the Relevant Periods. In connection with these loans, Enloe established a practice, followed by loan department employees, of using a variety of techniques to ignore and hide the borrower's troubled financial situation, including granting additional credit to the borrower for the purpose of making payments on existing loans and modifying the loans and granting the borrower concessions without downgrading the loans or

evaluating them as TDRs.[2] Enloe and other members of the Bank's management did not follow up on certain Bank employees' concerns regarding the manner in which the Bank was managing and accounting for these loans. Further, Enloe and other former members of the Bank's management and loan department employees undertook efforts to prevent the OCC, the Board, and other Bank personnel from reviewing this borrower's loans and discovering the troubled nature of the borrower.

10. In another instance, Enloe authorized numerous extensions to a borrower that delayed the borrower's repayment of the loans. The borrower's financial situation and payment history clearly indicated that he was struggling to make his payments in accordance with the terms of his notes; nonetheless, at Enloe's direction, the loan officer continued to extend additional credit to make interest payments and to provide renewals and extensions to prevent the borrower from appearing on the Bank's past due list. Under Enloe's direction, this borrower's loans were not handled in accordance with the Bank's internal policies and procedures. Further, in at least one instance, Enloe had the loan department provide the borrower additional funds in the name of his entity so it would not be readily apparent that a loan payment was made through the extension of additional credit.

Failure To Measure Individual Loan Impairments Properly

11. The Bank also made material errors by failing to measure properly the loss for individually impaired loans. A loan is impaired when it is probable a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. If a loan is individually impaired, the amount of impairment must be measured and recorded as a loss with a corresponding amount recorded to the ALLL. Generally Accepted Accounting Principles ("GAAP") permits the impairment to be measured using the fair value of the underlying collateral if the loan is collateral dependent, which is the method the Bank typically utilized. GAAP requires that the best information available in the circumstances be used to determine fair value.

12. Among other things, appraisals were used to value the Bank's collateral that was used to measure the loss on impaired collateral-dependent loans. For purposes of measuring the impairment on a collateral-dependent loan, the Bank was required to consider the current condition of the property, which can be accomplished by using an "as-is" appraisal value.[3] However, in at least two instances, Enloe directed the use of higher "as stabilized" or "as completed" values in measuring impairment losses when an as-is appraisal value should have been used.

13. One example involved a $4.2 million loan that was substandard and impaired during the Relevant Periods. In 2010, at the direction of Enloe, the Bank used an as-stabilized appraisal based on the hypothetical value of the project assuming construction was completed and operating profitably. The Bank then subtracted the cost-to-complete as provided by the borrower.

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[2] Pursuant to GAAP, a restructuring of a debt constitutes a TDR if the creditor grants a concession to the debtor due to the debtor's financial difficulties.

[3] ASC 820-10-20 defines fair value as the price that would be received to sell an asset in an orderly transaction between market participants as of the measurement date. The as-is appraisal considers the conditions of the property as of the measurement date, while the as-completed and as-stabilized appraisals do not.

In the second half of 2011, the Bank obtained updated cost estimates that, if utilized, would have resulted in an impairment loss of approximately $1 million; however, Enloe ignored those updated cost-to-complete estimates. In the second quarter of 2012, the Bank finally received an appraisal that included an "as-is" value, which would have required an impairment loss of approximately $3.7 million. Enloe "rejected" the appraisal, requested it be deleted from the Bank's electronic loan file, and the Bank continued to use the 2010 as-stabilized appraisal less the outdated cost to complete numbers. The resulting improper valuations on this loan resulted in the Bank avoiding approximately $3.7 million in impairment losses throughout 2011 and in the first two quarters of 2012.

14. In another instance, the Bank ignored an appraisal valuing the collateral supporting an $8.9 million loan that was substandard and impaired. Throughout 2011 and the first two quarters of 2012, the Bank measured the loan's impairment by relying on a February 2011 appraisal that valued the property at approximately $15.9 million. In March 2012, the Bank was notified that the property had been appraised in January 2012 in connection with foreclosure litigation. Using the January 2012 appraisal would have resulted in an impairment loss of approximately $3 million. At Enloe's direction, the Bank disregarded the January 2012 appraisal, ordered another appraisal from a different appraiser, and continued to solely rely on the outdated February 2011 appraisal in accounting for the loan for the year-end 2011 and in the first two quarters of 2012, thereby avoiding recognizing loan losses totaling approximately $3 million.

15. In another example, the Bank participated in a $20.5 million loan that was substandard and impaired throughout the Relevant Periods. In calculating the impairment throughout the Relevant Periods, Enloe directed that the Bank use the "as-stabilized" value of $32 million from a January 2010 appraisal and $27.4 million from a January 2011 appraisal. These "as-stabilized" values significantly overstated the fair value of the collateral, however, because they assumed significant changes to the property's operations, none of which occurred during the Relevant Periods.

16. In connection with that same loan, Enloe ignored other material information relevant to the property's value that indicated that the loan required a significant impairment loss, including a listing agreement that listed the property for sale at a price that was millions of dollars below the appraised "as-stabilized" values. Enloe also responded to inquiries of multiple potential buyers that the Bank was willing to accept a sales price that was millions of dollars below the appraised "as-stabilized" values. In addition, Enloe knew that another bank with an interest in the loan was accounting for the loan based on a collateral value of $13 million, and that an internal Bank analysis showed that the property could be worth $14 to $15 million assuming some improvements to the property's operating condition. By failing to measure the impairment on this loan properly, Enloe caused the Bank to avoid recording approximately $8.9 million of loan losses throughout the Relevant Periods.

17. Similarly, on another loan for $2.7 million, the Bank avoided a $1.1 million impairment loss in 2011 by ignoring clear evidence of a lower collateral value. In February 2012, the Bank consented to a letter of intent for the sale of a loan's collateral so long as the Bank obtained $1.65 million from the sale. In accounting for the loan in the first quarter of 2012,

however, at Enloe's direction, the Bank ignored the letter of intent and instead used the outstanding loan balance of $2.7 million as the collateral value.

18. Enloe also avoided necessary write downs on OREO properties by interfering with Trinity's appraisal process and obtaining appraisals late. For example, in early 2011, the Bank was in the process of foreclosing on a facility that was held as collateral on a loan. The facility had appraised for $1 million in February 2010, but in March 2011 the bank received a new appraisal that valued the property at $550,000. Enloe directed the loan department not to use the March 2011 appraisal and to hire a different appraiser to conduct another appraisal. On June 22, 2011, the Bank received a new appraisal, which valued the property at $382,000. Upon receiving an appraisal with an even lower value, Enloe instructed the loan department to use the March 2011 appraisal with the value of $550,000. As a result of this conduct, the Bank improperly failed to recognize approximately $444,000 of impairment losses as of March 30, 2011.

<u>Circumventing and Failing to Implement Internal Accounting Controls</u>

19. The material misstatements and the conduct by certain former members of Bank management, including Enloe, were facilitated by the intentional circumvention of internal accounting controls, but were also aided by Enloe's failure to devise and maintain a system of internal accounting controls.

20. During the Relevant Periods, Enloe failed to implement sufficient internal accounting controls over the periodic review of loans to ensure loans were accurately graded and to identify troubled and impaired loans. Further, due to Enloe's influence, the Bank's internal audit department was not independent from management and, as a result, the Bank's Audit Committee was not always provided with complete and independent internal audit findings. The Bank's internal audit department also lacked a formalized risk assessment process and, as a result, did not sufficiently consider risks in financial reporting in establishing audit procedures.

21. Enloe also circumvented the Bank's processes and internal accounting controls over TDRs, impaired loan loss calculations, and appraisals. As noted above, Enloe was involved in loans that relied upon stale appraisals and collateral values improperly based on "as-stabilized" valuations. Enloe also ignored appraisals that came in with valuations that would result in charge offs. By circumventing the Bank's processes and controls in these ways, Enloe caused the Bank to materially misstate its ALLL and loan loss provision.

22. Enloe also failed to implement sufficient internal controls over the accounting for ABC Loans and the analysis of TDRs. For example, the Bank's internal loan approval and credit review processes failed to require an analysis of whether a loan modification or extension was a TDR. Similarly, in some instances, feedback and working papers from independent, third-party loan reviews indicated that a TDR analysis should be performed on specific loans; however, there were no controls in place to confirm that this feedback was reviewed, noted, and acted upon. Further, during the Relevant Periods, TDRs were rarely discussed within the loan department, and employees were not properly instructed as to how and when to analyze modifications as potential TDRs. Finally, numerous loans should have been evaluated as TDRs because a new loan was

provided to pay interest or principal due on an existing loan. Enloe and the Bank's loan policy failed to consider whether this situation resulted in a "concession."

23. Enloe failed to devise and maintain internal accounting controls sufficient to provide reasonable assurances that the Bank's accounting for impaired loans was in conformity with GAAP. Loan department personnel calculating the impaired loan losses did not possess sufficient accounting expertise and there was not adequate involvement or review by the accounting department. As a result, errors occurred in the calculation of impaired loan losses.

24. Enloe also failed to implement sufficient internal controls over appraisals. While the appraisal process was to be separate and independent from the loan department, in practice, loan department employees were charged with determining when appraisals would be ordered on classified loans. Further, at the direction of certain former members of the Bank's management and loan department, including Enloe, appraisals were sometimes not ordered timely, delayed, or ordered without the standard request for an "as-is" fair value. The accounting department was not automatically notified when appraisals were received, which meant that it was not always aware of appraisals relevant to impairment measurements.

25. Additionally, appraisals and other information were not always used, as required by GAAP, in the Bank's loan impairment accounting. Enloe was aware of this by at least 2009 when the Bank's outside auditor found a $2.2 million accounting error. Nonetheless, Enloe failed to implement controls to adequately address this issue and, throughout the Relevant Periods, the Bank's internal audit and accounting departments continued to stumble across appraisals that had not been considered in the Bank's accounting.

26. Enloe also failed to implement sufficient internal accounting controls over the Bank's processes and computerized systems that housed appraisals and loan information. Controls were inadequate to ensure all received appraisals were preserved in the Bank's database. Numerous employees, including loan officers, had edit rights to these systems allowing them to alter or delete data about loans, appraisals, collateral values and customers. Because of these inadequacies, employees could delete appraisals or change collateral values without documenting why the alterations were made. When appraisals and collateral values were deleted, the result was that information was not made available to the OCC and other third parties, as well as other Bank employees.

Misleading Statements to Accountants

27. Enloe also made, or caused to be made, misleading statements to the Bank's accountants. For example, Enloe was aware of false and misleading information in impairment memos that were provided to internal accountants and the external auditors, including incorrect impairment calculations on loans that understated losses. Enloe was also aware of material information regarding the Bank's loan portfolio that was not provided to the external auditors, including evidence of significant borrower relationships where the borrowers were delinquent or had indicated an inability to pay and yet the Bank did not downgrade the loans below pass or designate the loans as impaired.

False Certifications

28. As CEO, during all Relevant Periods, Enloe signed certifications pursuant to Sections 302 and 906 of SOX in which he certified, among other things, that: (1) the information contained in the reports fairly presented, in all material respects, the financial condition and results of Trinity; (2) the financial statements were free of material misstatements and omissions; (3) he had disclosed any fraud involving management or other employees who had a significant role in the company's internal control over financial reporting; and (4) he had designed, or caused to be designed, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Nevertheless, during all Relevant Periods, Enloe knew about: (i) false and misleading information in impairment memos that made the information presented in Trinity's quarterly and annual reports not fairly present the Bank's financial condition and results; (ii) material misstatements and omissions in the Bank's financial statements tied to the Bank's loan portfolio; (iii) Trinity's failure to follow GAAP and its own loan policy in grading loans, designating loans as impaired, and designating loans as TDRs; and (iv) insufficient internal accounting controls over properly measuring impaired loans, use of ABC loans, appraisals, and the Bank's processes and computerized systems that housed appraisals and loan information.

Enloe Controlled and Directed Trinity's Violations

29. Enloe, as the CEO of Trinity, had management authority over Trinity, and did in fact control and direct Trinity's loan and OREO accounting. Further, as set forth above, Enloe orchestrated and was directly involved in Trinity's fraudulent financial reporting.

Violations

30. As a result of the conduct described above, Enloe 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.

31. As a result of the conduct described above, Enloe violated Sections 17(a)(1) and (3) of the Securities Act, which prohibit fraudulent conduct in connection with the offer or sale of securities.

32. As a result of the conduct described above, Enloe violated Section 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder, which prohibit persons from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, or knowingly falsifying any book, record, or account.

33. As a result of the conduct described above, Enloe violated Rule 13b2-2 of the Exchange Act, which prohibits any officer from either (1) making or causing to be made a materially false or misleading statement to an accountant, or (2) 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 any audit, review, or examination of the financial statements of an issuer.

34. As a result of the certifications described above, Enloe violated Rule 13a-14 of the Exchange Act, which requires that each report filed on Forms 10-Q and10-K include certifications signed by the principal executive and principal financial officer of the issuer.

35. As a result of the conduct described above, Enloe caused Trinity's violation of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

36. As a result of the conduct described above, Enloe caused Trinity's violations of Section 17(a) of the Securities Act, which prohibits fraudulent conduct in connection with the offer or sale of securities.

37. As a result of the conduct described above, Enloe caused Trinity's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

38. As a result of the conduct described above, Enloe caused Trinity's violations of 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 reflect their transactions and dispositions of their assets.

39. As a result of the conduct described above, Enloe caused Trinity's violations of Section 13(b)(2)(B) of the Exchange Act, which require 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; and prohibit persons from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, knowingly falsifying any book, record, or account, and directly or indirectly falsifying or causing to be falsified any book, record, or account.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent Enloe cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13a-14, 13b2-1, and 13b2-2 thereunder.

B. Pursuant to Section 8A(f) of the Securities Act and Section 21C(f) of the Exchange Act, Respondent Enloe is prohibited for a period of 5 years from acting as an officer or director of an 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 20 days of the entry of this Order, pay a civil money penalty in the amount of $250,000.00 to the Securities and Exchange Commission. The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to Exchange Act Section 21F(g)(3), transfer them to the general fund of the United States Treasury. If payment is not made by the date required by this Order, the balance of the civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, at the discretion of the Commission staff, 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 William C. Enloe 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 Tom Krysa, Division of Enforcement, Securities and Exchange Commission, 1961 Stout Street, Suite 1700, Denver, CO 80294-1961.

D. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty

Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Corporate Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9930 / September 28, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75997 / September 28, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3706 / September 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16837

In the Matter of **TRINITY CAPITAL CORPORATION,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND PENALTIES**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Trinity Capital Corporation ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Penalties ("Order"), as set forth below.

III.

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

Summary

This proceeding results from Trinity Capital Corporation and its wholly-owned subsidiary, Los Alamos National Bank (collectively, "Trinity" or "the Bank"), failing to account properly for the Bank's loan portfolio during 2010, 2011 and the first two quarters of 2012 (the "Relevant Periods"), and failing to account properly for its other real estate owned ("OREO") in 2011.

As the New Mexico economy declined during the financial crisis, the Bank experienced an increase in problem loans and a decrease in the collateral values supporting its loan portfolio and OREO. In response, certain former members of the Bank's management caused the Bank to engage in false and misleading accounting and reporting that concealed the Bank's loan delinquencies and declining collateral values and to hide the true nature of its loan portfolio. This conduct resulted in the Bank materially misstating its provision for loan losses and its allowance for loan and lease losses ("ALLL") during the Relevant Periods, including in its quarterly and annual filings with the Commission during 2010, 2011, and the first two quarters of 2012, and understating its OREO losses in 2011. This conduct by certain former members of the Bank's management was aided by the Bank's deficient internal accounting controls over loan and OREO accounting, as well as the overriding of internal accounting controls by certain employees and former members of management.

On December 12, 2014, Trinity filed its Form 10-K for the year ended December 31, 2013, which included the restatement of Trinity's consolidated financial data for the year ended December 31, 2011 and the quarterly periods ended March 31, 2012 and June 30, 2012, and the restated, unaudited, selected consolidated financial data for the year ended December 31, 2010. According to its restatement, Trinity's provision for loan losses was understated by $6.8 million (25%) in 2010, $22.3 million (73%) in 2011, and $4.5 million (68%) in the first quarter of 2012. Trinity overstated its provision for loan losses for the second quarter of 2012 by $2.3 million (31%).[2] Additionally, in 2011, Trinity's OREO losses were understated by $364,000 (10%).

Respondent

1. Trinity Capital Corporation is a New Mexico corporation headquartered in Los Alamos, New Mexico. Trinity is the holding company of Los Alamos National Bank, a national banking organization with $1.4 billion in assets. Trinity's common stock is registered with the

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

[2] The overstatement stemmed from the Office of the Comptroller of the Currency's ("OCC") 2012 examination, which uncovered numerous accounting errors and resulted in the Bank improperly recording losses in the second quarter of 2012, rather than in prior periods.

Commission pursuant to Section 12(g) of the Exchange Act; however, its stock is not listed on any automated quotation system or securities exchange and no firm makes a market in its stock. In 2010, Trinity issued common stock under a registration statement filed on Form S-8 (Registration No. 333-126980, filed July 28, 2005). In 2012, Trinity awarded Restricted Stock Units to certain personnel under the same registration statement. The registration statement incorporated by reference subsequent filings, including Trinity's 2010 Forms 10-Q and 10-K, 2011 Forms 10-Q and 10-K, and 2012 Forms 10-Q.

Facts

Relevant Accounting Guidance and Bank Policies

2. Banks carry loans on their balance sheets as assets and generally record interest income on the loans on their income statements. According to Generally Accepted Accounting Principles ("GAAP"), estimated loan losses must be accrued when it is probable that losses have been incurred and the amount of the loss can be reasonably estimated.[3] These loan losses are recorded on the balance sheet as the ALLL. The Bank's ALLL includes two components: (1) the allowance required for loans not individually assessed for impairment, which is based on grouping by loan grade and type and collectively evaluating the pools for impairment; and (2) the allowance required for individually impaired loans, which is based on an individual loan level measurement of impairment. Any increase in the ALLL must be accompanied by the recording of a provision for loan losses on the income statement, thereby increasing reported losses.

3. GAAP requires that OREO be valued upon receipt at fair value less costs to sell and on an ongoing basis measured at the lower of its carrying amount or fair value less cost to sell.[4] GAAP and Rule 9-04 Item 14(d) of Regulation S-X required the Bank to record on its income statement any loss on OREO.

The Bank Failed To Measure Collective Impairments Properly

4. The Bank's material misstatements regarding the first component of the ALLL primarily stemmed from the Bank failing to properly grade hundreds of loans. During the Relevant Periods, the Bank's loan policy provided for seven loan grades: pass1, pass2, pass3, special mention, substandard, doubtful, and loss. Throughout the Relevant Periods, the Bank's loan portfolio included numerous loans that were graded as pass, but should have been downgraded to special mention or substandard. These grading errors resulted in the Bank understating its ALLL because lower graded loans carry a higher loan loss estimate, thereby increasing the first component of the ALLL.

5. Pursuant to the Bank's loan policy, loans were to be graded special mention when they had potential weaknesses that deserved management's close attention. Loans were to be graded substandard when they demonstrated well defined weakness. Internal Bank training further elaborated on the characteristics of substandard loans, including those that are seriously

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[3] See ASC 450-20-25-2.
[4] See ASC 310-40-40-3.

past due (60 days or more) and those with inadequate future cash flow potential, insufficient cash flow, unprofitable operations and/or inadequate debt service coverage, questionable repayment source, and advances to fund interest payments.

6. During the Relevant Periods, the Bank's loan department operated under a culture that discouraged downgrading loans to special mention or substandard. Loan officers were under pressure from certain members of management to avoid having any "bad loans" in their loan portfolios, including any loans that were graded below pass and loans that were more than 30 days past due. As a result, the Bank's loan department ignored and hid loan weaknesses that required downgrades and waited as long as possible to downgrade loans below pass, which sometimes included waiting until the loan was at or over 90 days past due, or until the loan was selected for review by a third party and was therefore at risk for being identified as a grade "miss."

7. The Bank's loan department undertook steps to prevent downgrades on certain loan relationships, including authorizing checking account overdrafts and the extension of additional credit to borrowers who were unable to make their required principal and interest payments on their existing debt. Sometimes this additional credit would be granted using loans referred to as "ABC Loans," which stood for "Additional Balance Club Loans." The additional credit was used to make required payments on the existing debt, which would result in the borrower appearing current on loan payments when, in fact, the Bank was not actually making any collections from the borrower.

8. Certain former members of the Bank's management and loan department employees circumvented and ignored internal accounting controls by failing to downgrade troubled loan relationships. For example, one instance, a former member of the Bank's management backdated documents to make it appear as if additional credit had been extended prior to Trinity's internal audit department downgrading a loan relationship to substandard. In other instances, credit was extended to borrowers without the required credit analyses being completed. In one instance a borrower's loans were downgraded from pass to substandard by the internal audit department in late March 2011, were then updated to pass at the direction of former members of management in early April 2011, and were then again downgraded to substandard in May 2011 when the borrower appeared on a list of loans to be reviewed by a third party.

9. In the case of one borrower and his associated entities, approximately $8.8 million in loans were improperly graded as pass during nearly all of the Relevant Periods. In connection with these loans, certain former members of the Bank's management established a practice, followed by loan department employees, of using a variety of techniques to ignore and hide the borrower's troubled financial situation, including granting additional credit to the borrower for the purpose of making payments on existing loans and modifying the loans and granting the borrower concessions without downgrading the loans or evaluating them as Troubled Debt Restructurings ("TDRs").[5] Members of the Bank's management did not follow up on

[5] Pursuant to GAAP, a restructuring of a debt constitutes a TDR if the creditor grants a concession to the debtor due to the debtor's financial difficulties. See ASC 310-40-15-5.

employees' concerns regarding the manner in which the Bank was managing and accounting for these loans. Further, certain former members of the Bank's management and loan department employees undertook efforts to prevent the OCC, the Board, and other Bank personnel from reviewing this borrower's loans and discovering the troubled nature of the borrower.

10. In another instance, throughout the Relevant Periods, a borrower had numerous loan extensions that delayed the borrower's repayment of the loans. The borrower's financial situation and payment history clearly indicated that he was struggling to make his payments in accordance with the terms of his notes; nonetheless, at the direction of a former member of the Bank's management, the loan officer continued to extend additional credit to make interest payments and to provide renewals and extensions to prevent the borrower from appearing on the Bank's past due list. Under the direction of a former member of the Bank's management, this borrower's loans were not handled in accordance with the Bank's internal policies and procedures. Further, in at least one instance, the loan department provided the borrower additional funds in the name of his entity so it would not be readily apparent that a loan payment was made through the extension of additional credit.

<u>The Bank Failed To Identify Troubled Debt Restructurings And Other Individually Impaired Loans</u>

11. The Bank's failure to identify individually impaired loans, including TDRs, led to material misstatements regarding the second component of the ALLL. GAAP provides that a loan is impaired when it is probable that the creditor will be unable to collect all the contractual interest and principal payments as scheduled in the loan agreement.[6] When loans are changed, for example by a restructure, extension or other modification, GAAP requires the transaction be evaluated to determine if the change constitutes a TDR.[7] If a loan is determined to be a TDR, GAAP considers the loan individually impaired and requires the amount of the impairment to be measured based on the individual impairment guidance.

12. During the Relevant Periods, the Bank failed to identify hundreds of individually impaired loans, understating the loans that should have been considered individually impaired by more than $50 million or more than 70% during the Relevant Period. Many of the newly identified impaired loans were also TDRs.[8] In identifying impaired loans, the Bank's loan department ignored GAAP and failed to identify certain loans as impaired until all potential means of repayment, were exhausted which in certain cases included the Bank granting

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[6] <u>See</u> ASC 310-10-35-16.
[7] <u>See</u> ASC 310-40-15-9(c).
[8] Regulation S-K Item 303(a) requires discussion in the MD&A sections of public filings, any "information that the registrant believes to be necessary to an understanding of its financial condition." Bank holding companies are directed to SEC Industry Guide 3, which requests that bank holding companies discuss the policy for placing loans on nonaccrual and state the aggregate of loans in the following categories: nonaccrual, accruing loans which are contractually past due 90 days or more, and other loans that are TDRs. Because the Bank failed accurately to report loans that were contractually past due 90 days or more and TDRs, its 2010 and 2011 Forms 10-K also contained false disclosures regarding these items.

numerous concessions to the borrower. In some instances, the Bank's internal loan documents were intentionally drafted to avoid triggering a review of the transaction as a TDR.

The Bank Failed To Measure Individual Loan Impairments Properly

13. The Bank also made material errors regarding the second component of the ALLL by failing to measure properly the loss for individually impaired loans. If a loan is individually impaired, the amount of impairment must be measured and recorded as an expense with a corresponding amount recorded to the ALLL. GAAP permits the impairment to be measured using the fair value of the underlying collateral if the loan is collateral dependent, which is the method the Bank typically utilized.[9] GAAP requires that the best information available in the circumstances be used to determine fair value.

14. It was the Bank's practice to order annual appraisals on loans graded special mention, substandard, or worse. Among other things, these appraisals were used to value the Bank's collateral that was used to measure the loss on impaired collateral-dependent loans. The Bank's appraisal department used a standard engagement letter that required appraisers to value properties in their current state ("as-is").[10] On properties still under construction and completed properties generating income, the Bank also ordered appraisals that would provide the value of a property at the time construction was complete ("as-completed") or when the property reached stabilized net operating income ("as-stabilized"). For purposes of measuring the impairment on a collateral dependent loan, the Bank was required to consider the current condition of the property, which can be accomplished by usingan "as-is" appraisal value. However, in at least two instances, certain former members of the Bank's management directed the use of the higher "as stabilized" or "as completed" values in measuring impairment losses when an as-is appraisal should have been used.

15. One example involved a $4.2 million loan that was substandard and impaired during the Relevant Periods. In 2010, at the direction of a former member of management, the Bank canceled an "as-is" appraisal on the property collateralizing the loan, resulting in the appraisal only providing an "as-stabilized" value after construction of the project was completed and operating profitably. The Bank then calculated its own "as-is" value by subtracting the cost-to-complete as provided by the borrower from the as-completed value. In the second half of 2011, the Bank obtained updated cost estimates that, if utilized, would have resulted in an impairment loss of approximately $1 million; however, the Bank ignored those updated cost-to-complete estimates. In the second quarter of 2012, the Bank finally received an appraisal that included an "as-is" value; however, utilizing the as-is appraisal value would have required an impairment loss of approximately $3.7 million. The Bank "rejected" the appraisal, deleted it from the Bank's electronic loan file, and continued to use the 2010 internally calculated "as-is" value based upon the as stabilized appraisal less the outdated cost to complete numbers in

[9] See ASC 310-10-35-23.

[10] ASC 820-10-20 defines fair value as the price that would be received to sell an asset in an orderly transaction between market participants as of the measurement date. The as-is appraisal considers the conditions of the property as of the measurement date, while the as-completed and as-stabilized appraisals do not.

measuring the impairment for the second quarter of 2012. The resulting improper valuations on this loan resulted in the Bank avoiding approximately $3.7 million in impairment losses throughout 2011 and in the first two quarters of 2012.

16. In another instance, the Bank ignored an appraisal valuing the collateral supporting an $8.9 million loan that was substandard and impaired. Throughout 2011 and the first two quarters of 2012, the Bank measured the loan's impairment by relying on a February 2011 appraisal that valued the property at approximately $15.9 million. In March 2012, the Bank was notified that the property had been appraised in January 2012 in connection with foreclosure litigation. The January 2012 appraisal would have resulted in an impairment loss of approximately $3 million. The Bank then disregarded the January 2012 appraisal, ordered another appraisal from a different appraiser, and continued to solely rely on the outdated February 2011 appraisal in accounting for the loan for the year-end 2011 and in the first two quarters of 2012, thereby avoiding recognizing loan losses totaling approximately $3 million.

17. In another example, the Bank participated in a $20.5 million loan that was substandard and impaired throughout the Relevant Periods. In calculating the impairment throughout the Relevant Periods, the Bank used the "as-stabilized" value of $32 million from a January 2010 appraisal and $27.4 million from a January 2011 appraisal. These "as-stabilized" values significantly overstated the fair value of the collateral, however, because they assumed significant changes to the property's operations, none of which occurred during the Relevant Periods.

18. In connection with that same loan, the Bank also ignored other material information relevant to the property's value that indicated that the loan required a significant impairment loss, including a listing agreement that listed the property for sale at a price that was millions of dollars below the appraised "as-stabilized" values, the Bank responding to inquiries of multiple potential purchasers that it was willing to accept a sales price that was millions of dollars below the appraised "as-stabilized" values, the Bank learning that another bank with an interest in the property was accounting for the loan based on a collateral value of $13 million, and an internal analysis that showed that the property could be worth $14 to $15 million assuming some improvements to the property's operating condition. By failing to measure the impairment on this loan properly, the Bank avoided recording approximately $8.9 million of loan losses throughout the Relevant Periods.

19. Similarly, on another loan for $2.7 million, the Bank avoided a $1.1 million impairment loss in 2011 by ignoring clear evidence of a lower collateral value. In February 2012, the Bank consented to a letter of intent for the sale of a loan's collateral so long as the Bank obtained $1.65 million from the sale. In accounting for the loan in the first quarter of 2012, however, the Bank ignored the letter of intent and instead used the outstanding loan balance of $2.7 million as the collateral value.[11]

[11] In fact, the Bank should have used the $1.65 million value in measuring the impairment for year-end 2011 because the value was known to the Bank prior to the filing of its 2011 Form 10-K and therefore,

The Bank Failed To Take Appropriate Losses On OREO

20. During the Relevant Periods, it was the Bank's practice to order appraisals on properties that were moving into OREO and annual appraisals on properties that remained in OREO. In 2011, the Bank failed to properly value and account for impairments to its OREO by not using appraisals that indicated that the value of OREO properties had decreased and that a decrease in the net carrying amount of OREO was required. Additionally, subsequent event appraisals received after the end of a quarterly or annual period, but before the financial statements were filed, that provided a better estimate of the fair value of the OREO at the end of the prior period end, were not always used, as required by GAAP, in the Bank's OREO accounting.[12]

The Bank failed to Devise and Maintain a System of Internal Accounting Controls

21. The material misstatements and the conduct by certain former members of Bank management was facilitated by the intentional circumvention of internal accounting controls, but were also aided by the Bank's failure to devise and maintain a system of internal accounting controls.

22. During the Relevant Periods, the Bank lacked sufficient internal accounting controls over the periodic review of loans to ensure loans were accurately graded and to identify troubled and impaired loans. Further, the Bank's internal audit department was not independent from management and, as a result, the Bank's Audit Committee was not always provided with complete and independent audit findings. The Bank's internal audit department also lacked a formalized risk assessment process and, as a result, did not sufficiently consider risks in financial reporting in establishing audit procedures.

23. The Bank also lacked sufficient internal accounting controls over the use of ABC Loans and the analysis of TDRs. For example, the Bank's internal loan approval and credit review processes failed to require an analysis of whether a loan modification or extension was a TDR. Similarly, in some instances, feedback and working papers from independent, third-party loan reviews indicated that a TDR analysis should be performed on specific loans; however, there were no controls in place to confirm that this feedback was reviewed, noted, and acted upon. Further, during the Relevant Periods, TDRs were rarely discussed within the loan department, and employees were not properly instructed as to how and when to analyze modifications as potential TDRs. Finally, numerous loans should have been evaluated as TDRs because a new loan was provided to pay interest or principal due on an existing loan. The Bank's loan policy failed to consider whether this situation resulted in a "concession."

24. The Bank lacked sufficient internal accounting controls over its accounting for impaired loans in conformity with GAAP. Loan department personnel calculating the impaired loan losses did not possess sufficient accounting expertise and there was not adequate

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pursuant to GAAP, it constituted a subsequent event that should have been recognized in the Bank's year-end financial statements.

[12] See ASC 855-10-25 and ASC 450-20-25-2.

involvement or review by the accounting department. As a result, errors occurred in the calculation of impaired loan losses.

25. The Bank also lacked sufficient internal accounting controls over appraisals. While the appraisal process was to be separate and independent from the loan department, in practice, loan department employees were charged with determining when appraisals would be ordered on classified loans and OREO properties. Further, at the direction of certain former members of the Bank's management and loan department, appraisals were sometimes not ordered timely, delayed, or ordered without the standard request for an "as-is" fair value. The accounting department was not automatically notified when appraisals were received, which meant that they were not always aware of appraisals relevant to impairment measurements or OREO write downs.

26. Additionally, appraisals received after the balance sheet date were not always considered, as required by GAAP, in the Bank's loan and OREO impairment accounting. The Bank was aware of this internal control issue by at least 2009 when the Bank's outside auditor found a $2.2 million subsequent event accounting error. Nonetheless, the Bank failed to implement controls to adequately address this issue and, throughout the Relevant Periods, the Bank's internal audit and accounting departments continued to stumble across appraisals that had not been factored into the Bank's accounting.

27. The Bank also lacked sufficient internal accounting controls over the Bank's processes and computerized systems that housed appraisals and loan information. Controls were inadequate to ensure all received appraisals were preserved in the Bank's database. Numerous employees, including loan officers, had edit rights to these systems allowing them to alter or delete data about loans, appraisals, collateral values and customers. Because of these inadequacies, employees could delete appraisals or change collateral values without documenting why the alterations were made. When appraisals and collateral values were deleted, the result was that information was not made available to the OCC and other third parties, as well as other Bank employees.

Violations

28. As a result of the conduct described above, Trinity 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.

29. As a result of the conduct described above, Trinity violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities.

30. As a result of the conduct described above, Trinity 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 pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

31. As a result of the conduct described above, Trinity 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 reflect their transactions and dispositions of their assets.

32. As a result of the conduct described above, Trinity violated Section 13(b)(2)(B), 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; and prohibit persons from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, knowingly falsifying any book, record or account, and directly or indirectly falsifying or causing to be falsified any book, record, or account.

Respondent's Remedial Efforts

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

Undertakings

Respondent undertakes to:

34. Provide Ongoing Cooperation. Respondent agrees to cooperate fully with the Commission with respect to this action and any judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party relating to the matters in this Order. Respondent's cooperation shall include, but is not limited to:

a. Production of Information. At the Commission's request on reasonable notice and without a subpoena, Respondent shall truthfully and completely disclose information and documents reasonably requested by Commission staff in connection with the Commission's related investigation, litigation, or other proceedings. Respondent will have no obligation to provide information voluntarily that it is not legally permitted to provide without a subpoena.

b. Production of Cooperative Personnel. At the Commission's request on reasonable notice, and without a subpoena, Respondent shall use reasonable efforts to secure the attendance and truthful statements or testimony of any current officer, director, principal, agent, or employee of Respondent, at any meeting, interview, testimony, deposition, trial or other legal proceeding. Persons providing testimony will have no obligation to provide information voluntarily that he or she is not legally permitted to provide without a subpoena.

In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondent Trinity cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act.

B. Pursuant to Section 21C of the Exchange Act, Respondent Trinity 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)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, and 13a-13 thereunder.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $1,500,000 to the Securities and Exchange Commission. The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to Exchange Act Section 21F(g)(3), transfer them to the general fund of the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Trinity 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 Thomas J. Krysa, Associate Regional

Director, Division of Enforcement, Securities and Exchange Commission, 1961 Stout Street, Suite 1700, Denver, CO 80294-1961.

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

By the Commission.

Brent J. Fields
Secretary

Commissioner Gallagher
Not participating
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76013 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16846

In the Matter of	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS
UBS FINANCIAL SERVICES INCORPORATED OF PUERTO RICO	
Respondent.	

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), against UBS Financial Services Incorporated of Puerto Rico ("UBSPR" or "Respondent").

II.

In anticipation of the institution of these proceedings, UBSPR 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, UBSPR 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 UBSPR's Offer, the Commission finds[1] that:

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

SUMMARY

1. UBSPR failed reasonably to supervise Jose G. Ramirez Jr. ("Ramirez") with a view to preventing and detecting his violations of the federal securities laws from at least 2011 through 2013. Ramirez, a UBSPR registered representative, made material misrepresentations and engaged in a fraudulent scheme involving the use of proceeds of non-purpose lines of credit ("LOC") to purchase securities. UBSPR offered its customers LOCs from a Utah-based affiliate, UBS Bank USA ("BUSA"). UBSPR's internal policy and the customer's loan agreements with BUSA prohibited the use of LOC proceeds to purchase, carry, or trade in securities; rather, LOCs were to be used to provide existing customers with liquidity and immediate access to cash to cover other purchases or expenses.

2. However, Ramirez effected a scheme that resulted in an increase to his compensation by soliciting certain customers to use proceeds from LOCs to purchase additional shares in UBSPR closed-end funds ("CEFs"). So that holders can qualify for certain tax benefits, the CEFs predominantly hold Puerto Rico municipal bonds and are only available to Puerto Rico residents. Ramirez misrepresented to certain customers UBSPR's policy prohibiting the use of LOC proceeds to purchase securities by advising them to transfer money from their UBSPR LOC account to an outside bank account, wait a few days, and then deposit money from the outside bank account into the customer's UBSPR brokerage account and purchase CEFs. Ramirez also made material misrepresentations to these customers regarding the safety of this strategy and did not disclose the risks of maintenance calls BUSA could make in the event the value of the customer's account (including its CEF holdings) decreased below specified levels of collateralization. Ramirez offered and sold approximately $50 million in CEFs to certain customers and made over $1 million in additional compensation.

3. UBSPR did not establish or implement reasonable procedures and had inadequate systems in place designed to prevent and detect Ramirez's conduct and his misstatements and omissions advocating the use of LOC proceeds to purchase securities in contravention of UBSPR's policy and the customers' agreements with BUSA. Moreover, UBSPR was made aware on at least two occasions that Ramirez may have been violating that policy, yet UBSPR procedures failed to address reasonable follow-up for violations of this policy.

RESPONDENT

4. UBSPR, a Puerto Rico corporation with its principal place of business in Hato Rey, Puerto Rico, is a broker-dealer registered with the Commission since 1982. UBSPR is a subsidiary of UBS Financial Services Inc. ("UBSFSI"), a broker-dealer registered with the Commission.

OTHER INDIVIDUALS AND ENTITIES

5. Jose G. Ramirez Jr., 56, was a registered representative and associated person of UBSPR in UBSPR's Guaynabo branch and was also a sales manager in that branch for a brief period of time. Ramirez was terminated by UBSPR in January 2014. Ramirez has been permanently barred from association with any FINRA member in any capacity.

6. Ramiro L. Colon, III, 49, was a registered representative and associated person of UBSPR, and was the branch office manager ("BOM") in UBSPR's Guaynabo office from 2007 through 2014 where he served as Ramirez's supervisor. From early 2011 through 2014 Colon was also the BOM of the Ponce and Mayaguez branches in addition to the Guaynabo branch (collectively, the Guaynabo Complex). Since January 2015, Colon is employed as a registered representative and associated person of UBSFSI, and is a financial advisor at UBSFSI and no longer serves in a supervisory capacity.

7. BUSA is a Salt Lake City, Utah-based FDIC-insured industrial bank organized and licensed since 2003. BUSA is regulated by the Utah Department of Financial Institutions, the FDIC and the Consumer Financial Protection Bureau.

8. The CEFs are closed-end investment management companies incorporated and organized under the laws of the Commonwealth of Puerto Rico. Since 1995, UBSPR has offered its customers twenty-three CEFS, nine of which are co-managed CEFs and fourteen of which are sole managed CEFs. UBSPR has served as primary underwriter for the twenty-three CEFs. The CEFs are not eligible margin securities or traded on any exchange or quoted on any quotation service, with UBSPR serving as the main secondary market dealer or liquidity provider. The CEFs are not registered with the Commission.

UBSPR's LINE OF CREDIT PROGRAM

9. In approximately 2003, BUSA began offering UBSPR brokerage customers a non-purpose line of credit through UBSPR at no initial cost to the customer and at interest rates below interest rates charged for margin loans. UBSPR encouraged registered representatives to open LOCs for new customers. Registered representatives were incentivized to offer LOCs, in part, because they received compensation based on an additional production credit and, in 2013, credit for net new assets when an LOC was drawn upon.

RAMIREZ'S VIOLATIVE CONDUCT

10. From 2011 through 2013, Ramirez offered and sold millions of dollars of CEFs to certain customers while soliciting them to use LOCs to purchase such securities and fraudulently misrepresenting the risks of this strategy to them. Ramirez knew that UBSPR policy and the customers' agreements with BUSA did not allow customers to use proceeds from the LOCs for the purpose of purchasing securities. Moreover, Ramirez signed LOC application forms misrepresenting that he had explained to those customers that: (1) BUSA can demand repayment of the loan at any time and (2) if the value of the pledged collateral falls below BUSA's maintenance requirements BUSA may require the customer to deposit additional collateral and/or sell the pledged collateral to repay the loan.

11. Despite the prohibitions on doing so, Ramirez presented to certain customers a way to make additional money by using the LOCs to increase their holdings of the CEFs. Because customers could borrow money through LOCs at rates as low as 1.5 percent and the CEFs were generating tax advantaged returns of greater than 6 percent, there was an arbitrage opportunity for customers and Ramirez also saw an opportunity to increase his production and commissions if customers purchased additional CEF shares with the proceeds of LOCs. To

accomplish his scheme, Ramirez encouraged these customers to withdraw funds from their LOC accounts, deposit those funds into an account at another bank, wait several days, and then re-deposit the funds from the outside bank account into a UBSPR brokerage account and purchase CEFs.

12. Ramirez misrepresented the strategy to numerous customers. When asked about the purpose of the deposit and redeposit, Ramirez explained to certain customers that one could not transfer money from an LOC internally to another UBSPR account. However, Ramirez stated that there was no violation as long as the proceeds were first transferred to an outside bank account. In meetings with these customers, to reassure them of the propriety of his strategy, Ramirez would take a dollar bill out of his wallet and say "if I give you this dollar and you bring [a different dollar] back next month, it's not the same dollar." Many of Ramirez's customers had been with Ramirez for many years and made money by going along with Ramirez's recommendations and strategies and knew of his standing within UBSPR as a top broker. Therefore, they either wrote a check or requested a wire transfer from their LOC account for deposit into their personal bank accounts at outside banking institutions. Customers then redeposited money into their UBSPR brokerage accounts and Ramirez purchased CEF shares on behalf of his customers contrary to UBSPR policy and their agreement with BUSA.

13. By advising certain customers to use LOC proceeds to purchase CEF shares, Ramirez exposed customers – some of whom were listed in their account documents as being "conservative" with regard to risk tolerance – to a greater risk than they otherwise would have been exposed. From January 2011 through September 2013, Ramirez executed more than 200 trades on behalf of customers in connection with this scheme. By September 2013, these Ramirez customers had received tens of millions of dollars in maintenance calls from BUSA after the value of their CEF shares declined.

UBSPR'S FAILURE REASONABLY TO SUPERVISE

14. UBSPR's "Credit Line Products WM Americas Compliance Policy" required that a credit line obtained from the firm must be used for purposes other than to purchase, trade, or carry securities. The customers' agreements with BUSA contained similar prohibitions, which also appeared on the face of the loan checks that customers received. The policy also required that, as part of the application process, registered representatives take reasonable steps to ensure customers understood the risks associated with taking a LOC, including that their collateral may become insufficient due to market declines and, in such circumstances, the customer may be required to increase the collateral, repay funds borrowed and/or sell securities voluntarily or involuntarily via a maintenance call.

15. However, UBSPR's policy did not provide for how the policy should be implemented nor did it describe steps registered representatives should take to ensure customers understood the risks involved. Although BUSA monitored transfer activity between UBSPR brokerage accounts for potential misuse of LOCs, UBSPR's policy did not implement any procedures concerning monitoring the proscribed and prohibited conduct when proceeds were transferred outside of UBSPR accounts.

16. UBSPR had inadequate procedures or systems in place to address compliance with its policy after the application process was completed and once the LOC was approved by BUSA. Indeed, UBSPR's Branch Office Managers' Supervisory Manual only addressed the application process and did not speak to the usage of LOCs once approved. Further, supervisors and operations personnel in the Guaynabo branch, where Colon served as supervisor and Ramirez worked, received no reports concerning credit line usage (other than compensation and production), and therefore did not conduct reviews for whether customers were using LOC proceeds to purchase securities, even though they were responsible for making sure registered representatives followed firm policy.

17. In August 2011, an operations manager in the Guaynabo branch questioned a series of transactions in the accounts of a Ramirez customer which she believed could have been the result of improper use of LOC proceeds to purchase securities. The operations manager raised her concerns to her supervisor, the Complex Administrative Manager ("CAM"), who took the information to Colon, who then met with Ramirez and discussed the transaction. Although Ramirez strenuously denied any impropriety, Colon reviewed the customer profile and discussed the activity with the CAM but conducted no additional investigation or monitoring and never discussed with the customer his usage of LOC proceeds or these specific transactions. Weeks later, the operations manager noticed a similar series of transactions by the same Ramirez client. Again, the operations manager raised the issue with the CAM. Upon hearing the concerns, and instead of escalating the issue, the CAM did not raise the issue with Colon or anyone else.

18. In addition, UBSPR failed to establish reasonable policies and procedures for follow-up of indications of misuse of LOCs. In the fall of 2011, the branch office manager in UBSPR's Hato Rey office – UBSPR's main branch – raised concerns to UBSPR's compliance group and asked it to investigate whether UBSPR registered representatives were improperly encouraging customers to use LOC proceeds to purchase securities. The compliance group contacted a compliance officer for BUSA who stated BUSA ran a report with the ability to track whether or not purchases had been made in accounts being used as collateral for LOCs within a certain time from a withdrawal and transfer from the LOC. It was not understood, however, that this report would not have captured the activity at issue because the money was first sent outside the firm before being redeposited and used to purchase securities. Until these events became known, UBSPR did not have a system in place to track LOC money moved outside the firm and then returned to the firm.

19. The Hato Rey manager followed up with the compliance group at various times in 2012 and was ultimately informed that compliance found no improper conduct. However, although certain reports were run, they were not adequately reviewed and, in any event, the Guaynabo branch was not included in the reports because of a clerical mistake that was not noticed. The compliance group's failure to adequately review this LOC information, including activity in the Guaynabo branch, was a significant lapse. Despite having twenty percent fewer registered representatives than UBSPR's headquarters in Hato Rey, Guaynabo branch customers had $475 million in total LOCs as of July 2013, nearly double Hato Rey's portfolio. Also, Ramirez was UBSPR's leading credit line producer among registered representatives in Puerto Rico during this period.

20. In 2013, the Puerto Rico bond market collapsed. The significant erosion in Puerto Rico bond prices beginning in August 2013 hit Puerto Rico investors hard, and particularly CEF holders, because the CEFs employed leverage up to 50 percent of the total CEF assets.

21. Many of Ramirez's customers with LOCs collateralized by brokerage accounts holding CEFs began receiving maintenance calls starting in August of 2013 and met with UBSPR representatives to discuss outstanding maintenance calls. During these meetings certain customers informed UBSPR representatives, including Colon, that Ramirez solicited them to use proceeds from LOCs to reinvest in additional CEF shares. Ramirez did not inform many of these customers of the risk associated with doing so.

22. As a result of these meetings with customers and related complaints, UBSPR conducted an internal investigation into the conduct alleged in the complaints. This review uncovered further incidences of using LOC proceeds to purchase CEF shares by certain customers of Ramirez. As a result, UBSPR terminated Ramirez and issued to Colon a letter of education for inaction related to this improper use of LOCs.

VIOLATIONS AND FAILURE REASONABLY TO SUPERVISE

23. Under Section 15(b)(4)(E) of the Exchange Act, broker-dealers are responsible for reasonably supervising, with a view to preventing and detecting violations of the federal securities laws, persons subject to their supervision. Respondent was responsible for supervising Ramirez.

24. Ramirez engaged in conduct that violated Section 17(a) of the Securities Act of 1933, which prohibits fraudulent conduct in the offer and sale of securities, and 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. Respondent failed reasonably to supervise Ramirez for the purposes of Section 15(b)(4)(E) of the Exchange Act because Respondent failed to establish procedures reasonably designed to prevent and detect Ramirez's violations of the securities laws and failed to have a system to implement any such procedures in a manner that would reasonably be expected to prevent and detect the violations by Ramirez.

AGREEMENT TO COOPERATE

25. 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 use all best efforts to make its principals, partners, officers, and employees available 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 counsel as agent to receive service of such notices and subpoenas; (iv) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (v)

consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept the Offer, the Commission has considered this agreement to cooperate.

IV.

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

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

A. UBSPR is censured.

B. UBSPR shall, within 14 days of the entry of this Order, pay disgorgement of $1,188,149.41, plus prejudgment interest of $174,196.97, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. UBSPR shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $13,637,653.62 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying UBSPR 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, Division of Enforcement, Securities and Exchange Commission, Miami Regional Office, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, prejudgment interest and penalties referenced in Section IV, Paragraph B above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76014 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16847

In the Matter of **RAMIRO L. COLON, III** **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 Ramiro L. Colon, III ("Colon" 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 Administrative Proceedings, Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

SUMMARY

1. Respondent, a former branch office manager of the Guaynabo Complex of offices of UBS Financial Services Incorporated of Puerto Rico ("UBSPR"), failed reasonably to supervise Jose G. Ramirez Jr. ("Ramirez") with a view to preventing and detecting Ramirez's violations of the federal securities laws from 2011 through 2013. Ramirez, a UBSPR registered representative, made misrepresentations and engaged in a fraudulent scheme involving the use of proceeds of non-purpose lines of credit ("LOC") to purchase securities. UBSPR offered its customers LOCs from a Utah-based affiliate, UBS Bank USA ("BUSA"). UBSPR's internal policy and the customers' loan agreement with BUSA prohibited the use of LOC proceeds to purchase, carry, or trade in securities; rather, LOCs were to be used to provide existing customers with liquidity and immediate access to cash to cover other purchases or expenses.

2. However, Ramirez effected a scheme that resulted in an increase to his compensation by soliciting certain customers to use proceeds from LOCs to purchase additional shares in UBSPR closed-end funds ("CEFs"). So that holders can qualify for certain tax benefits, the CEFs predominantly hold Puerto Rico municipal bonds and are only available to Puerto Rico residents. Ramirez misrepresented to certain customers UBSPR's policy prohibiting the use of LOC proceeds to purchase securities by advising them to transfer money from their UBSPR LOC account to an outside bank account, wait a few days, and then deposit money from the outside bank account into the customer's UBSPR brokerage account and purchase CEFs. Ramirez also made material misrepresentations to these customers regarding the safety of this strategy and did not disclose the risks of maintenance calls BUSA could make in the event the value of the customer's account (including its CEF holdings) decreased below specified levels of collateralization. Ramirez offered and sold approximately $50 million in CEFs to certain customers and made over $1 million in additional compensation.

3. In 2011, Respondent was alerted to the possibility that Ramirez was engaged in a scheme to use proceeds from LOCs to purchase CEFs. Instead of reasonably responding to and investigating this red flag, after reviewing the customer's profile, Respondent accepted Ramirez's explanation and did not follow up with the customer. Respondent failed to follow up on the red flag despite his awareness that Ramirez's performance and the performance of the Guaynabo branch with respect to LOC originations exceeded Ramirez's fellow registered representatives and that of the other Puerto Rico branches.

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

RESPONDENT

4. Ramiro L. Colon, III, 49, was a registered representative and associated person of UBSPR, and was the branch office manager ("BOM") in UBSPR's Guaynabo office from 2007 through 2014 where he served as Ramirez's supervisor. From early 2011 through 2014 Colon was also the BOM of the Ponce and Mayaguez branches in addition to the Guaynabo branch (collectively, the Guaynabo Complex). Since January 2015, Colon is employed as a registered representative and associated person of UBS Financial Services Inc. and no longer serves in a supervisory capacity.

OTHER RELEVANT ENTITIES AND INDIVIDUAL

5. UBSPR, a Puerto Rico corporation with its principal place of business in Hato Rey, Puerto Rico, is a broker-dealer registered with the Commission since 1982. UBSPR is a subsidiary of UBS Financial Services, Inc. ("UBSFSI"), a New York, NY broker-dealer registered with the Commission.

6. Jose G. Ramirez Jr., 56, was a registered representative and associated person of UBSPR in UBSPR's Guaynabo branch and was also a sales manager in that branch for a brief period of time. Ramirez was terminated by UBSPR in January 2014. Ramirez has been permanently barred from association with any FINRA member in any capacity.

7. BUSA is a Salt Lake City, Utah-based FDIC-insured industrial bank organized and licensed since 2003. BUSA is regulated by the Utah Department of Financial Institutions, the FDIC and the Consumer Financial Protection Bureau.

8. The CEFs are closed-end investment management companies incorporated and organized under the laws of the Commonwealth of Puerto Rico. Since 1995, UBSPR has offered its customers twenty-three CEFs, nine of which are co-managed CEFs and fourteen of which are sole managed CEFs. UBSPR has served as primary underwriter for the twenty-three CEFs. The CEFs are not eligible margin securities or traded on any exchange or quoted on any quotation service, with UBSPR serving as the main secondary market dealer or liquidity provider. The CEFs are not registered with the Commission.

UBSPR'S LINE OF CREDIT PROGRAM

9. In approximately 2003, BUSA began offering UBSPR brokerage customers a non-purpose line of credit through UBSPR at no initial cost to the customer and at interest rates below interest rates charged for margin loans. UBSPR Management encouraged registered representatives to open LOCs for new brokerage customers. Registered representatives were incentivized to offer LOCs, in part, because they received compensation based on an additional production credit and credit for net new assets when an LOC was drawn upon.

RAMIREZ'S VIOLATIVE CONDUCT

10. From 2011 through 2013, Ramirez offered and sold millions of dollars of CEFs to certain customers while soliciting them to use LOCs to purchase such securities and fraudulently misrepresenting the risks of this strategy to them. Ramirez knew that UBSPR policy and the customers' agreements with BUSA did not allow customers to use proceeds from the LOCs for the purpose of purchasing securities. Moreover, Ramirez signed LOC application forms misrepresenting that he had explained to customers that: (1) BUSA can demand repayment of the loan at any time and (2) if the value of the pledged collateral falls below BUSA's maintenance requirements BUSA may require the customer to deposit additional collateral and/or sell the pledged collateral to repay the loan.

11. Despite the prohibitions on doing so, Ramirez presented to certain customers a way to make additional money by using the LOCs to increase their holdings of the CEFs. Because customers could borrow money through LOCs at rates as low as 1.5 percent and the CEFs were generating tax advantaged returns of greater than 6 percent, there was an arbitrage opportunity for customers and Ramirez also saw an opportunity to increase his production and commissions if customers purchased additional CEF shares with the proceeds of LOCs. To accomplish his scheme, Ramirez encouraged these customers to withdraw funds from their LOC accounts, deposit those funds into an account at another bank, wait several days, and then redeposit the funds from the outside bank account into a UBSPR brokerage account and purchase CEFs.

12. Ramirez misrepresented the strategy to numerous customers. When asked about the purpose of the deposit and redeposit, Ramirez explained to certain customers that one could not transfer money from an LOC internally to another UBSPR account. However, Ramirez stated that there was no violation as long as the proceeds were first transferred to an outside bank account. In meetings with these customers, to reassure them of the propriety of his strategy, Ramirez would take a dollar bill out of his wallet and say "if I give you this dollar and you bring [a different dollar] back next month, it's not the same dollar." Many of Ramirez's customers had been with Ramirez for many years and made money by going along with Ramirez's recommendations and strategies and knew of his standing within UBSPR as a top broker. Therefore, they either wrote a check or requested a wire transfer from their LOC account for deposit into their personal bank accounts at outside banking institutions. Customers then redeposited money into their UBSPR brokerage accounts and Ramirez purchased CEF shares on behalf of his customers contrary to UBSPR policy and their agreement with BUSA.

13. By advising certain customers to use LOC proceeds to purchase CEF shares, Ramirez exposed customers – some of whom were listed in their account documents as being "conservative" with regard to risk tolerance – to a greater risk than they otherwise would have been exposed. From January 2011 through September 2013, Ramirez executed more than 200 trades on behalf of customers in connection with this scheme. By September 2013, these Ramirez customers had received tens of millions of dollars in maintenance calls from BUSA after the value of their CEF shares declined.

COLON'S FAILURE REASONABLY TO SUPERVISE

14. In August 2011, an operations manager in the Guaynabo branch questioned a series of transactions in the accounts of a Ramirez customer which she believed could have been the result of improper use of LOC proceeds to purchase securities. The operations manager raised her concerns to her supervisor, the Complex Administrative Manager ("CAM"), who took the information to Colon, who then met with Ramirez and discussed the transaction. Although Ramirez strenuously denied any impropriety, Colon reviewed the customer profile and discussed the activity with the CAM but conducted no additional investigation or monitoring and never discussed with the customer his usage of LOC proceeds or these specific transactions.

15. Despite having twenty percent fewer registered representatives than UBSPR's headquarters in Hato Rey, Colon was aware that Guaynabo branch customers had $475 million in total LOCs as of July 2013, nearly double Hato Rey's portfolio. Also, Ramirez was UBSPR's leading credit line producer among registered representatives in Puerto Rico during this period. Colon did not find this activity suspicious, however given this disparity, Colon should have looked further into Ramirez's performance.

16. In 2013, the Puerto Rico bond market collapsed. The significant erosion in Puerto Rico bond prices beginning in August 2013 hit Puerto Rico investors hard, and particularly CEF holders, because the CEFs employed leverage up to 50 percent of the total CEF assets.

17. Many of Ramirez's customers with LOCs collateralized by brokerage accounts holding CEFs began receiving maintenance calls starting in August of 2013 and met with UBSPR representatives to discuss outstanding maintenance calls. During these meetings certain customers informed UBSPR representatives, including Colon, that Ramirez solicited them to use proceeds from LOCs to reinvest in additional CEF shares. Ramirez did not inform many of these customers of the risk associated with doing so.

18. As a result of these meetings with customers and related complaints, UBSPR conducted an internal investigation into the conduct alleged in the complaints. This review uncovered further incidences of using LOC proceeds to purchase CEF shares by certain customers of Ramirez. As a result, UBSPR terminated Ramirez and issued to Colon a letter of education related to his supervision of Ramirez.

VIOLATIONS AND FAILURE REASONABLY TO SUPERVISE

19. Section 15(b)(4)(E) of the Exchange Act, authorizes the Commission to impose sanctions against an associated person of a registered broker-dealer for failing reasonably to supervise another person subject to the broker-dealer's supervision who committed a securities law violation. Exchange Act Section 15(b)(6) incorporates by reference Section 15(b)(4)(E) and authorizes the Commission to impose sanctions against an associated person of a broker-dealer for failing reasonably to supervise another associated person whom he or she supervised.

20. Ramirez engaged in conduct that violated Section 17(a) of the Securities Act of

1933, which prohibits fraudulent conduct in the offer and sale of securities, and Sections 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. Based on the above, Respondent failed reasonably to supervise Ramirez for the purposes of Section 15(b)(4)(E) of the Exchange Act.

AGREEMENT TO COOPERATE

21. 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 use all best efforts to be available 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 counsel as agent to receive service of such notices and subpoenas; (iv) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (v) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

In determining whether to accept the Offer, the Commission has considered this agreement to cooperate.

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.

V.

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

A. Respondent be, and hereby is, suspended from association with, in a supervisory capacity, any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, or from participating in an offering of penny stock for a period of 12 months, effective on the second Monday following the entry of this Order.

B. Respondent shall pay a civil money penalty in the amount of $25,000.00 to the Securities and Exchange Commission. The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, subject to Exchange Act Section 21F(g)(3), transfer them to the general fund of the United States Treasury. Respondent shall make this payment in two installments of $12,500.00. Respondent shall make the first installment of $12,500.00 within 14 days of the entry of this Order and the second and final installment of $12,500.00 within 180 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 the civil penalty, 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 Colon 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, Division of Enforcement, Securities and Exchange Commission, Miami Regional Office, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

C. Regardless of whether the Commission in its discretion orders the creation of a Fair Fund for the penalties ordered in this proceeding, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

VI.

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
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76027 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16849

In the Matter of **CHRISTOPHER MIRE,** **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 Christopher Mire ("Mire" or the "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Exchange Act, Making Findings, and Imposing a Cease-and-Desist Order (the "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 involves insider trading by Mire in the securities of Teche Holding Company ("Teche") and IberiaBank Corp. ("IberiaBank") in advance of the January 13, 2014 announcement that IberiaBank had agreed to acquire Teche (the "Announcement"), and its subsidiary bank, Teche Federal Bank (the "Bank").

2. During the months leading up to the Announcement, Mire received material non-public information about the proposed acquisition from his ex-wife and then companion, who was the administrative assistant to Teche's Senior Vice-President and Chief Operating Officer, and then traded on the basis of that information. As a result of his improper use of the inside information, Mire realized a trading profit of at least $2,128.21.

3. As a result of his conduct, Mire 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.

RESPONDENT

4. Mire, 49, a resident of New Iberia, Louisiana, is self-employed and owns an appliance repair shop. Mire and his ex-wife were married for 22 years before divorcing in 2008. The couple began living together again in May 2011, and did so during the time the relevant conduct occurred.

OTHER RELEVANT ENTITIES

5. Teche, based in New Iberia, Louisiana, was the holding company for the Bank, a state-chartered commercial institution with branches in the state of Louisiana. Teche's stock traded on the NASDAQ under the symbol "TSH" but was delisted on May 31, 2014, as a result of its acquisition by IberiaBank.

6. IberiaBank is a financial holding company with branch offices in Louisiana, Arkansas, Florida, Alabama, Tennessee, and Texas, and mortgage representatives in 10 states. IberiaBank's stock trades on the NASDAQ under the symbol "IBKC". In May of 2014, IberiaBank announced completion of the acquisition of Teche and its subsidiary bank.

[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

7. On January 13, 2014, Teche announced that it would be acquired by IberiaBank in an all-stock transaction valuing Teche stock at $72.16 per share, or 1.162 IberiaBank shares per share of Teche. On the same day, Teche's stock price increased from $54.50 to $70.17, a 28.76% increase.

8. This acquisition concluded a process that began as early as July 2013, when Teche's President and Chief Executive Officer decided to sell the Bank and took steps to explore strategic combinations. On August 12, 2013, Teche hired an investment firm to assist in exploring strategic combinations, including the possible sale of Teche and its subsidiary bank.

9. On October 3, 2013, this investment firm began contacting various financial institutions to ascertain their interest. In late November, two institutions, including IberiaBank, submitted written expressions of interest and proposals for business combinations. On January 12, 2014, Teche signed an Agreement and Plan of Merger with IberiaBank.

10. On July 31, 2013, Teche's President and Chief Executive Officer told Mire's ex-wife of his decision to sell the Bank and that as a result, she would be privy to confidential information and possibly be required to work extended hours. Mire owed a duty to his ex-wife because they were close family members with a practice of sharing confidences.

11. In the months preceding the merger, Mire's ex-wife had continued access to confidential information concerning the proposed acquisition and in December 2013 told Mire that she was worried about losing her job as a result of the merger, that IberiaBank was going to be the acquiring bank, and that this news would be made public in January 2014. She instructed Mire not to act on this information.

12. Subsequently, in a breach of duty of trust or confidence, Mire purchased 40 shares of IberiaBank stock on December 16, 2013 and 100 shares of Teche stock on December 18, 2013. Mire purchased these shares on the basis of material non-public information regarding the proposed acquisition, which he knew to be confidential. He sold all 100 Teche shares on January 13, 2014, and all 40 IberiaBank shares on January 15, 2014. Mire made a profit of $2,128.21 trading in Teche and IberiaBank stock.

13. As a result of the conduct described above, Mire violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Mire shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent shall, within ten (10) days of the entry of this Order, pay disgorgement, which represents profits gained as a result of the conduct described here of $2,128.21, prejudgment interest of $80.79, and a civil money penalty in the amount of $2,128.21 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 SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Christopher Mire 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, 18th Floor, Miami, FL 33131.

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. 76025 / September 29, 2015

WHISTLEBLOWER AWARD PROCEEDING

File No. 2015-8

In the Matter of the Claim for Award

in connection with

Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On July 13, 2015, the Claims Review Staff 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). Further, the Claims Review Staff recommended that such award be set in the amount of twenty-eight percent (28%) of the monetary sanctions collected or to be collected in the Covered Action. In arriving at this recommendation, the Claims Review Staff considered the factors set forth in Rule 21F-6, 17 C.F.R. § 240.21F-6, in relation to the facts and circumstances of Claimant's application.

On August 19, 2015, 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), 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 twenty-eight (28%) 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

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Corporate Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76006 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16843

In the Matter of **Hyperdynamics Corporation** **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 (the "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 (the "Exchange Act") against Hyperdynamics Corporation ("Hyperdynamics" or "Respondent" or the "Company").

II.

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

1. Hyperdynamics failed to accurately record certain payments made by its subsidiary based in the Republic of Guinea. The company initially recorded the payments as public relations and lobbying expenses to unrelated third parties without evidence that such services were actually performed. The company later determined that its Guinean-based employee controlled the third party entities, but did not record the payments as related party transactions. Hyperdynamics also failed to implement or maintain a system of adequate internal accounting controls to track the subsidiary's use of funds, as well as to determine whether the company's subsidiary paid related parties. The company's internal accounting controls also failed to provide reasonable assurances that Hyperdynamics's recording of such expenditures was accurate.

RESPONDENT

2. Hyperdynamics is a Delaware corporation headquartered in Houston, TX. Hyperdynamics's stock is registered under Section 12(g) of the Exchange Act and its shares are quoted by the OTCQX, an over-the-counter marketplace operated by OTC Market Group, Inc. Hyperdynamics is an emerging independent oil and gas exploration company which is exploring for oil and gas offshore the Republic of Guinea in West Africa.

FACTS

3. Hyperdynamics was founded in 1996 as a commercial computer and communications service provider. In 2001, the company transitioned to the oil and gas industry, and one year later, Hyperdynamics purchased contract rights from a small oil company which owned the exclusive drilling rights offshore the Republic of Guinea. Company executives began travelling to Guinea in 2005, and eventually opened a wholly-owned subsidiary in Conakry to facilitate ongoing operations.

4. From July 2007 through October 2008, Hyperdynamics, through its subsidiary, paid $130,000 for public relations and lobbying services in the Republic of Guinea to two supposedly unrelated entities – $55,000 to BerMia Service SRL, and $75,000 to Africa Business Service ("ABS"). The subsidiary's books and records were consolidated with Hyperdynamics's books and records, and these payments were recorded as public relations and lobbying expenses, even though the company lacked sufficient supporting documentation to determine whether the services were actually provided and to identify the ultimate recipient of the funds.

5. In late 2008, Hyperdynamics discovered that a Guinean-based employee controlled BerMia and ABS. Hyperdynamics also learned that this employee was the sole signatory on the ABS account. But Hyperdynamics could not determine how, if at all, BerMia or ABS spent the funds they had received, or whether any services actually were provided. Moreover, the company could not recover the funds. There is no evidence that these funds were in fact spent on legitimate public relations and lobbying activities, yet Hyperdynamics's books and records continued to reflect that the funds were spent for these purposes.

6. Hyperdynamics lacked adequate internal accounting controls over its disbursement of funds through its Guinean subsidiary, as well as its recording of such disbursements. In addition, the company did not have a due diligence and monitoring process in place for vetting third-party vendors; accordingly, it failed to conduct due diligence on BerMia and ABS. As a result, Hyperdynamics did not timely discover that the payments were made to companies controlled by its employee, nor could it ascertain the true purpose for which these funds were spent. The inadequate controls also led Hyperdynamics to record these disbursements as public relations and lobbying expenses without any supporting documentation that such services were provided.

7. As a result of the conduct described above, Hyperdynamics violated Section 13(b)(2)(A) of the Exchange Act, which requires issuers 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.

8. In addition, Hyperdynamics violated Section 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: (i) are executed in accordance with management's general or specific authorization; and (ii) are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets.

HYPERDYNAMICS'S REMEDIAL EFFORTS AND COOPERATION

9. Beginning in July 2009, Hyperdynamics replaced its senior management team and its entire Board of Directors. The company also hired its first in-house lawyer, who implemented a number of training programs and revised company policies related to its Guinean operations. Hyperdynamics also increased the number of its accounting personnel, and instituted a series of procedures to more strictly control and identify transfers of funds to Guinea, including the transfer of signature authority over Guinean accounts to Houston-based employees, as well as requiring corporate pre-approval for all Guinean expenditures.

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

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, Hyperdynamics cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. Hyperdynamics shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $75,000 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 Hyperdynamics 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.

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 76011 / September 29, 2015

Admin. Proc. File No. 3-15978

In the Matter of the Application of

MICHAEL NICHOLAS ROMANO

For Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDINGS

Registered securities association barred associated person in expedited proceeding based on failure to respond to information requests after denying motion to stay proceeding and after associated person's subsequent refusal to participate. *Held*, review proceeding is *dismissed*.

APPEARANCES:

Edward V. Sapone, of *Edward V. Sapone, LLC*, for Michael Nicholas Romano.

Alan Lawhead and *Andrew J. Love* for Financial Industry Regulatory Authority, Inc.

Appeal filed: July 16, 2014
Last brief received: November 17, 2014

Michael Nicholas Romano, formerly a co-founder and executive director of, and a registered representative with, WJB Capital Group, Inc. ("WJB"),[1] a former member firm of the Financial Industry Regulatory Authority, Inc. ("FINRA"), appeals from FINRA disciplinary action barring him from associating with any FINRA member in any capacity, based on his failure to provide information in response to a FINRA Rule 8210 request.[2] Romano's arguments concern "FINRA's wrongful denial of [his] motion to stay the FINRA proceedings." He asks that his bar "be overturned and the matter sent back to FINRA with instructions to stay the proceedings pending the outcome of [a] criminal trial" currently pending against Romano. Based on an independent, *de novo* review of the record, we find that FINRA acted within its discretion in denying Romano's motion and dismiss his application for review.

I. Background

Romano's appeal concerns a FINRA Rule 8210 request for information made in early 2014 and criminal proceedings instituted at that time by local prosecutors in New York. Romano claims that because FINRA and prosecutors coordinated their investigations, the FINRA information request constituted "state action" instead of private action and that, therefore, he should have been allowed to invoke his right against self-incrimination under the Fifth Amendment to the United States Constitution and his "Sixth Amendment right not to give up his attorney-client privilege and divulge his defenses to the pending criminal indictment."[3] He further claims that, because he properly invoked those rights, FINRA wrongfully denied his request to stay proceedings against him that were based on his refusal to provide the requested information. FINRA defends its investigation by stating that its Rule 8210 request pertained to

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1 WJB ceased operations and filed for bankruptcy in January 2012. Romano also owned between 50% and 75% of WJB.

2 Rule 8210 requires associated persons, such as Romano, to provide "information or testimony" in connection with a FINRA investigation.

3 The Fifth Amendment states, in part, that "[n]o person . . . shall be compelled in any criminal case to be a witness against himself." U.S. Const. amend. V. The Sixth Amendment provides, in part, that "[i]n all criminal prosecutions, the accused shall . . . have the assistance of counsel for his defense." U.S. Const. amend. VI. Where the Sixth Amendment right to the effective assistance of counsel attaches, this right includes the ability to speak candidly and confidentially with counsel free from unreasonable government interference. *See, e.g., Adams v. Carlson*, 488 F.2d 619, 630-31 (7th Cir. 1973) (recognizing confidentiality in the attorney-client relationship as an essential component of the Sixth Amendment right to effective assistance of counsel).

Courts have held that the Fifth Amendment and other constitutional provisions restrict only government conduct and will constrain a private entity such as FINRA only insofar as its actions are found to be "fairly attributable" to the government. *Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass'n*, 531 U.S. 288, 295 (2001). Actions are "fairly attributable" to the government where "there is a sufficiently close nexus between the State and the challenged action." *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 161 (2d Cir. 2002) (quoting *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 351 (1974)).

"serious allegations that Romano defrauded investors, filed false tax returns, and embezzled and misused funds from his firm." Further, FINRA argues that Romano made "generalized, sweeping allegations that FINRA acted hand-in-hand with prosecutors in his criminal action, without providing the necessary evidence to support such claims" and "chose not to appear at the hearing he had requested."

A. FINRA expelled WJB and barred certain of its officers.

In early 2012, FINRA commenced an investigation of WJB, its former chief executive officer, and its chief financial officer (the "2012 FINRA Investigation"). Pursuant to a Letter of Acceptance, Waiver, and Consent accepted by FINRA in June 2012, WJB was expelled from FINRA membership, its former CEO was barred from association with any FINRA member firm in all capacities, and its CFO was barred from association with any FINRA member firm in any principal capacity. As part of this settlement, FINRA found, among other things, that WJB had: (i) inappropriately booked certain loans and tax obligations and thus misstated its balance sheet and other books and records; (ii) misclassified certain receivables and thus misstated its FOCUS reports and net capital calculations by at least $1 million on a monthly basis for approximately two years; and (iii) at various times during 2011, engaged in securities transactions when it was below its minimum required net capital.[4] FINRA took no disciplinary action against Romano in connection with the 2012 Letter of Acceptance, Waiver, and Consent.

B. In February 2014, Romano was charged with criminal violations.

On February 6, 2014, the New York County District Attorney charged Romano and WJB's former CEO and CFO with seventy-one felony counts, including fraud and embezzlement involving WJB and at least fifteen investors. According to the indictment, the defendants sold fictitious receivables to one of WJB's customers, and Romano withdrew funds from WJB's bank accounts and used them for "payments toward a home mortgage and luxury cars, as well as at nightclubs, hotels, and country clubs." These alleged activities occurred between at least 2008 and 2012.

C. FINRA requested information and Romano failed to respond.

On February 6, 2014, Romano's then-employer, FINRA member firm ICAP Corporates LLC, terminated Romano after learning of his indictment and filed a Form U5 providing notice to regulatory authorities of his termination. A few days later, FINRA commenced its investigation of Romano (the "2014 FINRA Investigation").

On February 18, 2014, FINRA requested, pursuant to Rule 8210, that Romano provide a detailed response regarding, among other things, whether he had defrauded investors of more

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[4] 2012 WL 5281345, at *55-56 (Oct. 15, 2012). WJB and its former CEO and CFO "neither admitted nor denied the charges, but consented to the entry of FINRA's findings."

than $11 million in a bid to prop up WJB, participated in the embezzling of at least $7.1 million from WJB, and filed false tax returns.[5]

On February 28, 2014, Romano's attorney acknowledged receiving the information request, but declined to comply because of the pending criminal action. On March 4, 2014, FINRA sent Romano a second notice repeating its request for the specified information and informed him that a refusal to provide the information would result in disciplinary proceedings against him and potentially Romano's suspension and bar from the securities industry. On March 7, 2014, Romano responded to FINRA's second request, stating again that he would not provide the information while criminal proceedings remained pending.

D. FINRA instituted expedited proceedings against Romano.

On March 24, 2014, FINRA's Department of Enforcement issued Romano a notice pursuant to FINRA Rule 9552(a) (the "Pre-Suspension Notice"), informing him that, pursuant to FINRA provisions for expedited proceedings under its Rule 9550 Series, he would be suspended from associating with any FINRA member in any capacity, effective April 17, 2014, for his failure to respond to the prior Rule 8210 requests.[6] The Pre-Suspension Notice informed Romano that he could take corrective action to prevent the suspension, request a hearing in response to the notice or, if suspended, request termination of the suspension on the ground of full compliance. The Pre-Suspension Notice also stated that if Romano requested a hearing, he was required to state any and all defenses with specificity and that he would be barred automatically on June 27, 2014, if he failed to request a termination of the suspension.[7] On April 16, 2014 (one day before the suspension was to take effect), Romano requested a hearing, which was granted and scheduled for May 16, 2014.[8]

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[5] Other information requested by FINRA included a list of and statements for Romano's banking and brokerage accounts; his credit card statements; a list of his outside business activities and of judgments and liens against him while employed by WJB; a list of his e-mail addresses and phone numbers; and his tax returns.

[6] Under FINRA Rule 9552(a), if a member or associated person fails to provide information requested under Rule 8210, FINRA staff may provide written notice specifying such failure and stating that its continuation for twenty-one days after service of the notice will result in suspension of the member or associated person.

[7] Under FINRA Rule 9552(h), "a member or person who is suspended under this Rule and fails to request termination of the suspension within three months of issuance of the original notice of suspension will automatically be expelled or barred."

[8] *See* FINRA Rule 9552(d) (stating that, in expedited disciplinary proceeding for failure to provide information, suspension will take effect twenty-one days after service of the Pre-Suspension Notice, unless stayed by a hearing request); FINRA Rules 9559(a) and (c) (authorizing associated persons who are subject to expedited disciplinary proceedings to request a hearing and stating that such a request stays the effectiveness of a pre-suspension notice). As a result of Romano's hearing request, the effective date of the suspension was stayed.

A week later, on April 23, 2014, Romano filed a motion that was captioned "Motion to Stay FINRA Action," arguing that compliance with the information request would violate "his constitutional rights to remain silent" and that participating in the proceeding would "force[] [him] to give up his attorney-client privilege and divulge his defenses to the indictment." According to Romano's motion, the FINRA proceeding was "centered upon the identical alleged unlawful activity with which Mr. Romano is charged criminally," and the two proceedings were "sufficiently closely coordinated as to make FINRA an essential agent of the prosecuting authority."

FINRA's Enforcement staff opposed the motion. As support, it submitted three sworn declarations from FINRA staff members, acknowledging that FINRA staff had met with the New York District Attorney in 2012 and 2013 and provided documents and other information to the District Attorney relating to the 2012 FINRA Investigation. But the staff denied discussing the 2014 FINRA Investigation of Romano with prosecutors. Specifically, a FINRA investigator who had worked on the 2012 FINRA Investigation and met with District Attorney prosecutors declared that the purpose of those meetings was "to review the documents that had been collected by FINRA for FINRA's own investigation [of WJB] prior to May 2012." And a FINRA attorney who worked on the 2012 FINRA Investigation and met with District Attorney prosecutors confirmed that Romano "was not the subject of FINRA discipline in connection with the [2012 FINRA] Investigation" and that the 2012 FINRA Investigation "was completed in the Spring of 2012." The FINRA attorney also stated that neither FINRA nor the District Attorney asked the other to use its authority to obtain information. Further, a different FINRA staff attorney who worked on the 2014 FINRA Investigation of Romano stated, "Neither I, nor anyone assigned to this matter, have had any contact with the District Attorney's office concerning the Romano matter since opening the Romano matter."

E. Romano failed to participate in the hearing and was barred.

In orders issued April 29 and May 2, 2014, the hearing officer denied Romano's motion, finding that Romano had "not shown good cause." The hearing officer based his determination on several considerations, including that Romano sought a stay "of indeterminate length" and that "such an open-ended stay runs counter to the overall purpose of an expedited proceeding." He also noted that the information requested concerned serious allegations, including possible fraud and embezzlement. Moreover, the hearing officer found that Romano had not established that he was "likely to suffer prejudice" without a stay because he had "not shown that asserting his defenses" in the FINRA proceeding "would require him to waive any rights or privileges he claims to possess." The hearing officer simultaneously issued an order directing Romano to supplement his hearing request with a statement "setting forth with specificity the factual basis . . . if [he] intend[ed] to assert a defense based on alleged state action by FINRA." Romano never supplemented his hearing request.

In early May 2014, after his stay request was denied, Romano notified FINRA that he would not participate in the hearing, "as he could not do so without waiving his Fifth Amendment right against compelled self-incrimination and his attorney-client privilege, and divulging his defenses to the pending indictment." On May 7, 2014, based on Romano's refusal to participate further or provide a more definitive statement of his defense, the hearing officer found that Romano had abandoned his appeal and had waived his prior hearing request.[9] Accordingly, the Pre-Suspension Notice was "deemed to be final FINRA action." Romano filed no further appeals or hearing requests, and on June 27, 2014 (the date specified in the Pre-Suspension Notice), FINRA informed Romano that he was barred.

II. Analysis

Our review of FINRA's action in barring Romano is governed by Section 19(f) of the Securities Exchange Act of 1934.[10] That provision requires us to dismiss Romano's appeal if: (1) "the specific grounds" on which FINRA based its action "exist in fact," (2) the action was taken in accordance with FINRA's rules, and (3) "such rules are, and were applied in a manner, consistent with the purposes of" the Exchange Act.[11]

A. The specific grounds for the bar exist in fact.

We find that the specific grounds on which FINRA based its bar of Romano, as summarized above, exist in fact. Romano admits, and the record shows, that he violated Rule 8210 by not providing the information FINRA requested, and that, contrary to the hearing officer's orders, he neither participated in the subsequent FINRA hearing in early May 2014 regarding that violation nor supplemented his hearing request with a statement setting forth with specificity, for example, the factual basis supporting any defense based on alleged state action by FINRA.

B. FINRA acted in accordance with its rules.

We find that FINRA acted in accordance with its rules. As discussed above, FINRA Rule 9559(m) provides that if a respondent fails to support his appeal in an expedited disciplinary proceeding and refuses to participate in a scheduled hearing or to comply with any

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[9] Under FINRA Rule 9559(m), a respondent who fails to appear at a scheduled hearing or fails to comply with any order of the hearing officer shall be considered to have abandoned his defense and waived any opportunity for a hearing provided under FINRA's rules. Upon such a finding, the notice issued, here the initial suspension notice, "shall be deemed to be final FINRA action."

[10] 15 U.S.C. § 78s(f). Section 19(f) provides the standard for our review of expedited disciplinary proceedings for violations of Rule 8210. *See, e.g., Ryan R. Henry*, Securities Exchange Act Release No. 53957, 2006 WL 1565128, at *3 (June 8, 2006) (reviewing bar after expedited disciplinary proceeding under Section 19(f)); *Elliot M. Hershberg*, Exchange Act Release No. 53145, 2006 WL 140646, at *2 (Jan. 19, 2006) (same).

[11] 15 U.S.C. § 78s(f). Section 19(f) further requires that we set aside the challenged action if we find that it "imposes any burden on competition not necessary or appropriate in furtherance of the purposes of this title." Romano does not allege, and the record does not suggest, that barring him imposes any burden on competition.

order of a FINRA hearing officer, he will be deemed to have abandoned his appeal and the Pre-Suspension Notice will become the final action of FINRA. The Pre-Suspension Notice barred Romano as of June 27, 2014.

C. FINRA applied its rules consistently with the Exchange Act.

We find that FINRA applied its rules in a manner consistent with the Exchange Act. As we have emphasized, Rule 8210 is essential to FINRA's ability to investigate possible misconduct by its members and associated persons.[12] Given the regulatory importance of Rule 8210, FINRA's bar of Romano for failure to provide the requested information is appropriate and consistent with the purposes of the Exchange Act. The information at issue concerned allegations of significant and far-reaching misconduct, including fraud and embezzlement of millions of dollars, and raised serious doubts about Romano's fitness to continue as a securities professional. In seeking this information, FINRA was properly exercising its self-regulatory role of investigating possible misconduct by an associated person to determine whether disciplinary proceedings were warranted. Further, we have held that the use of expedited disciplinary proceedings for violations of Rule 8210 is consistent with the Exchange Act because it promotes an "efficient disciplinary process."[13]

D. The hearing officer's denial order was not an abuse of discretion.

As noted above, Romano bases his appeal on what he claims is the hearing officer's error in denying his stay request. We review the hearing officer's action under an abuse of discretion standard.[14] We will affirm a denial unless the hearing officer applied the wrong legal standard or

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[12] Rule 8210 is the principal means by which FINRA obtains information from member firms and associated persons in order to detect and address industry misconduct. *See, e.g., Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 WL 3306105, at *6 (Nov. 8, 2007) (stating that, because of a lack of subpoena power, Rule 8210 is a "vitally important" tool to acquire information).

[13] Exchange Act Release No. 61242, 2009 WL 5125425, at *1 (Dec. 28, 2009).

[14] *See, e.g., ORS Automation, Inc.*, Exchange Act Release No. 23256, 1986 WL 626182, at *3 (May 20, 1986) (reviewing stay denial in connection with national market system appeal by applying abuse of discretion standard).

Likewise, federal district court denials of analogous stay requests are reviewed for abuse of discretion. *See, e.g., SEC v. Wright*, 261 F. App'x 259, 262-63 (11th Cir. 2008) (applying abuse of discretion standard in reviewing stay denial and holding that the "blanket assertion of the privilege against self-incrimination is an inadequate basis for the issuance of a stay") (citations omitted); *Microfinancial, Inc. v. Premier Holidays Int'l, Inc.*, 385 F.3d 72, 77 (1st Cir. 2004) ("The decision whether or not to stay civil litigation in deference to parallel criminal proceedings is discretionary. Accordingly, we review the denial of a motion to stay for abuse of discretion.") (internal citations omitted).

As discussed below, FINRA's Rule 9550 Series, which governs expedited proceedings such as the disciplinary proceedings against Romano, does not specifically provide applicants

(continued...)

made a clear error of judgment.[15] And, in reviewing a denial of a motion to stay under the abuse of discretion standard, the moving party "must carry a heavy burden to succeed."[16]

The hearing officer considered Romano's motion under Rule 9559(d)(6), which provides for the extension of time periods in expedited proceedings where the moving party has shown good cause.[17] Although the motion sought a "stay" rather than an extension, there is no provision in FINRA's rules for staying expedited proceedings. Given the absence of any more specific provision and the general fairness of the "good cause" standard,[18] we find that the hearing officer applied the proper standard.[19] We also find that, in applying Rule 9559 to

(...continued)

with the ability to request a stay. But Rule 9559(d)(6) permits the hearing officer to extend or shorten any time limits prescribed in the expedited proceedings rule "[f]or good cause shown." We have held that such determinations are likewise subject to review under an abuse of discretion standard. *See Robert J. Prager*, Exchange Act Release No. 51974, 58 SEC 634, 2005 WL 1584983, at *13 (Jul. 6, 2005) ("In NASD proceedings, the trier of fact has broad discretion in determining whether to grant a request for a continuance."); *Falcon Trading Grp., Ltd.*, Exchange Act Release No. 36619, 52 SEC 554, 1995 WL 757798, at *5 (Dec. 21, 1995) ("It is well settled that in NASD proceedings, as in judicial proceedings, the trier of fact has broad discretion in determining whether a request for continuance should be granted, based upon the particular facts and circumstances presented."), *petition denied*, 102 F.3d 579 (D.C. Cir. 1996); *Whiteside & Co.*, Exchange Act Release No. 26187, 1988 WL 901551, at *4 (Oct. 14, 1988) ("The law does not require unlimited postponements of judicial proceedings, and the NASD has broad discretion as to whether or not a continuance should be granted. We find no abuse of discretion here."), *aff'd*, 883 F.2d 7 (5th Cir. 1989).

15 *See, e.g., United States v. Lopez*, 649 F.3d 1222, 1236 (11th Cir. 2011) (citing *United States v. Frazier*, 387 F.3d 1244, 1259 (11th Cir. 2004)). In applying the abuse of discretion standard, our "inquiry is limited to determining whether the denial constituted 'an unreasoning and arbitrary insistence upon expeditiousness in the face of a justifiable request for delay.'" *See Falcon Trading*, 1995 WL 757798, at *5 (quoting *Richard W. Suter*, 47 SEC 951, 963 (1983)).

16 *Microfinancial*, 385 F.2d at 77.

17 Rule 9559(d)(6) provides that, "[f]or good cause shown, . . . the Hearing Officer . . . may extend or shorten any time limits prescribed by" FINRA's Rule 9500 Series governing hearing procedures for expedited proceedings.

18 We similarly have considered postponement requests in our own administrative proceedings based on a good cause standard. *See, e.g., John Roger Faherty*, Exchange Act Release No. 41454, 1999 WL 331878, at *1-2 (May 26, 1999) (denying postponement of Commission's review of NASD disciplinary action where moving party failed to show good cause).

19 In support of his stay request, Romano invoked FINRA Rule 9222, which applies to non-expedited disciplinary proceedings, but which otherwise applies a "good cause" standard identical to the standard in Rule 9559 to a hearing officer's determinations regarding extensions of time and postponements of hearing dates. Romano also acknowledged that FINRA's rules do

(continued...)

Romano's stay request, the hearing officer did not make a clear error of judgment, as discussed below.

1. The hearing officer properly considered FINRA's interest in proceeding expeditiously.

The hearing officer's decision properly reflected FINRA's interest in proceeding expeditiously in cases in which its members or their associated persons fail to cooperate with investigations.[20] The language of Rule 8210 is "unequivocal" regarding an associated person's responsibility to cooperate with FINRA information requests. Vigorous enforcement of Rule 8210 "helps ensure the continued strength of the self-regulatory system—and thereby enhances the integrity of the securities markets and protects investors."[21] The indefinite stay Romano requested would have delayed FINRA's investigation into, among other things, allegations that he had defrauded investors of $11 million and thereby thwarted this vital FINRA objective and threatened the public interest in prompt and effective regulatory enforcement.

Romano contends that FINRA had no "need to proceed with particular haste" in making its Rule 8210 requests, given the length of the criminal investigation (approximately fifteen months) prior to Romano's indictment. We disagree. Whatever delay there may have been in the institution of criminal proceedings did not justify a further delay in FINRA's investigation and its efforts to protect the public interest. And it is undisputed that granting Romano's motion would have caused a substantial delay. In his response to questions regarding the length of the proposed stay, Romano's counsel stated that he "would have a much better outlook on the

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not specifically authorize a hearing officer to grant an indefinite stay of a disciplinary proceeding.

20 FINRA's Rules expressly permit it to bring expedited proceedings for Rule 8210 violations. *See* FINRA Rule 9552(a) (authorizing expedited proceedings for failure to respond to requests for information). The purpose of expedited proceedings in cases like this is to provide "a procedural mechanism for FINRA to address certain types of misconduct in an accelerated timeframe." *See FINRA Regulatory Notice 10-13* (Feb. 2010), at 1, 2. In general, FINRA decisions regarding the initiation of proceedings and the sanctions sought are entitled to considerable deference. *See Schellenbach v. SEC*, 989 F.2d 907, 912 (7th Cir. 1993) (stating that NASD proceedings are "an exercise of prosecutorial discretion [and] . . . are given wide latitude").

Expedited disciplinary proceedings in failure-to-respond cases are consistent with the purposes of the Exchange Act because they promote an efficient but fair and reasonable process. *Cf.* Exchange Act Release No. 61242, 2009 WL 5125425, at *1 (finding that Rule 9552's shortened suspension period—from six months to three months—is consistent with the purposes of the Exchange Act "because it is designed to promote a reasonable, fair, and efficient disciplinary process").

21 *See Howard Brett Berger*, Exchange Act Release No. 58950, 2008 WL 4899010, at *4 (Nov. 14, 2008), *aff'd*, 347 F. App'x 692 (2d Cir. 2009).

criminal case . . . within three to four months," at which point he would "likely know whether [he] only need[ed] another three to four months or another nine to twelve months."

2. The hearing officer properly considered the seriousness of the charges against Romano.

We also agree with the hearing officer's finding that the seriousness of the allegations weighed against Romano's motion. Romano seeks to minimize the significance of these allegations by asserting that they do not "include allegations connected to the purchase, retention or sale of securities." But FINRA has a strong interest in, and a long history of, investigating indications of dishonesty in business-related conduct, even when not related to securities transactions.[22] As the hearing officer noted, the allegations against Romano raised serious questions about Romano's fitness to continue in the securities industry. In our view, FINRA would have been remiss in not investigating such matters or in doing so on the delayed schedule proposed by Romano.

3. The denial did not prejudice Romano.

We also find no error in the hearing officer's determination that the denial would not prejudice Romano. Romano challenges this holding by asserting that "[i]f Romano were to have testified at the hearing or provided documents, it would have constituted a waiver of his constitutional rights for all purposes." Romano argues that he could not participate in the hearing for *any* purpose (including the introduction of evidence to support his state-action claims) because, according to his interpretation of cases applying the attorney-client privilege, "[t]here is no selective waiver [of the privilege] that can be made; a knowing, intentional waiver is a waiver for all purposes and all times."[23] Thus, according to Romano, he did not abandon his appeal by refusing to participate in the hearing, but took "a necessary step in preserving his constitutional arguments."

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22 *See, e.g., John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *7 (June 14, 2013) ("It is well established that FINRA's disciplinary authority . . . 'is broad enough to encompass business-related conduct . . . even if that activity does not involve a security.'") (quoting *Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 WL 32128, at *5 n.18 (Jan. 6, 2012)).

23 A selective waiver occurs when a client discloses privileged attorney communications to one party but seeks to continue asserting the privilege with respect to those same communications against other parties. *See Westinghouse Elec. Corp. v. Republic of the Phil.*, 951 F.2d 1414, 1423 & n.7 (3d Cir. 1991) (citations omitted). Romano has not explained why he would have had to divulge *any* privileged information to support his state-action claims. But if Romano had testified or provided documentation regarding the state-action issue at the FINRA hearing in such a way that required him to divulge privileged communications, he could have argued that it was a partial waiver that applied only to the information actually disclosed. *Id.*, 951 F.2d at 1426 & n.12 (citing *In re Von Bulow*, 828 F.2d 94 (2d Cir. 1987)) ("When a party discloses a portion of otherwise privileged materials while withholding the rest, the [attorney-client] privilege is waived only as to those communications actually disclosed. . . .").

We agree with the hearing officer that Romano failed to show "that asserting his defenses would require him to waive any rights or privileges he claims to possess or would otherwise prejudice him." The sole basis for Romano's defense to the Rule 8210 violation is his claim that FINRA engaged in state action—triggering constitutional limitations—by conducting its investigation in a "closely coordinated" manner on behalf of New York prosecutors. We have held that, if state action is established, an associated person otherwise subject to Rule 8210 may refuse information requests based on the Fifth Amendment.[24] But proving that status would require evidence of a high degree of integration between FINRA and the government, such as indications that FINRA sought information from Romano at the direction or behest of the District Attorney. And there is no direct evidence of such an interdependent relationship here.

Romano argues that the similar subject matter and close timing of the criminal charges against him and the FINRA information request show that FINRA engaged in state action. But we have held that "general collaboration or cooperation between the SRO and a government agency" does not demonstrate state action in the absence of "evidence suggesting an 'interdependence' between the government investigations and the SRO's [information] requests."[25] Romano also suggests that our "close oversight of SROs" and what Romano describes as "quasi-governmental powers" that FINRA exercises support his claim of state action, but reviewing courts have rejected similar claims.[26] Further, it is well established that close timing of FINRA and government investigations by themselves do not establish state action.[27]

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24 *See, e.g., Warren E. Turk*, Exchange Act Release No. 55942, 2007 WL 1800481, at *3 (June 22, 2007) (stating that "[a]lthough SROs are not . . . generally state actors, under certain limited circumstances, they may engage in state action" and thereby become subject to the Fifth Amendment right against self-incrimination). *See also supra* note 3 (discussing authority regarding when a private entity can be found to have engaged in state action).

Romano challenges the stay denial by arguing that "[a] person cannot be deprived of his employment [i.e., barred,] for declining to provide testimony that could be used against him in a criminal prosecution." But we have rejected similar arguments, holding that state-action defenses related to the loss of employment apply only when a private entity both engages in state action *and* forces an individual to choose between testifying and losing his employment. *See Turk*, 2007 WL 1800481, at *2 & n.11.

25 *Michael Sassano*, Exchange Act Release No. 58632, 2008 WL 4346410, at *9 (Sept. 24, 2008).

26 Courts have generally found that self-regulatory organizations, including FINRA's predecessor, NASD, are not inherently state actors based on their regulatory function, even where evidence suggests some degree of governmental cooperation in its investigations. *See, e.g., D.L. Cromwell*, 279 F.3d at 162-63.

27 *See, e.g., id.* (declining to find state action based on the fact that Rule 8210 requests "followed shortly after individual appellants contested grand jury subpoenas" and that NASD "refused to delay the Rule 8210 interviews until after completion of the . . . criminal investigation"); *Sassano*, 2008 WL 4346410, at *7 (finding that "the timing of the actions in the

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Given Romano's failure to proffer what specific testimony or other evidence would have established state action (or otherwise provided a defense to the Rule 8210 allegations against him), we see no basis for finding that his constitutional rights were implicated in the hearing officer's denial of his motion. Accordingly, we find that Romano failed to show any error in the hearing officer's determination that asserting his defenses would have required him to waive any constitutional rights or privileges or would otherwise have prejudiced Romano.

4. Precedent does not support Romano's appeal.

Romano cites several of our prior decisions regarding state-action claims to support his argument that FINRA erred. But the precedent he cites is readily distinguishable. For example, he cites *Frank P. Quattrone*,[28] where we remanded an NASD disciplinary action based on an alleged violation of Rule 8210. Romano argues that the applicant in that case was given the "opportunity to prove state action" on remand to NASD and suggests that he should be afforded the same opportunity. But in *Quattrone*, the applicant had not had an opportunity before the remand to introduce evidence regarding his state-action defense. Romano's situation is different because he had an opportunity to participate in the hearing and present evidence on his state action claim but chose not to take it.

Similarly misplaced is Romano's reliance on *Justin F. Ficken*,[29] where we remanded disciplinary proceedings based in part on our finding that Ficken may not have "had sufficient access to relevant information" on the state-action question. Unlike Ficken, Romano has made no claim that FINRA inhibited any efforts to obtain evidence of state action.[30]

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simultaneous regulatory investigations is insufficient to prove a 'causal connection between the requests for testimony' in the separate investigations").

28 *Frank P. Quattrone*, Exchange Act Release No. 53547, 2006 WL 768606, at *5-6 (Mar. 24, 2006).

29 *Justin F. Ficken*, Exchange Act Release No. 54699, 2006 WL 3147424 (Nov. 3, 2006).

30 In *Ficken*, we emphasized that the burden to establish state action was high and rested on the party asserting it, noting that the applicant "may not use the discovery process to go on a fishing expedition in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory." *Id.* at *6 & n.36 (citing *G.K. Scott & Co.*, Exchange Act Release No. 33485, 51 SEC 961, 1994 WL 17114, at *8 (Jan. 14, 1994); *John Montelbano*, Exchange Act Release No. 47227, 2003 WL 147562, at *12 (Jan. 22, 2003)). Although some of Ficken's claims relating to state action are similar to those asserted by Romano, including overlap between the subject matters of the two investigations and cooperation between governmental and non-governmental regulatory authorities, we did not find that they established state action. Instead, we found that Ficken should be given the opportunity to develop his state-action defense with the benefit of our decision in *Quattrone*, which was issued after the underlying decision in *Ficken*.

Romano also cites *Warren E. Turk*, another SRO proceeding that was remanded based on the applicant's claim of state action. But in *Turk*, although the applicant cited certain specific evidence, we found that the evidence he cited was "insufficient to establish state action."[31] That evidence included: (1) that Commission staff and the NYSE had sought the applicant's testimony within one month of each other; (2) that the Commission and the NYSE instituted proceedings on the same day and federal prosecutors filed criminal charges three days later; (3) that press releases indicated that the government agencies had cooperated with and assisted each other; and (4) that the applicant's former employer had told the applicant that federal prosecutors had requested that his employer member firm remove the applicant from the NYSE trading floor.[32]

Like Turk, Romano has failed to show state action. Romano's state-action arguments are less specific than Turk's and are unsupported. Given this failure and Romano's refusal to participate in a hearing where he could have introduced evidence to support his state-action claim, a remand is unwarranted here.

* * *

Based on our determination that FINRA's action in barring Romano satisfied the elements identified in Exchange Act Section 19(f) and that the hearing officer's determination to deny Romano's stay motion was not an abuse of discretion, we will dismiss this review proceeding. An appropriate order will issue.[33]

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

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

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31 *Turk*, 2007 WL 1800481, at *5.

32 Although we found no state action based on the record that had been developed, we nevertheless held that Turk "should have a further opportunity to develop and present his state action claim" because his evidentiary hearing occurred before the issuance of the decisions in *Quattrone* and *Ficken*. *Id.* at *5. In *Turk*, to support our finding that Turk had failed to show state action, we relied on *Quattrone* and *D.L. Cromwell*, which held that mere cooperation between a private actor and the government does not establish the existence of state action. *Id.* at *4.

33 We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76011 / September 29, 2015

Admin. Proc. File No. 3-15978

In the Matter of the Application of

MICHAEL NICHOLAS ROMANO

For Review of Action Taken by

FINRA

ORDER DISMISSING REVIEW PROCEEDING

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

ORDERED that the application for review filed by Michael Nicholas Romano be, and it hereby is, dismissed.

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 EXCHANGE ACT OF 1934
Release No. 76005 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16842

In the Matter of **Imperial Petroleum, 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 Imperial Petroleum, Inc. ("Imperial" or "Respondent").

II.

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

III.

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

1. Imperial (CIK No. 355356) is a Nevada corporation headquartered in Evansville, Indiana with a class of securities registered with the Commission under Exchange Act Section 12(g). As of August 14, 2015, the common stock of Imperial (symbol "IPMN") was traded on the OTC Link (formerly, "Pink Sheets") marketplace operated by OTC Markets Group, Inc., had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Imperial has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed an Annual Report on Form 10-K for any fiscal year subsequent to its fiscal year ending July 31, 2011, or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending April 30, 2012.

IV.

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

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means 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 the registration of each class of Imperial'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. 9932 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16267

In the Matter of PANKAJ KUMAR SRIVASTAVA and NATARAJ KAVURI, Respondents.	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933

I.

On November 12, 2014, the Securities and Exchange Commission ("Commission") instituted administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Pankaj Kumar Srivastava and Nataraj Kavuri (collectively, the "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, 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 ("Order") as set forth below.

III.

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

SUMMARY

1. These proceedings arise from an online high-yield securities offering fraud through which the Respondents solicited investments in a so-called pooled investment fund that would purportedly yield guaranteed profits. From approximately April 2013 until February 2, 2014, the Respondents operated a website, www.profitsparadise.com (hereafter "the Profits Paradise Website" or "the Website"), through which they solicited investments in securities. Investors were invited to deposit funds that would supposedly be pooled with other investors' funds to make "huge profits" in forex, stocks, and commodity trading. Profits Paradise offered three investment plans, each with a term of 120 business days. The first purportedly yielded 1.5% daily interest on investments of $10 to $749, the second purportedly yielded 1.75% daily interest on investments of $750 to $3,499, and the third purportedly yielded 2% daily interest on investments of $3,500 and above. The Website and related social media sites described the profits as "huge," "lucrative," "handsome," and "guaranteed," and they characterized the risk as "minimal." These claims of guaranteed profits were false. The offering also was structured in such a way that, under certain conditions, investors could never recover their principal investments.

2. The investments offered by Profits Paradise had the hallmark of a type of highly suspicious offering called a high-yield investment program ("HYIP"). According to the Commission's investor protection website at www.investor.gov, "The hallmark of a HYIP scam is the promise of incredible returns at little or no risk to the investor.... If you are approached online to invest in one of these, you should exercise extreme caution – it is likely a fraud."

3. Srivastava, a software engineer turned Internet marketer, directed the scheme. At Srivastava's request, his friend Kavuri took the lead in designing and marketing the Profits Paradise Website. In addition to the Website, Srivastava and Kavuri utilized Facebook, YouTube and other social media in an effort to attract investors. In conducting the fraud, the Respondents disguised their identities, including by communicating under pseudonyms. Based on this conduct, Srivastava and Kavuri violated Securities Act Sections 17(a)(1) and (3).

RESPONDENTS

4. **Pankaj Kumar Srivastava** ("Srivastava"), a resident of Mumbai, India, is an Internet marketer who created the Profits Paradise Website. He is trained as a software engineer and was previously employed at Tata Consultancy Services ("Tata"), a multinational information technology service, consulting and business solutions company headquartered in India. In 2005, Srivastava began a career as an affiliate marketer and worked for www.quixtar.com in Minneapolis, Minnesota. In 2007, he returned to India and became a full-time Internet marketer. Srivastava also ran the Internet marketing businesses associated with the websites www.unitedpaycheck.com and www.revenuetimes.com. Until May 2014, Srivastava maintained a personal website at www.pankajsrivastava.com. To conceal his identity while conducting the Profits Paradise fraud, Srivastava used the pseudonym "Paul Allen."

5. **Nataraj Kavuri** ("Kavuri"), a resident of Hyderabad, India, at all relevant times was employed at a multinational software company and played a leading role in designing and marketing the Profits Paradise Website. Concealing his identity while conducting the Profits Paradise fraud, Kavuri used the pseudonym "Nathan Jones." Kavuri admitted that he did so at Srivastava's request. Kavuri also assisted Srivastava in conducting business through the website www.unitedpaycheck.com.

BACKGROUND

A. Srivastava and Kavuri Created Profits Paradise

6. By February 2013, United Paycheck's business was failing and Srivastava created other Internet businesses, one of which was Profits Paradise. On February 1, 2013, Srivastava directed the Uttar Pradesh, India office of a company that provides web design and other services (hereafter, the "web designer") to register the domain name www.profitsparadise.com, and paid the web designer for its services. He gave the web designer a detailed explanation of the concept of Profits Paradise.

7. Following Srivastava's instruction, on or about February 2, 2013, the web designer registered the domain name www.profitsparadise.com through GoDaddy.com, LLC. In doing so, the web designer provided GoDaddy with the following identifying information supplied by Kavuri:

Registrant Name	Registrant Address	Registrant Telephone Number	Registrant Email
Jane Roe	300 Boylston Ave. E., Seattle, WA 98102	866-564-3789	janeroe032@gmail.com

Jane Roe is a fictitious name, and there is no connection between Profits Paradise and the dwelling at 300 Boylston Ave E., in Seattle, Washington, or its residents. The telephone number provided to GoDaddy is a toll-free number for a conference call center that is unrelated to Profits Paradise, and the Internet Protocol ("IP") addresses from which janeroe032@gmail.com was routinely accessed were located in India, not Seattle.

8. Kavuri disguised Profits Paradise's physical location by providing the false "whois" data, indicating that Profit Paradise's operations were within the United States when they were not.

9. To register a domain name, registrants must provide their full name, postal address, e-mail address, telephone number, and fax number (if available) for publicly searchable "whois" purposes, and certify that they have provided accurate and reliable contact details. Publicly available "whois" searches are designed to allow members of the public to discover who has registered a domain name and where to find them. Conducting a "whois" search for the Profits Paradise Website yielded the pseudonym "Jane Roe," the Seattle address that is unrelated to the Website, and the telephone number for a conference call center that is also unrelated to the Website. By supplying this fictitious information, Kavuri effectively prevented members of the public from discovering who was responsible for the Website.

10. The phony name and address served a dual purpose. In addition to concealing the fact that Srivastava and Kavuri were behind the Website, the domain name registration to Jane Roe at a Seattle address was meant to attract American investors. Additionally, to create the illusion that mainly American investors were visiting the Profits Paradise Website, Srivastava instructed the web designer to ensure that the "Alexa detail" showed the Website's "rank in the United States" rather than its "rank in India." "Alexa" refers to a website (www.alexa.com) that ranks other websites, by country, based on the amount of Internet traffic directed to the website.

11. Once the Profits Paradise domain name was registered, Srivastava began using the fictitious name Paul Allen with the email address unitedforex47@gmail.com to disguise his association with Profits Paradise. He instructed Kavuri to "use this email ID for any further communications." At Srivastava's request, Kavuri used the fictitious name Nathan Jones, which was associated with the email address coolblu49@gmail.com.

12. By late February 2013, online payment processor accounts were opened to receive investor funds. On February 23, 2013, Srivastava provided the web designer with the account numbers, and related information, for three Profits Paradise accounts at the payment processor Liberty Reserve. He also provided the web designer with information concerning a Profits Paradise account at another payment processor, Perfect Money. Kavuri directed the web designer to integrate the payment processor links into the Profits Paradise Website. On May 21, 2013, Srivastava provided the web designer with details for "Profits Paradise Testing accounts" at Perfect Money, Liberty Reserve, and another payment processor, EgoPay. In addition to providing the account information to the web designer, Srivastava indicated: "I have transferred 20$ [sic] to each account."

13. Kavuri played the lead role in developing the content for the Profits Paradise Website. On February 3, 2013, he sent Srivastava the first page of the Website. Over the next two months, Kavuri sent content for the Website to Srivastava and the web designer, including a version of the Website he sent on March 1, 2013, and an email he sent later that day with "Plan details." The three plan details promised: daily returns of 1.5% on an investment of $10-$750 (for a total return on investment of 180%); daily returns of 1.75% on an investment of $750-$3,500 (for a total return on investment of 210%); and daily returns of 2% on an investment of $3,500 and above (for a total return on investment of 240%) (hereinafter the "Plan Details"). Kavuri directed the web designer to "[u]se the numbers accordingly" and also wrote: "And compounding as we discussed earlier. Please call me if you need any clarification."

14. On March 1, 2013, under the subject line "About Profit [P]aradise business" Srivastava circulated key descriptive text for the Website that he and Kavuri had received earlier that day from an individual assisting them:

> Profits Paradise is an investment management company that deals in multiple financial sectors. The current economic instability in the world makes it imperative to look for stable sources of income that provide guaranteed profits on your investment. Here's where we come in.
>
> It is a known fact that massive profits require massive investment capital which is out of the reach of the average small investor. Not anymore. We at Profits Paradise allow investors to join in with small amounts which are pooled together to make huge profits in forex, stocks, and commodities trading. Whether you are an individual or a group, with small, medium or large investment budgets, we have something just for you.
>
> Our dedicated staff works round the clock to tap the best financial deals across the globe. Your money is handled by a team of qualified professionals with several

years of experience in investment portfolio management. Our unique trading strategy, extensive marketing research, and industry know-how guarantee profits with minimal risk so that you can relax and reap the benefits of our financial expertise.

15. Kavuri incorporated this language into the Profits Paradise Website and, on March 10, 2013, emailed it to Srivastava. This version of the Website included the Plan Details describing the three investment plans and their respective daily returns of 1.5%, 1.75% and 2%. The Website also explained how to open an account with Profits Paradise, and how to fund the account by depositing funds with a payment processor. It also offered "handsome commissions" for soliciting investments in Profits Paradise.

16. Kavuri provided instructions to the web designer as the Website was being developed. For example, on March 13, 2013, Kavuri emailed the web designer: "Could you pls ensure that Integrated version of PP [the Profits Paradise website] is launched on test site immediately. We want to complete final phase of testing and Launch it by this weekend." Srivastava likewise provided instructions to the web designer. During this period, Kavuri and Srivastava worked hand in glove on the Website. For example, on March 22, 2013, Srivastava provided Kavuri with a critique of content Kavuri added to the Website. And at Kavuri's request, Srivastava agreed to provide him with a "Mission and Vision" paragraph for the Website.

17. Concurrently, Srivastava and Kavuri began to market Profits Paradise through social media sites that they or individuals assisting them created. On February 25, 2013, Kavuri emailed Srivastava: "And now the other imp. thing is the video creation for PP." Two weeks later, Kavuri emailed Srivastava a link to a YouTube video. His subject line read: "PP Video – Final Cut." A few weeks later, on March 23, Kavuri asked Srivastava to create a YouTube account and upload Kavuri's Profits Paradise video, which they could then link to the Profits Paradise Website. The published version of the YouTube video outlined the three investment plans and their returns—1.5% daily for Plan A, 1.75% daily for Plan B, and 2% daily for Plan C—and represented that an "experienced professional handles your investment portfolio." In truth, both Srivastava's and Kavuri's professional backgrounds are in software engineering and/or Internet marketing, and neither are investment advisers or have other professional investment experience. Like the Profits Paradise Website, the YouTube video did not include a mailing address, telephone number, or the name of any person associated with Profits Paradise. Excessive secrecy, such as hiding who is behind a Website and investment scheme, is a hallmark of high-yield investment schemes.

18. In March 2013, Srivastava assigned responsibilities for the marketing of Profits Paradise, including a "Facebook campaign," and marketing through Twitter and GooglePlus. In doing so, he announced that Kavuri "will lead the team from the front. With his passion we are sure of success." The Facebook page—created on or about February 23, 2013—described Profits Paradise as "an investment management company that deals in multiple financial sectors" and advertised the three investment plans that would purportedly yield daily returns of 1.5%, 1.75%, and 2%. The Facebook page also advertised Profits Paradise's "5% Referral Commission." Other postings on the Facebook page referred to the "[h]igh profits generated by our financial experts" and promised that investors could "Enjoy Hassle Free Income." The Facebook page did not include a mailing address, telephone number, or the name of any individual associated with Profits Paradise.

19. Profits Paradise's Twitter account linked to the Profits Paradise Website, and to the Profits Paradise YouTube video. One of the Tweets stated: "We allow investors to join with small amounts which are pooled together to make huge profits in Forex." Another Tweet stated: "Profits Paradise offers 3 lucrative plans that offer fixed returns daily." Yet another stated: "We

encourage you to use your referral link and promotional banner on social media, blog, forum and email to share it with interested parties." The Twitter site did not include a mailing address, telephone number, or the name of any individual associated with Profits Paradise.

20. Profits Paradise's GooglePlus site also promoted investments in Profits Paradise. The GooglePlus site included the following statements, among others: "Our traders tap financial market trends and signals with stringent analysis and portfolio diversification spread over Forex, stocks, and commodity trading to ensure handsome profits for our customers," and "[w]e at Profits Paradise allow investors to join in with small amounts which are pooled together to make huge profits in forex, stocks and commodity trading." The GooglePlus site did not include a mailing address, telephone number, or the name of any individual associated with Profits Paradise.

21. The Profits Paradise Website and social media sites were available online from the spring of 2013 through early 2014. By December 2013, the Profits Paradise Facebook page had more than 3,000 "Likes." By mid-January 14, 2014, the Website had more than 4,000 visits each day, including more than 200 U.S. visits.

B. Profits Paradise was a Classic High-Yield Offering Fraud Scheme

22. The published version of the Profits Paradise Website contained the description that Srivastava emailed Kavuri in early March 2013, including the representation that "[w]e at Profits Paradise allow investors to join in with small amounts which are pooled together to make huge profits in forex, stocks, and commodity trading." The Website also described the three investment plans that Profits Paradise was offering:

In offering these investments, the Website explained that "[e]ach plan has a term of 120 business days" and that "[p]rofits are returned daily to your ProfitsParadise account." The Website also explained that "you can compound your deposits in multiples of 10%," a subject Kavuri had instructed the web designer on.

23. The Website included links to online payment processors through which investors could fund their Profits Paradise accounts: "Opening an account with any of the four payment processors is a simple and easy process. Please click on your preferred processor to open on [sic] account and follow the instructions provided to fund them."

24. The Respondents offered investments in the United States and their conduct took place on U.S. territory. Their investment scheme also was directed at United States investors, and the scheme had foreseeable and substantial effects in the United States. Among other things, the Website used the ".com" domain name for global reach and appeal, was registered claiming a physical location and point of contact within the United States, and contained writing in American English, using American spelling and the "$" sign. Respondents' related social media sites, directed to attracting and funneling investors to the Website via Facebook, YouTube and GooglePlus, were likewise written in American English and designed to solicit United States investors. By mid-January 2014, the Respondents' Website had more than 200 visitors per day from the United States.

25. The Website also encouraged investors to solicit others to invest in Profits Paradise, by promising referral commissions: "Yes, you can earn handsome commissions through our Affiliate Partnership program without funding your account. Successful partners can expect extra bonuses from the management based on their marketing skills." The Website further encouraged investors to advertise Profits Paradise through social media and elsewhere: "We encourage you to use your referral link and promotional banners on social media, blogs, forums and email to share it with interested parties."

26. The investment returns promised by Profits Paradise were extraordinary—180%, 210%, or 240% in 120 business days—and far exceeded the returns investors could reasonably expect on legitimate investments. According to the Website, an investment of $3,500 would yield a total return of $8,400 (240%) in a 120-day period, without taking into account "compounding" that Profits Paradise offered. If the same investor reinvested only the principal amount for the second 120-day period available in a calendar year, he or she would have earned approximately $16,800 (480%) annually, also without taking compounding into account.

27. The Website advertised that investors could "compound" their deposits "in multiples of 10%." It did not define the term compounding or otherwise explain its meaning. Instead, the Website contained a "Profits Calculator" that was intended to show investors the returns they could achieve through compounding. There, investors could type in two numbers: the dollar amount of their principal investment, and a "compounding %" of anywhere between 10% and 100% (in multiples of 10%). When the investor clicked the "Calculate" button, the Profits Calculator would display the results of compounding at the selected rate. According to the Website, compounded at a rate of 10%, an investor's initial $3,500 deposit would yield a total return of $9,483.01 (270.94%) after 120 days; at 50% compounding the same investment would yield USD $16,102.71 (460.08%) after 120 days; at 100% compounding, $34,178.07 (976.52%) after 120 days. If an investor reinvested the entire return ($34,178.07) for a second 120-day period at 100% compounding, then that initial investment of $3,500 would be worth $333,753 (9,535.82%) at the end of a single year.

28. The Website used the following terms to describe the risk involved in the investment: "guaranteed profits," "guaranteed profits with minimal risk," and "stable sources of income."

29. The investment offered by the Respondents through their Website was never legitimate and is a classic example of a high-yield investment program. The fields of investment described in the Website—namely foreign exchange, stocks, and commodities—involve high risk and could not sustain the returns guaranteed by Profits Paradise. Such returns are far in excess of returns that would be yielded by a safe, if any, investment.

30. Also, the Profits Paradise offering was structured so that under certain conditions investors could never recover their principal investments. The Website set the following limitation on what investors could withdraw from their Profits Paradise accounts: "Minimum withdrawal is $5. Maximum withdrawal is $400 per day." As a result, if an investor were to invest $20,000, he or she could not withdraw more than the earned interest at a rate of 2% per day or $400; that is, the investor could not withdraw any of the principal. Therefore, any investment above $20,000 could never be repaid even if the investor withdrew $400 each business day.

C. The Investments that Profits Paradise Offered Were Securities

31. The products offered by Profits Paradise were investment contracts because the Website: (a) solicited investors to deposit money, (b) that would purportedly be pooled with other investor money, (c) resulting in very high daily returns derived solely from the efforts of a team of purportedly qualified investment professionals.

32. The Profits Paradise offering was available to investors in the United States and worldwide, through the Website www.profitsparadise.com. The Respondents never registered the Profits Paradise offering or filed anything with the Commission.

33. During the Enforcement Division's investigation, on February 2, 2014, the Respondents allowed the domain name registration for www.profitsparadise.com to expire, removing publication of the Website from the Internet.

VIOLATIONS

34. As a result of the conduct described above, the Respondents violated Sections 17(a)(1) and (3) of the Securities Act, which prohibit fraudulent conduct in the offer or sale of securities.

CIVIL PENALTIES

35. Srivastava has submitted a sworn Statement of Financial Condition dated May 7, 2015, and other evidence and has asserted his inability to pay a civil penalty.

36. Kavuri has submitted a sworn Statement of Financial Condition dated May 27, 2015, and other evidence and has asserted his inability to pay a civil penalty.

UNDERTAKING

Respondents Srivastava and Kavuri have undertaken to:

Forgo participating in the issuance, offer, or sale of any security, directly or indirectly, whether through the Internet or by other means, including, but not limited to, through any entity owned or controlled by either of the Respondents; provided, however, that this undertaking shall not prevent Respondents from: (i) participating in the issuance, offer, or sale of any security offered and sold only by and to persons or entities resident outside the United States and for which the offering materials explicitly provide that the security is not being offered or sold to residents of the United States; and (ii) purchasing or selling any security for their own personal accounts.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents' Offers.

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(a) of the Securities Act.

B. Respondents shall comply with the undertaking set forth in Section III above.

C. Based on Srivastava's sworn representations in his Statement of Financial Condition dated May 7, 2015, and other documents submitted to the Commission, the Commission is not imposing a penalty against Srivastava.

D. Based on Kavuri's sworn representations in his Statement of Financial Condition dated May 27, 2015, and other documents submitted to the Commission, the Commission is not imposing a penalty against Kavuri.

E. The Division of Enforcement may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether both Respondents 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 the Respondents was fraudulent, misleading, inaccurate, or incomplete in any material respect. The Respondents may not, by way of defense to such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

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. 9936 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76033 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16870

In the Matter of **Ross, Sinclaire & Associates, LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Ross, Sinclaire & Associates, LLC ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, organized in Ohio and headquartered in Cincinnati, Ohio, is registered with the Commission as a broker-dealer, investment adviser, and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements or material omissions about prior compliance were the following:

- A 2013 competitive securities offering in which an obligor failed to disclose that it filed, just prior to the offering, an audited financial report on the MSRB's Electronic Municipal Market Access system 773 days late, and failed to file a required notice of the late filing;

- A 2011 competitive securities offering in which an obligor made no statement regarding its prior compliance and thereby failed to disclose that it filed an audited financial report 45 days late, failed to file required operating data for two consecutive years, and failed to file required notices of late filings for each of those; and

- A 2011 competitive offering in which an obligor failed to disclose that it failed to file operating data for two consecutive years it had previously undertaken to make, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is

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MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $220,000 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 Ross, Sinclaire & Associates, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9937 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76034 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16871

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against UBS Financial Services Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Delaware and headquartered in Weehawken, New Jersey is registered with the Commission as a broker-dealer and investment adviser.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A competitive securities offering in 2011 and another in 2012 in which an issuer failed to disclose that it filed annual financial reports and operating data for two fiscal years between 196 and 771 days late, and failed to file required notices of late filings for each of those. Respondent also acted as underwriter for a prior offering by the issuer;

- A 2011 competitive securities offering in which an issuer failed to disclose that, despite filing timely audited financial statements, it failed to file an annual continuing disclosure report containing certain operating data that it had previously undertaken to file for three of the previous five years, and that it had failed to file the required late filings for each of those. Respondent also acted as an underwriter for a prior offering by the issuer; and

- A competitive securities offering in 2011 and another in 2013 in which an issuer failed to disclose that it had filed two annual financial reports between 300 and 666 days late, failed to file operating data that it had previously undertaken to provide for any of the previous five years, and failed to file required late filings for each of those. Respondent also acted as an underwriter for a prior offering by the issuer.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make

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MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the

Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $480,000 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 UBS Financial Services Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9938 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76035 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16872

In the Matter of **UMB Bank, N.A. Investment Banking Division,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15B(c) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15B(c) of the Securities Exchange Act of 1934 ("Exchange Act") against UMB Bank, N.A. Investment Banking Division ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15B(c) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent is a separately identifiable division of UMB Bank, N.A., which is a national bank headquartered in Kansas City, Missouri. Respondent is registered with the Commission as a municipal securities dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB")

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2014 competitive securities offering in which an issuer failed to disclose that it had not filed two annual financial reports it had previously undertaken to make, despite disclosing that other annual financial reports were late, and failed to file the required late notices for each of those reports. Respondent also acted as underwriter in a prior securities offering by this issuer;

- 2013 and 2012 competitive securities offerings in which an issuer failed to disclose that since 2009 it had not filed any annual financial reports it had previously undertaken to make, and had not filed required notices of late filings for each of those reports. Respondent also acted as underwriter in a prior securities offering by this issuer; and

- A 2012 competitive securities offering in which an issuer failed to disclose that it had failed to file two annual financial reports, and had not filed required notices of late filings for either report. Respondent also acted as underwriter in a prior securities offering by this issuer.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the

Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15B(c) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $420,000 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 UMB Bank, N.A. Investment Banking Division 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9939 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76036 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16873

In the Matter of **U.S. Bank Municipal Securities Group, a Division of U.S. Bank National Association,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15B(c) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15B(c) of the Securities Exchange Act of 1934 ("Exchange Act") against U.S. Bank Municipal Securities Group, a Division of U.S. Bank National Association ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15B(c) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered municipal securities dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, a Division of U.S. Bank National Association, the banking subsidiary of U.S. Bancorp, incorporated in Delaware and headquartered in Minneapolis, Minnesota, is registered with the Commission as a municipal securities dealer. U.S. Bank National Association is registered with the Commission as a municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB")

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a municipal securities offering in which the official statement essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. The offering in which the official statement contained false or misleading statements about prior compliance was

- A 2011 negotiated securities offering in which an issuer failed to disclose that it filed an audited financial report on the MSRB's Electronic Municipal Market Access system 499 days late, and failed to file the required notice of late filing.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the

Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for

further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15B(c) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) 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 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 U.S. Bank Municipal Securities Group, a Division of U.S. Bank National Association 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9940 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76037 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16874

In the Matter of **Estrada Hinojosa & Company, Inc.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Estrada Hinojosa & Company, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Texas and headquartered in Dallas, Texas, is registered with the Commission as a broker-dealer and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which an issuer failed to disclose that it filed an annual financial report 363 days late, and failed to file the required notice of late filing; and

- A 2013 negotiated securities offering in which an issuer failed to disclose that it filed an annual financial report 33 days late, and failed to file the required notice of late filing.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the

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MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the

Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for

further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $40,000 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 Estrada Hinojosa & Company, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9941 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76038 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16853

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Fifth Third Securities, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Ohio and headquartered in Cincinnati, Ohio, is registered with the Commission as a broker-dealer, an investment adviser, and a municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB")

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which (i) an issuer failed to disclose that it filed three annual financial reports, including audited financial statements, between 34 and 90 days late, and failed to file required notices of late filings for each of those, and (ii) an obligor, just prior to the offering, filed four annual financial reports which were between 79 and 1,175 days late, but represented in the offering that it had not failed to comply with its continuing disclosure obligations over the prior five years without disclosing the late reports, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and

procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $20,000.00 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 Fifth Third Securities, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9942 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76039 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16854

In the Matter of **The Frazer Lanier Company, Incorporated,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against The Frazer Lanier Company, Incorporated. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Delaware and headquartered in Montgomery, Alabama, is registered with the Commission as a broker-dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2012 negotiated securities offering in which an issuer failed to disclose that it failed to file two annual financial reports it had previously undertaken to make, filed one annual financial report seventeen months late, and failed to file notices of late filing for each of those;

- A 2012 negotiated securities offering in which an issuer failed to disclose that it failed to file three annual financial reports it had previously undertaken to make, and had not filed notices of late filings for each of those; and

- A 2011 negotiated securities offering in which an issuer failed to disclose that it failed to file four annual financial reports it had previously undertaken to make, filed one annual financial report over a year late, and failed to file notices of late filing for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 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 The Frazer Lanier Co., Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9943 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76040 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16855

In the Matter of J.J.B. HILLIARD, W.L. LYONS, LLC, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against J.J.B. Hilliard, W.L. Lyons, LLC ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, a Kentucky limited liability company, headquartered in Louisville, Kentucky, is registered with the Commission as a broker-dealer, investment adviser, and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB")

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which an issuer failed to disclose that it did not file two years of operating data it had previously undertaken to provide, filed its audit for one of those years 46 days late, and failed to file required notices of late filings for each of those;

- A 2012 competitive securities offering in which an issuer failed to disclose that it did not file one year of operating data it had previously undertaken to provide, filed two audits 75 and 157 days late, and failed to file required notices of late filings for each of those. Respondent underwrote a prior issue by this issuer; and

- A 2012 negotiated securities offering in which an issuer failed to disclose that it did not file one year of operating data it had previously undertaken to provide, filed an audit 27 days late, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $420,000.00 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 J.J.B. Hilliard, W.L. Lyons, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9944 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76041 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16856

In the Matter of Joe Jolly & Co., Inc., Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Joe Jolly & Co., Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Delaware and headquartered in Birmingham, Alabama, is registered with the Commission as a broker-dealer and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements or material omissions about prior compliance were the following:

- A 2011 negotiated securities offering in which an issuer failed to disclose that it filed two annual financial reports between three and forty-eight months late, and failed to file required notices of late filings for each of those;

- A 2013 negotiated securities offering in which an issuer failed to disclose that it failed to file an annual financial report it had previously undertaken to file annually, and had not filed a required notice of late filing for that report; and

- A 2012 negotiated securities offering in which an issuer made no statement regarding its prior compliance and thereby failed to disclose that it filed two annual financial reports between two and three months late, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 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 Joe Jolly & Co., Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9945 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76042 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16857

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Mesirow Financial, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Delaware and headquartered in Chicago, Illinois, is registered with the Commission as a broker-dealer and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2011 negotiated securities offering in which an issuer failed to disclose that it failed to file an audited financial report it had previously undertaken to make, and failed to file a required notice of late filing;

- A 2010 negotiated securities offering in which an issuer failed to disclose that it failed to file four annual financial reports it had previously undertaken to make, and failed to file required notices of late filings for each of those; and

- A 2011 competitive securities offering in which an issuer failed to disclose that it filed an audited financial report 183 days late, and failed to file the required notice of late filing for that report. Respondent underwrote a prior offering by this issuer.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the Securities and Exchange Commission 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 Mesirow Financial, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9946 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76043 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16858

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Northland Securities, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Minnesota and headquartered in Minneapolis, Minnesota, is registered with the Commission as a broker-dealer, investment adviser, and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB")

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements or material omissions about prior compliance were the following:

- A 2013 negotiated securities offering in which an obligor made no statement regarding its prior compliance and thereby failed to disclose that it filed one annual financial report 166 days, and failed to file the required notice of late filing;

- Three negotiated securities offerings in 2011 and a negotiated securities offering in 2012 in which an issuer failed to disclose that it had not filed one annual financial report which it had previously undertaken to make, was 330 days late filing a second annual financial report, and failed to file required notices of late filings for each of those; and

- A 2012 negotiated securities offering in which an issuer failed to disclose that it had not filed one annual financial report that it had previously undertaken to make, and failed to file the required notice of late filing.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

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

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $220,000.00 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 Northland Securities, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9947 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76044 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16859

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against NW Capital Markets Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Delaware and headquartered in Hoboken, New Jersey, is registered with the Commission as a broker-dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2011 negotiated securities offering in which (i) an obligor failed to disclose that it had filed an annual audit 169 days late, failed to file operating data it had previously undertaken to provide for the same year, and failed to file required notices of late filings for each of those, and (ii) another obligor failed to disclose that it failed to file two annual financial reports it had previously undertaken to provide, and failed to file required notices of late filing for each of those; and

- Two negotiated securities offerings between 2011 and 2012 in which an obligor failed to disclose that it had filed an annual audit 169 days late, failed to file operating data it had previously undertaken to provide for the same year, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in

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MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and

procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 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 NW Capital Markets Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9948 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76045 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16860

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Ameritas Investment Corp. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Nebraska and headquartered in Lincoln, Nebraska, is registered with the Commission as a broker-dealer, investment adviser, and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2014 negotiated securities offering in which an obligor failed to disclose that it failed to file audited financial reports and operating data for two fiscal years it had previously undertaken to make, and failed to file required notices of late filings for each of those;

- A 2013 negotiated securities offering in which an issuer failed to disclose that it failed to file an annual financial report it had previously undertaken to make, and failed to file required notice of late filing for it; and

- A 2014 negotiated securities offering in which an issuer failed to disclose that, contrary to its previous undertakings, it failed to file any annual financial reports or audits for the previous three fiscal years, and failed to file the required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $200,000.00 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 Ameritas Investment Corp. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9949 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76046 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16861

In the Matter of **BB&T Securities, LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against BB&T Securities, LLC ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Delaware and headquartered in Richmond, Virginia, is registered with the Commission as a broker-dealer, investment adviser, and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2011 negotiated securities offering in which an issuer failed to disclose that it failed to file operating data for two fiscal years it had previously undertaken to make, and failed to file required notices of late filings for each of those;

- A 2012 negotiated securities offering in which an obligor failed to disclose that it filed an annual financial report over four months late, despite having filed a notice of late filing for that report; and

- A 2012 negotiated securities offering in which an obligor failed to disclose that it filed four annual financial reports between one and four months late, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and

procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $200,000.00 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 BB&T Securities, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9950 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76047 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16862

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Comerica Securities, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

140 of 147

III.

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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Michigan and headquartered in Detroit, Michigan, is registered with the Commission as a broker-dealer and investment adviser.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which a guarantor failed to disclose that since 2009 it had not filed its audited financial statements in the MSRB's Electronic Municipal Market Access system, and had not filed notices of late filings for each of those;

- A 2011 competitive securities offering in which an issuer failed to disclose that since 2006 it had not filed its audited financial information and had not filed timely notices of late filings for each of those. Respondent also underwrote a prior offering by this issuer; and

- A 2014 negotiated securities offering in which an issuer failed to disclose that it filed an annual financial report over 230 days late, and failed to file a required notice of late filing.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) 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 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 Comerica Securities, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9951 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76048 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16863

In the Matter of **Commerce Bank Capital Markets Group,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15B(c) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15B(c) of the Securities Exchange Act of 1934 ("Exchange Act") against Commerce Bank Capital Markets Group ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15B(c) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered municipal securities dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Missouri and headquartered in Kansas City, Missouri, is registered with the Commission as a municipal securities dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. The offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2012 competitive securities offering and a 2012 negotiated offering in which an issuer failed to disclose that it filed an annual financial report eight months late, and failed to file a required notice of late filing for that report. While the required annual financial report had been included in an official statement before the deadline, the issuer failed to provide within EMMA a cross-reference to that official statement.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the

Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for

further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15B(c) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $40,000.00 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 Commerce Bank Capital Markets Group 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9952 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76049 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16864

In the Matter of **Country Club Bank,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15B(c) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15B(c) of the Securities Exchange Act of 1934 ("Exchange Act") against Country Club Bank ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15B(c) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered municipal securities dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent is a state chartered banking institution with its principal offices in Kansas City, Missouri. Respondent is a subsidiary of CCB Financial Corporation, a Missouri Corporation headquartered in Kansas City, Missouri. Respondent is registered with the Commission as a municipal securities dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB")

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2011 competitive securities offering in which an issuer failed to disclose that it had not filed an annual financial report that it had previously undertaken to make, and failed to file the required notice of late filing. Respondent acted as an underwriter in a prior securities offering by this issuer;

- A 2012 competitive securities offering in which an issuer failed to disclose that it filed three annual financial reports between 201 and 369 days late, and failed to file required notices of late filings for each of those. Respondent also acted as underwriter in a prior offering by this issuer; and

- A 2014 competitive securities offering in which an issuer failed to disclose that it had failed to file annual and financial operating data for one fiscal year that it had previously undertaken to make in connection with a prior offering, and failed to file the required notice of late filing. Respondent also acted as underwriter in a prior offering by this issuer.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

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

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15B(c) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $140,000.00 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 Country Club Bank 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9953 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76050 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16865

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Crews & Associates, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Arkansas and headquartered in Little Rock, Arkansas, is registered with the Commission as a broker-dealer and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements or material omissions about prior compliance were the following:

- 2012 and 2013 negotiated securities offerings in which an issuer made no statement regarding its prior compliance and thereby failed to disclose that since 2009 it had not made any filings in the MSRB's Electronic Municipal Market Access system, and failed to file required notices of late filings for each of those;

- A 2012 negotiated securities offering in which an issuer made no statement regarding its prior compliance and thereby failed to disclose that it failed to file two audited financial reports in the MSRB's Electronic Municipal Market Access system, and failed to file required notices of late filings for each of those; and

- A 2011 negotiated securities offering in which an obligor failed to disclose that it filed two audited financial reports in the MSRB's Electronic Municipal Market Access system between 70 and 127 days late, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $250,000 to the Securities and Exchange Commission 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 Crews & Associates, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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.76026 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16848

In the Matter of **EDDIE R. LEBLANC,** **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 Eddie R. LeBlanc ("LeBlanc" or the "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "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 involves insider trading by LeBlanc in the securities of Teche Holding Company ("Teche") in advance of the January 13, 2014 announcement that IberiaBank Corp. ("IberiaBank") had agreed to acquire Teche (the "Announcement").

2. During the months leading up to the Announcement, LeBlanc received material non-public information about the proposed sale of Teche from Teche's President and Chief Executive Officer, and then traded on the basis of that information. As a result of his improper use of the inside information, LeBlanc realized a trading profit of at least $15,045.72.

3. As a result of his conduct, LeBlanc 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.

RESPONDENT

4. LeBlanc, 57, a resident of Youngsville, Louisiana, has over 35 years of experience in the banking sector. In September 1995, he was hired by Teche's subsidiary bank, Teche Federal Bank (the "Bank"), as its Senior Vice President and Chief Risk Officer. In this role, he managed the internal audit and compliance division for the Bank and reported directly to the Audit Committee of the Board of Directors and other senior level management of the Bank. Each year, LeBlanc read and signed an acknowledgement of a code of ethics, which, among other things, prohibited the use of confidential inside information for personal gain or benefit. LeBlanc remained Senior Vice President and Chief Risk Officer at the Bank until May 30, 2014, when his position was eliminated due to the acquisition by IberiaBank.

OTHER RELEVANT ENTITIES

5. Teche, based in New Iberia, Louisiana, was the holding company for the Bank, a state-chartered commercial institution with branches in the state of Louisiana. Teche's stock traded on the NASDAQ under the symbol "TSH" but was delisted on May 31, 2014, as a result of its acquisition by IberiaBank.

6. IberiaBank is a financial holding company with branch offices in Louisiana, Arkansas, Florida, Alabama, Tennessee, and Texas, and mortgage representatives in 10 states. IberiaBank's stock trades on the NASDAQ under the symbol "IBKC". In May of 2014, IberiaBank announced completion of the acquisition of Teche and its subsidiary bank.

[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

7. On January 13, 2014, Teche announced that it would be acquired by IberiaBank in an all-stock transaction valuing Teche stock at $72.16 per share, or 1.162 IberiaBank shares per share of Teche. On the same day, Teche's stock price increased from $54.50 to $70.17, a 28.76% increase.

8. This acquisition concluded a process that began as early as July 2013, when Teche's President and Chief Executive Officer decided to sell the Bank and took steps to explore strategic combinations. On August 12, 2013, Teche hired an investment firm to assist in exploring strategic combinations, including the possible sale of Teche and its subsidiary bank.

9. During either the last week of July or the first week of August 2013, Teche's President and Chief Executive Officer told LeBlanc of his decision to sell the Bank, that Teche was exploring potential strategic combinations, and that this information was confidential.

10. Subsequently, on August 8, 2013, LeBlanc purchased 595 shares of Teche stock in breach of a fiduciary duty owed to Teche's shareholders. LeBlanc purchased these shares on the basis of material non-public information regarding the decision to sell the Bank and to explore strategic combinations, which he knew to be confidential.

11. On August 12, 2013, Teche hired an investment firm to assist in exploring strategic combinations, including the possible sale of Teche and its subsidiary bank.

12. On October 3, 2013, this investment firm began contacting various financial institutions to ascertain their interest. In late November, two institutions, including IberiaBank, submitted written expressions of interest and proposals for business combinations.

13. On January 12, 2014, Teche signed an Agreement and Plan of Merger with IberiaBank.

14. LeBlanc sold his Teche stock on April 1, 2015. LeBlanc made a profit of $15,045.72 trading Teche Stock.

15. As a result of the conduct described above, LeBlanc violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent LeBlanc shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. For a period of three (3) years from the date of this Order, Respondent is hereby prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

C. Respondent shall, within ten (10) days of the entry of this Order, pay disgorgement, which represents profits gained as a result of the conduct described here of $15,045.72, prejudgment interest of $807.13, and a civil money penalty in the amount of $15,045.72 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 SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Eddie R. LeBlanc 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, 18th Floor, Miami, FL 33131.

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. 76007 / September 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16844

In the Matter of **ALLEN ROSS SMITH, Esq.** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i)(B) OF THE COMMISSION'S RULES OF PRACTICE**

I.

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

II.

The Commission finds that:

1. Allen Ross Smith is an attorney licensed in the State of Florida.

2. In April 2011, Smith signed a "Certification Letter" on his attorney letterhead that stated he had personal knowledge that his client, Malom Group ("Malom"), and its principals,

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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: (B) [f]ound by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party . . . to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

had "sufficient liquidity to immediately tender payment" of any refunds demanded by investors in Malom's fraudulent scheme to offer "structured notes" on unspecified "Western European exchanges." Smith had no basis for believing that the representations he made in the Certification Letter were truthful.

3. On May 2, 2014, the Commission filed a complaint against Smith alleging that he violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and Sections 5(a) and 17(a) of the Securities Act of 1933 ("Securities Act"), and aided and abetted violations of Exchange Act Section 10(b) and Rule 10b-5, and of Securities Act Section 17(a). The complaint sought a permanent statutory-based injunction; a conduct-based injunction from participating in the issue, offer, or sale of securities; disgorgement plus prejudgment interest; and civil monetary penalties. *SEC v. Allen R. Smith*, D. NH Case No. 14-cv-192-PB.

4. On July 2, 2015, the United States District Court for the District of New Hampshire granted the Commission's motion for summary judgment on its claims against Smith. The court found there was no genuine dispute of material fact that Smith was at least extremely reckless in violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The court further found that Smith's violations aided and abetted violations of Securities Act Section 17(a) and Exchange Act Rule 10b-5 by Malom and its principals. Finally, the court found there was no genuine dispute of material fact that Smith violated Securities Act Section 5, based on the undisputed factual showing that the fictional instruments underlying Malom's fraudulent "structured notes" investment scheme were unregistered, Smith signed the April 2011 Certification Letter used to secure investments in this unregistered offering, and Malom and Smith promoted the offering through multiple channels of interstate commerce. Based on these findings, Smith was ordered to pay disgorgement of $43,342, reflecting his principal earnings—plus prejudgment interest—from participating in the fraud. The court also found that the Commission was entitled to entry of a permanent injunction enjoining Smith from further violations of the securities laws and from participating in the offer or sale of securities, including as a paymaster, although to date it has not entered the final judgment.

III.

Based on the foregoing, the Commission finds that Smith has been found by a court of competent jurisdiction, in an action brought by the Commission, to have willfully violated and aided and abetted violations of provisions of the Federal securities laws, within the meaning of Rule 102(e)(3)(i)(B) of the Commission's Rules of Practice. In view of this finding, the Commission deems it appropriate and in the public interest that Smith be temporarily suspended from appearing or practicing before the Commission as an attorney.

IT IS HEREBY ORDERED that Smith 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 Smith 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 Smith personally or by certified mail at his last known address.

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. 76028 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16850

In the Matter of **CONTINUITYX SOLUTIONS, INC.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES**

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 ContinuityX Solutions, Inc. ("ContinuityX" 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 Pursuant to Section 12(j) of the Securities Exchange Act of 1934, Making Findings, and Revoking Registration of Securities ("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.

A. ContinuityX (CIK No. 1497814) is a Delaware corporation located in New York, NY. On February 14, 2013, ContinuityX filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code. On or about February 14, 2013, Robert L. Geltzer was appointed interim Trustee of ContinuityX, and was subsequently designated as the permanent Trustee of ContinuityX pursuant to an Order of the United States Bankruptcy Court for the Southern District of New York entered on June 28, 2013. At all times relevant to this proceeding, the securities of ContinuityX have been registered under Exchange Act Section 12(g). ContinuityX is currently quoted as CUSXQ on OTC Link operated by OTC Markets Group, Inc., has six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. ContinuityX 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 any annual report on Form 10-K since the period ended June 30, 2012, or quarterly reports on Form 10-Q since the period ended September 30, 2012.

IV.

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

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

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

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

By the Commission.

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. 76029 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16851

In the Matter of **LATOUR TRADING LLC** **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 (the "Commission") deems it appropriate and in the public interest that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act") against Latour Trading LLC ("Latour" 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 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 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:

INTRODUCTION

1. Much of the order flow in today's securities markets is typified by high-speed, high-volume, automated trading, with orders routed for execution in milliseconds or even

microseconds.[1] Market participants that engage in high-speed algorithmic trading use automated processes to generate orders, check for compliance with the securities laws, and transmit orders to the market. When these processes are designed or implemented incorrectly, the result can be that a market participant quickly sends to the market large numbers of orders in violation of applicable rules and regulations, such as Regulation National Market System ("Reg NMS") and the Market Access Rule (Rule 15c3-5 under the Exchange Act). Both of these regulations have requirements and protections that are important to the fair and efficient operation of the securities markets.

2. From October 2010 through August 2014, Latour Trading LLC ("Latour") sent approximately 12.6 million Intermarket Sweep Orders ("ISOs") that did not comply with the requirements of Reg NMS. These orders totaled over 4.6 billion shares, had a notional value of approximately $116 billion, and caused over 1.1 million trade-throughs and 1.7 million locked or crossed markets.[2] Latour's non-compliant ISOs resulted predominantly from a software coding change made by Latour's parent company in July 2011, without Latour's knowledge or approval, to a portion of the trading infrastructure that it shared with Latour. This coding change introduced an error into the software Latour used to send ISOs to the market. In addition, beginning in October 2010, Latour made a series of changes to its ISO routing logic that caused it to send ISOs to the market, under certain circumstances, that did not comply with the requirements of Reg NMS. Finally, throughout the relevant time period, Latour did not have adequate post-trade surveillance tools in place to detect its millions of non-compliant ISOs. Latour corrected many of these issues by October 2012, but the firm sent an additional approximately 322,000 non-compliant ISOs until August 2014, when it had addressed the remaining issues.

3. Latour violated both Rule 15c3-5 and Reg NMS. First, Latour violated the provision of Rule 15c3-5 that requires brokers and dealers with market access to have "direct and exclusive control" over their "financial and regulatory risk management controls."[3] Second, Latour violated the provisions of Rule 15c3-5 that require brokers and dealers to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access activity, including reasonably designed regulatory risk management controls.[4] Third, Latour violated Rule 611(c) of Reg NMS, which requires that brokers and dealers take reasonable steps to establish that the ISOs they send to trading centers satisfy the requirements for such orders under Reg NMS.

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[1] Risk Management Controls for Brokers or Dealers with Market Access, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (final rule release) ("Rule 15c3-5 Adopting Release").

[2] The terms ISOs, trade-throughs, locked markets, and crossed markets are explained below at paragraphs 7 – 11.

[3] 17 C.F.R. § 240.15c3-5(d).

[4] 17 C.F.R. § 240.15c3-5(b) and (c)(2)(i).

FACTS

A. Respondent

4. Latour Trading LLC ("Latour"), a U.S.-based broker-dealer, has been registered with the Commission since July 2009. Latour does not have any customers and engages only in proprietary trading. Until January 2014, Latour was wholly owned by Tower Research Capital Investments LLC, and its managing member was Tower Research Capital LLC ("Tower Research"), a firm that engages in quantitative investment strategies through affiliates ("trading teams") that trade on multiple domestic and foreign markets. In January 2014, Tower Research Capital Investments LLC assigned all of the issued and outstanding interests of Latour to Tower Research.

5. Latour uses high-frequency algorithmic trading strategies to conduct its proprietary trading in Exchange Traded Funds ("ETFs") and equity securities. During the period from October 2010 to April 2015, Latour sent over 12.8 billion orders to U.S. exchanges, approximately 233 million orders on average per month. During this same time period, Latour sent over 1 billion ISOs to U.S. exchanges, approximately 19 million ISOs on average per month. Latour's ISOs were much more likely to be executed than its non-ISOs. While approximately 7% of Latour's total orders received at least a partial execution, nearly 62% of its ISOs received at least a partial execution. Approximately, 12.3 million of Latour's 12.6 million non-compliant ISOs occurred between October 2010 and October 2012, comprising approximately 2.32% of the ISOs it sent during that time period and approximately 0.16% of its overall orders.

B. Regulatory Requirements

Rule 15c3-5

6. The Commission adopted Rule 15c3-5 to require that brokers or dealers, as gatekeepers to the financial markets, "appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system."[5] Rule 15c3-5(d) generally provides that the financial and regulatory risk management controls and supervisory procedures required by the rule must be under the "direct and exclusive control" of the broker or dealer. Rule 15c3-5(b) requires that brokers or dealers with market access must establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access activity. Rule 15c3-5(c)(2)(i) requires that brokers or dealers with market access must have controls and procedures reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis. Such regulatory requirements include the conditions that must be satisfied under Reg

[5] Rule 15c3-5 Adopting Release at 69792.

NMS before an order can be marked as an ISO.[6]

Reg NMS

7. Rule 611 of Reg NMS, also known as the Order Protection Rule, establishes protection against trade-throughs for all NMS stocks[7] across multiple trading centers. A trade-through occurs when a trading center executes an order at a price that is inferior to the price of a protected quotation displayed at another trading center. Protected quotations generally are the best bids and offers displayed by a national securities exchange or a national securities association.[8] Rule 611 promotes dual objectives: supporting competition among multiple trading centers while also linking those trading centers into a unified system so that orders themselves can compete.[9]

8. ISOs are an exception to the trade-through prohibition reflected in Rule 611. The ISO exception contemplates a market participant seeking to access multiple price levels at different trading centers at the same time.[10] Rule 600(b)(30) defines an ISO as a limit order that meets the following requirements: (1) the limit order is identified as an ISO; and (2) simultaneously with the routing of the limit order, one or more additional limit orders, as necessary, are routed to execute against all better-priced protected quotations displayed by other trading centers up to their displayed size. These additional orders also must be marked as ISOs.

9. A trading center that receives an ISO may execute the order immediately, even if doing so would appear from the perspective of the trading center to trade-through the protected quotations at one or more other trading centers.[11] Under Rule 611, by marking an order as an ISO, a broker or dealer represents to a trading center that it has sent all of the necessary orders to execute against the pertinent protected quotations displayed at other trading centers. Rule 611(c) imposes an affirmative obligation on brokers or dealers sending ISOs to take reasonable steps to establish that they have satisfied the requirements of sending an ISO, i.e., sending all of the necessary orders to execute against the pertinent protected quotations.[12]

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[6] *See id.* at 69803.

[7] *See* 17 C.F.R. § 242.600(b)(46) and (47) (defining "NMS stock" and "NMS security").

[8] *See* 17 C.F.R. §242.600(b)(57), (58) (defining "protected bid," "protected offer," and "protected quote).

[9] *See* Regulation NMS, 70 Fed. Reg. 37496, 37498 (June 29, 2005) ("Reg NMS Adopting Release").

[10] *See id.* at 37523 ("The Commission also included in the reproposal paragraphs (b)(5) and (b)(6) of Rule 611 that provided exceptions for intermarket sweep orders that respond to the need of market participants to access multiple price levels simultaneously at different trading centers.").

[11] *See id.* ("Paragraph (b)(5) allows a trading center to execute immediately any order identified as an intermarket sweep order, without regard for better-priced protected quotations displayed at one or more other trading centers."); *see also id.* at 37536 (illustration of operation of ISO exception).

[12] 17 C.F.R. § 242.611(c) and § 242.600(b)(30).

10. Rule 610 of Reg NMS, known as the Access Rule, also has relevance for ISOs. Rule 610(d), in particular, requires national securities exchanges and associations to implement written rules that require their members to reasonably avoid displaying, and prohibit them from engaging in a pattern or practice of displaying, quotes that lock or cross protected quotations. This requirement promotes "fair and orderly markets by establishing that the first protected quotation at a price is entitled to an execution at that price instead of being locked or crossed by a quotation on the other side of the market."[13] These exchange rules generally provide an exception if the member designates the order that it wishes to have displayed as an ISO and simultaneously sends other ISOs to execute against any equally- or better-priced quotations displayed at other trading centers, thereby taking reasonable measures to avoid displaying, or engaging in a pattern or practice of displaying, quotes that result in locked or crossed markets.[14]

11. Generally, the failure by a market participant to comply with the ISO requirements under Rule 611 and exchange rules adopted pursuant to Rule 610 can result in potential consequences to other market participants who lose executions that they otherwise might have received. In addition, in some instances, other market participants might not receive rebates that they otherwise might have obtained. For example, a non-compliant ISO could execute against a worse-priced, contra-side order at one trading center while a better-priced, contra-side order at another trading center remains unexecuted. Additionally, a non-compliant ISO could create a locked market because the market participant did not send an ISO to execute against an equally-priced, contra-side order displayed at another trading center. In both scenarios, the contra-side order might not receive the execution and/or the rebate that it otherwise might have received. Moreover, depending on a trading center's priority rules, a non-compliant ISO could receive execution priority over an equally-priced, same-side order that had been submitted to the trading center earlier but not displayed because it would have locked a protected quotation.

C. <u>Latour's Use of ISOs</u>

12. Latour employs ISOs in two principal contexts. First, Latour uses ISOs to hedge positions that it acquires. Sending a set of ISOs enables Latour to access the best-priced quotations available at multiple trading centers simultaneously, thereby acquiring the desired number of shares needed to hedge a position quickly and at the lowest cost possible. Second, Latour places post-only ISOs[15] through which it will receive exchange rebates when incoming orders execute against its posted ISOs.

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[13] Reg NMS Adopting Release at 37503.

[14] *See, e.g.,* BATS Exchange Rule 11.20(b) and (d)(3), *available at* http://cdn.batstrading.com/resources/regulation/rule_book/BATS_Exchange_Rulebook.pdf.

[15] A post-only ISO is an ISO that also is marked with a modifier offered by exchanges, generally referred to as "post-only" or "add liquidity only." A post-only order is an order that only will execute if it first is added, or "posted," to the exchange's order book and then, after being posted, is matched with another order. Because post only-orders will not be matched with an order that already is present on the exchange's order book, such orders are often defined as orders that will not remove liquidity.

13. As part of its automated process for sending ISOs, Latour generates a "snapshot" of the protected quotations displayed at each U.S. exchange, as reflected in the market quote data that it receives.[16] Based on this snapshot, Latour determines which ISOs it must send to satisfy the requirements of Reg NMS. As explained above, if Latour is using a set of ISOs to execute against multiple layers of displayed liquidity, Latour must send as many ISOs as necessary, consistent with Rule 611 of Reg NMS, to remove any better-priced protected quotations. If Latour is using a set of ISOs to display a post-only order, it must comply with the rules adopted by exchanges under Rule 610 of Reg NMS and send ISOs to remove any equal- or better-priced protected quotations.[17]

14. Latour has developed and maintains source code for its trading software that contains the decisional parameters it believes necessary to achieve compliance with these requirements. This ISO routing logic is applied on a high-speed automated basis to the millions of ISOs that Latour sends each day.

D. Software Coding Change Resulted in ISOs that Did Not Comply with Reg NMS

Latour's Trading Infrastructure

15. Latour and each of the individual Tower Research trading teams build and maintain the software source code for their respective trading strategies, including the code they use to generate orders. To reach trading centers, however, the orders first pass through additional software code and trading infrastructure maintained by the Core Engineering department within Tower Research, Latour's parent.[18] For example, Core Engineering maintains a trade server application, which is a computerized process that translates Latour's orders from Latour's internal formats into the order message formats required by exchanges. The trade server application also applies Latour's financial risk management controls required under Rule 15c3-5 of the Exchange Act.

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[16] Latour primarily relies on direct feeds that it receives from various exchanges to obtain quotation data, and it uses the quotations distributed by the Securities Information Processor (the "SIP") for two smaller-volume exchanges.

[17] An exchange that receives a post-only ISO generally will display the order even if it would appear to lock a protected quotation of another trading center based upon its reliance on the broker-dealer sending the order to also send ISOs to execute against any equally-priced protected quotations. These concepts are discussed in response to Question 5.02 of the Responses to Frequently Asked Questions Concerning Rule 611 and 610 of Regulation NMS, which were prepared by the staff of the Division of Trading and Markets (April 4, 2008 update) (available at https://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm) ("Reg NMS FAQs") ("The ISO exception to the SRO lock/cross rules, in contrast, requires that ISOs be routed to execute against all protected quotations with a price that is *equal* to the display price (*i.e.*, those protected quotations that would be locked by the displayed quotation), as well as all protected quotations with prices that are better than the display price (*i.e.*, those protected quotations that would be crossed by the displayed quotation).").

[18] Tower Research-affiliated trading teams do not use Latour to access the market.

16. Portions of the software code within the trade server application are used by both Latour and Tower Research trading teams. Latour and each Tower Research trading team have trade server applications dedicated to their respective order flow, but the trade server software is managed in a common code base. Only Core Engineering developers have access to the trade server, including the common code base. If Latour needs to modify the software code in the trade server application, it must have a Core Engineering developer make the desired change.

17. Latour recognized that changes to the common code base in the trade server application could inadvertently affect the processing of Latour's orders. To address this risk, Latour relied on a system of controls and procedures. For instance, only a small number of Core Engineering personnel specifically approved by Latour could update the trade server applications used in production by Latour. Latour communicated with these personnel regarding Latour's use of the common code base. Core Engineering personnel were expected to inform Latour of any change to the common code base that might affect Latour, in which case, Latour would review the change for potential problems and recommend any necessary adjustments. If Core Engineering personnel decided that a change to the common code base would not affect Latour, they typically would not give Latour notice of the change.

18. The effectiveness of this system depended on the Core Engineering developers being sufficiently familiar with Latour's systems to assess the potential impact of changes to the common code base, recognizing when a change affected Latour, and informing Latour. As described below, this process proved inadequate.[19]

Latour's Use of Directed ISOs and a New Messaging Protocol

19. During the relevant time period, Latour was not a member of and thus could not send orders directly to the Chicago Stock Exchange ("CHX"), the National Stock Exchange ("NSX"), and the American Stock Exchange (later renamed "NYSE MKT"). Accordingly, when Latour was required under Reg NMS to send an ISO to one of these exchanges, it sent a "directed ISO" to one of the exchanges operated by BATS Global Markets, Inc. ("BATS"). A directed ISO instructs BATS to route the ISO upon receipt to the exchange specified in the order instructions (in this case, CHX, NSX, or NYSE MKT).

20. In the spring of 2011, Latour and Core Engineering began preparations to deploy a new internal messaging protocol within Latour. This messaging protocol governed the manner in which Latour's orders were communicated by Latour's trading algorithms to the trade server applications managed by Core Engineering. The trade server applications first translated the orders it received from Latour's algorithms into a format used by the trade server for processing purposes and then applied various checks, including Latour's financial risk management controls required by Rule 15c3-5. The trade servers next translated the orders again, this time into the appropriate order message format used by the respective exchange. After this last translation occurred, the trade server sent the order message to the pertinent exchange.

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[19] Latour subsequently has taken steps to address its control over its regulatory and financial risk management controls and supervisory procedures.

21. Core Engineering deployed the new messaging protocol to Latour in stages, beginning in June 2011. After the initial stage of the deployment in June 2011, Latour verified that its directed ISOs were being properly translated by the trade server into order messages and that they reached their intended destinations at CHX, NSX, or NYSE MKT. Latour did so by confirming with BATS that BATS had received a sample set of directed ISOs and had routed them to the specified destination exchange. Latour did not conduct any further such testing as Tower Research continued the deployment. By March 2012, Latour was using the new protocol for the majority of its ISOs.

Routing Destination Erroneously Dropped from Directed ISOs Using the New Messaging Protocol

22. In June 2011, shortly after Latour began using the new internal messaging protocol for a portion of its ISOs, a Core Engineering developer made a change to the trade server common code base used to send messages to the BATS exchanges. The Core Engineering developer made this change at the request of a Tower Research trading team. The change was viewed within Core Engineering as a routine modification to the BATS trade server application. In July 2011, the modified software code was released for Latour when its BATS trade server application was upgraded.

23. In the course of examining the software code to make the requested change, the Core Engineering developer observed a difference in how the code translated orders to be sent to BATS' U.S. exchanges as compared to those to be sent to BATS' European exchange. The developer then eliminated some of the code sequences that he believed created an operational inefficiency.

24. The code sequences that the Core Engineering developer eliminated, however, were crucial to the proper translation of directed ISOs that Latour sent to the trade server application using the new internal messaging protocol. In particular, as a result of the coding change, which went into effect in July 2011, the BATS trade server application dropped the routing destination when it translated any such directed ISO into an order message to send to BATS.

25. The Core Engineering developer did not understand that the changes he made to the code sequences would affect the directed ISOs generated by Latour's trading algorithms. Although Latour and Core Engineering had given the developer some information regarding the new internal messaging protocol, he was not sufficiently familiar with the details of the protocol's operation to recognize that his coding change might affect Latour's orders. As a result, he did not apprise Latour of the change.

Impact of Coding Change on Latour's Use of Directed ISOs

26. As a result of the change, certain directed ISOs that Latour sent to BATS did not

have a routing instruction.[20] In the absence of an instruction to route the orders to another exchange, BATS either executed the orders or canceled them, depending upon whether it had liquidity that could satisfy the order. As a result, directed ISOs that Latour needed to send to CHX, NSX, and NYSE MKT in order to comply with Reg NMS did not reach those destinations.

27. In many instances, the affected ISOs were part of ISO decision sets in which Latour also sent ISOs to other exchanges to execute against quotes at prices inferior to the protected quotation that was supposed to be taken out by the directed ISO. In such situations, both the directed ISO and the other ISOs failed to satisfy the requirements of Reg NMS because Rule 600(b)(30) of Reg NMS requires *all* necessary ISOs to be sent in order for *each* ISO to be compliant. Further, whenever the exchanges receiving these other ISOs executed them in reliance on the order's designation as an ISO, and the quote at CHX, NSX, or NYSE MKT that Latour had intended to execute against remained available, a trade-through occurred.

28. In other instances, the directed ISOs were part of ISO decision sets in which Latour needed to execute against a protected quotation in order to post ISOs at other exchanges at prices that would otherwise lock or cross the protected quotations. In these instances, Latour violated exchange rules adopted under Rule 610 of Reg NMS that require exchange members to reasonably avoid displaying, and prohibit them from engaging in a pattern or practice of displaying, orders that lock or cross protected quotations.

Discovery of the Directed ISO Problem

29. In October 2012, Latour received a regulatory inquiry from FINRA regarding certain of its ISOs that appeared to trade through protected quotations. In reviewing these potential trade-throughs, Latour discovered the problem in the software code that affected its directed ISOs. By that point, Latour had sent approximately 9.3 million non-compliant ISOs over 15 months as a result of the directed ISO issue. Latour fixed the coding issue within hours of discovering the problem.

E. <u>Latour's Reliance on Previously-Sent ISOs Resulted in ISOs that Did Not Comply with Reg NMS</u>

Overview

30. Between October 2010 and October 2012, Latour sent approximately 3 million non-compliant ISOs due to flaws in its ISO routing logic. Latour's problems with its ISO routing logic stemmed from the firm's efforts to use the information available to it to identify instances in which the protected quotations it saw in its quote snapshots were "stale," i.e., no longer available. Latour's risk management system assumed certain fill rates for its ISOs, and these assumptions affected its hedging activities. Using these fill rate assumptions on orders that, in actuality, had little chance of being filled (because the quotes they targeted no longer

[20] The change did not affect the translation of directed ISOs sent to the trade server using the old internal messaging protocol. Latour did not use the new internal messaging protocol for a majority of its ISOs until March 2012.

were available) could adversely impact Latour's risk management.

31. Latour recognized that there could be instances in which a protected quotation for an exchange appearing in Latour's current quote snapshot had, in fact, been removed, even though Latour had not yet received a market data update from the exchange reflecting this information. When Latour developed its initial ISO routing logic in late 2009, it included a functionality that allowed it to rely for up to one second on a canceled (or partially canceled) ISO that it had previously sent to an exchange, even though Latour's quote snapshot for that exchange still showed the same protected quotation.[21] In such instances, the cancellation reflected that either some other market participant had removed the protected quotation before Latour's ISO reached the exchange or the order underlying the protected quote had been canceled. Latour relied on the cancellation of its previously-sent ISO and not on its quote snapshot, which, possibly due to latencies in the dissemination of quote updates, did not yet reflect a new protected quotation.[22] In another part of its ISO routing logic, Latour embedded a "failsafe" timer, which was intended to limit to one second the maximum amount of time that Latour could rely on any previously-sent ISO irrespective of whether that ISO was cancelled or executed.

32. Latour modified its ISO routing logic in October 2010 to sometimes also rely on the execution of previously-sent ISOs to ignore a protected quotation reflected in a snapshot for a new ISO decision. Based on its experiences at one exchange, Latour believed that previously-sent ISOs sometimes executed against and, thereby, removed protected quotations, but Latour's new quote snapshot did not reflect a new protected quotation for that exchange due to data feed latencies. Latour modified its ISO routing logic to permit it to rely on any executed previously-sent ISO until it received an updated quote from the pertinent exchange.

Problems with Latour's Reliance on Executed Previously-Sent ISOs

Issues with Waiting for Quote Updates

33. Latour's October 2010 modification to its ISO routing logic did not account for two situations in which system latencies were not the reason that the same protected quotation persisted in the quote snapshot after an execution of a previously-sent ISO.

34. First, Latour failed to account for circumstances in which it sent an ISO to

[21] If, during this one-second period, Latour received a market update that indicated that the pertinent exchange was displaying a new protected quotation, Latour would immediately cease relying upon the previously-sent ISO.

[22] In adopting this functionality, Latour relied upon written guidance provided by the Division of Trading and Markets. See Reg NMS FAQs, Question 4.06 ("Yes, waiting one full second to route a new ISO to an unchanged price at a trading center (after receiving a no-fill or partial fill cancellation of a previous ISO seeking to execute against a protected quotation at such trading center) would qualify as a reasonable policy and procedure under Rule 611(a)(1) to prevent trade-throughs, as well as a reasonable step under Rule 611(c) to establish that orders meet the requirements for ISOs set forth in Rule 600(b)(30).").

execute against a protected quotation but its order executed against a better-priced, non-displayed order (i.e., a hidden order) instead of the protected quotation. Such executions did not result in any changes to the protected quotations because the protected quotations had not been removed. Yet, because Latour was waiting to see a change to that protected quotation in the quote data before it stopped relying on the previously-sent ISO, Latour did not send a new ISO when it was required to do so under Reg NMS or exchange rules adopted pursuant to Rule 610 of Reg NMS.

35. Second, with regard to certain exchanges, Latour failed to account for executions against protected quotations that were the initial displayed quantity of a reserve order.[23] So long as such an order has sufficient quantity in reserve, an execution will result in the protected quotation being immediately replenished at the same price and quantity. The exchange then sends data indicating that a new displayed protected quotation exists at the same price and quantity. In the quote snapshot assembled for a new ISO decision, such a replenished protected quotation will bear a new timestamp. However, for three exchanges, the Tower Research data servers used by Latour had not been programmed to recognize the replenishment of a reserve order. As a result, for these exchanges, the new quote snapshot reflected a protected quotation with the same timestamp as the one used for the previous ISO decision. Latour erroneously assumed that the executed previously-sent ISO removed that quotation, but that, owing to latencies, the exchange had not yet sent an updated quote. Latour therefore did not send a new ISO when it was required to do so under Reg NMS or exchange rules adopted pursuant to Rule 610 of Reg NMS.

Latour Mitigated But Did Not Fix the Problem Until August 2014

36. Beginning in September 2011, Latour noticed that its quote snapshots did not account for executions against reserve orders on certain exchanges, and Latour made a series of adjustments to its ISO routing logic as it pertained to its reliance on executed previously-sent ISOs. These alterations to Latour's ISO routing logic significantly reduced the number of non-compliant ISOs that resulted from Latour's reliance on executed previously-sent ISOs. Nevertheless, Latour did not fully address instances involving executions against reserve and non-displayed orders until August 2014, when the firm stopped relying in any circumstances on a fully-executed previously-sent ISO in subsequent ISO routing decisions.

Latour's "Failsafe" Control Was Not Implemented Correctly

37. Latour's ISO routing logic included a "failsafe" control to limit the maximum period of time during which it would rely on executed previously-sent ISOs. From late 2009 through January 2013, Latour intended for the maximum period of reliance to be one second. In January 2013, Latour reduced the maximum period to 50 milliseconds.

38. However, Latour did not properly implement the failsafe from late 2009, when it

[23] A reserve order is an order that allows market participants to display only a fraction of their entire order, and then replenish the component of the order that is displayed as it gets executed. *See, e.g.*, NASDAQ Equity Rule 4703(h) *available at* http://nasdaq.cchwallstreet.com.

was first deployed, until October 2012. During this time period, the control did not check the age of a previously-sent ISO at the time of each new ISO decision. Instead, as the "failsafe" was coded, Latour checked the age of a previously-sent ISO only if Latour had received an update to the protected quote against which Latour had sent the previously-sent ISO. Owing to the problems with executions against hidden and reserve orders, waiting for a quote update before checking the age of a previously-sent ISO rendered the "failsafe" ineffective to prevent non-compliant ISOs in those situations.

39. Latour discovered the implementation problem with its failsafe control in October 2012, when the firm responded to the regulatory inquiry described above in paragraph 29. Latour revised the coding for its failsafe so that it tested the age of a previously-sent ISO when it assembled the quote snapshot for a new ISO decision. This change prevented Latour from relying on an executed previously-sent ISO for more than one second. In January 2013, Latour shortened this maximum reliance period to 50 milliseconds. However, these changes still permitted Latour's unwarranted reliance for periods of less than one second (or 50 milliseconds) on previously-sent ISOs that executed against hidden orders and the reserve orders at certain exchanges.[24]

Problems with Reliance on Directed Previously-Sent ISOs

40. In some instances, the previously-sent ISO upon which Latour's ISO routing logic relied was a directed ISO that had not reached its intended destination due to the translation error caused by the coding change (discussed above in paragraphs 15 - 29). To the extent that the protected quotation at the intended destination remained available and superior in price at the time, the ISOs that Latour sent as part of that subsequent ISO decision failed to comply with Reg NMS. Further, during the period that the "failsafe" timeout was incorrectly implemented, Latour's unwarranted reliance on such directed ISOs could continue for periods longer than one second, potentially affecting multiple subsequent ISO decisions.

F. Latour's Post-Trade Surveillance Tools Were Inadequate

41. Latour's use of directed ISOs and its reliance on executed previously-sent ISOs were important elements of its ISO routing procedures. Latour's automated, post-trade surveillance tools were inadequate to determine whether these components were functioning as intended or to detect malfunctions in its systems that could affect ISOs before Latour sent them to the market.

42. Latour's post-trade surveillance tools did not use the ISOs that Latour sent to the exchanges. Instead, Latour chose to use its internal version of the ISOs as they existed before they were translated into the unique messaging formats used by the respective recipient exchanges. As a result of using this pre-translation version, Latour applied its post-trade regulatory compliance tools to the orders it *intended* to send to the exchanges and not the orders

[24] Latour continued to rely improperly on previously-sent ISOs for which it had received executions against non-displayed or reserve orders, resulting in approximately 322,000 non-compliant ISOs between November 2012 and August 2014.

that it *actually sent*. Accordingly, Latour did not detect that the ISOs it intended to send to BATS as directed ISOs did not, in fact, reach their necessary destinations.

43. Latour had several other means at its disposal for detecting the directed ISO problem. For example, Latour received execution reports from BATS that explicitly provided the venue where the order had been executed. These reports indicated that BATS executed these orders, not the intended venues. These reports also contained information regarding the fees or rebates associated with the transaction, which also indicated whether an order was executed on BATS or routed and executed elsewhere. Upon discovering the directed ISO issue in October 2012, Latour implemented an automated, post-trade control to check this field in BATS execution messages to enable it to detect the failure of a directed ISO to reach its intended destination.

44. Similarly, Latour had information available to it that would have enabled the firm to recognize that some of its previously-sent ISOs had not executed against the pertinent protected quotation. For example, any previously-sent ISO that executed against a hidden order did so at a price different from that of the pertinent protected quotation. Latour knew both of these relevant prices, but Latour did not compare this data or otherwise use it to determine when the firm could not rely on executed previously-sent ISOs. Latour also did not check for the unwarranted reliance on previously-sent ISOs that executed against reserve orders. The one second "failsafe" control could have limited the number of instances in which Latour improperly relied on executed previously-sent ISOs. Until October 2012, however, this pre-order control did not function as intended, and Latour had no post-trade surveillance tool to detect this failure. In October 2012, Latour implemented a post-trade surveillance tool to identify any instance in which Latour relied for longer than one second (later revised to 50 milliseconds) on a previously-sent ISO that had not been cancelled. Latour also implemented a tool to confirm that a previously-sent cancelled ISO was not relied upon for more than one-second after Latour received a message indicating that the ISO had been fully or partially cancelled. As discussed above, Latour did not fully address the problems involving executions against reserve and hidden orders until August 2014, when it stopped relying on fully executed previously-sent ISOs in subsequent ISO decisions.

VIOLATIONS

45. As described above, Latour sent nearly 12.6 million non-compliant ISOs between October 2010 and August 2014. These non-compliant ISOs caused approximately 1.1 million trade-throughs and 1.7 million locked or crossed protected quotations. Latour received $2,784,875 in gross trading profits and exchange rebates from its non-compliant ISOs.

A. Market Access Rule: Section 15(c)(3) and Rule 15c3-5

Section 15(c)(3)

46. Section 15(c)(3) of the Exchange Act, among other things, prohibits a broker or dealer from effecting any securities transactions in contravention of the rules and regulations the Commission prescribes as necessary or appropriate in the public interest, or for the protection of investors, to provide safeguards with respect to the financial responsibility and related practices

of brokers or dealers. Latour violated this provision through its violations of Rule 15c3-5 described below.

Rule 15c3-5(d)

47. Rule 15c3-5(d) requires that the controls and supervisory procedures of a broker or dealer to manage the financial and regulatory risks of its market access (as required by Rule 15c3-5(c)) must be under the direct and exclusive control of the broker or dealer.

48. Latour violated Rule 15c3-5(d) because its financial and regulatory risk management controls and supervisory procedures were not under its direct and exclusive control. As explained above, Tower Research's Core Engineering department could (and did) make changes to the common code base Latour used to access the U.S. markets without Latour's knowledge or approval. As demonstrated by the translation error with directed ISOs, such changes could nullify the effectiveness of the ISO regulatory controls that Latour applied before such orders reached the common code base. Additionally, although the changes at issue here had no effect on Latour's financial risk management controls, changes to the common code base potentially could have impacted how those controls were applied. The steps that Latour took to guard against such changes to the common code base were inadequate to give it direct and exclusive control over its regulatory and financial risk management controls.

Rule 15c3-5(b) and (c)(2)(i)

49. Rule 15c3-5(b) requires that a broker or dealer with market access establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of its market access activity.

50. Rule 15c3-5(c)(2)(i) requires that a broker or dealer's risk management controls and supervisory procedures be reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis. Rule 15c3-5(a)(2) defines "regulatory requirements" to mean all federal securities laws, rules and regulations, and rules of self-regulatory organizations, that are applicable in connection with market access.

51. Latour violated Rule 15c3-5(b) and (c)(2)(i) because its pre-trade ISO controls and procedures were not reasonably designed to prevent the entry of orders that did not comply with Rules 600(b)(30) and 611(c) of Reg NMS and exchange rules to prevent the display of locking and crossing quotes (adopted in response to Rule 610 of Reg NMS). As explained above, Latour's pre-order controls and procedures were not reasonably designed to ensure that the directed ISOs that Latour sent to BATS contained the instructions regarding the destination venue that were necessary for Latour to comply with Reg NMS. These controls and procedures also were not reasonably designed to prevent Latour's unwarranted reliance on previously-sent ISOs that had executed against non-displayed and reserve orders. As a result, Latour sent millions of ISOs to exchanges that did not comply with the requirements of Rules 600(b)(30) and 611(c) of Reg NMS and the rules adopted by exchanges pursuant to Rule 610 regarding the display of locking or crossing quotes. Further, changes made to the common code base without

Latour's knowledge or approval could – and did – render critical aspects of its ISO regulatory controls ineffective. Finally, Latour incorrectly implemented a failsafe control that could have prevented some of the non-compliant ISOs.

B. <u>Regulation NMS: Rule 611(c)</u>

52. Rule 611(c) requires that brokers or dealers take reasonable steps to establish that an ISO meets the requirements of Rule 600(b)(30).

53. Rule 600(b)(30) defines an ISO as a limit order that is identified as an ISO. In addition, simultaneously with the routing of the ISO, one or more additional orders, as necessary, must be routed to execute against the full displayed size of any protected bid (in the case of a limit order to sell) or protected offer (in the case of a limit order to buy) for the stock with a price that is superior to the limit price of the ISO. These additional routed orders also must be marked as ISOs.

54. Latour violated Rule 611(c) because it failed to take reasonable steps to establish that its ISOs met the requirements set forth in Rule 600(b)(30). Latour sent approximately 12.6 million non-compliant ISOs between October 2010 and August 2014. The majority of these non-compliant ISOs resulted from Latour's failure to include necessary destination instructions on its directed ISOs. Latour sent these non-compliant ISOs despite having information available indicating that the orders did not reach their intended destinations. Latour also relied on flawed ISO routing logic that failed to account for executions against hidden liquidity or reserve orders. Latour did so despite having information available indicating that its previously-sent ISOs had executed against hidden orders and not protected quotations. Additionally, as described above, Latour's post-trade surveillance steps were inadequate.

<u>REMEDIAL EFFORTS</u>

55. In determining to accept this offer, the Commission considered the remedial acts undertaken by Latour and cooperation afforded the Commission staff.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Latour cease and desist from committing or causing any violations and any future violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder and Rule 611(c) of Regulation NMS.

B. Respondent Latour shall, within ten (10) days of the entry of this Order, pay disgorgement of $2,784,875, which represents profits gained as a result of the conduct described herein, and prejudgment interest of $268,564, for a total of $3,053,439, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Action Section 21F(g)(3). If a timely payment of disgorgement plus prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Latour also shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $5,000,000 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 of the civil monetary penalty is not made, additional interest will accrue pursuant to 31 U.S.C. §3717. Payments 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 Latour as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert A. Cohen, Co-Chief, Market Abuse Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549.

C. 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 tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

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. 76058 / September 30, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4212 / September 30, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31854 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16877

In the Matter of

HOWARD RICHARDS

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECUTRITIES 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 Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Howard Richards ("Respondent" or "Richards").

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 Sections 15(b) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Investment Advisers Act, and Section 9(b) of the Investment Company Act, 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 2010 through July 2013, Richards, an investment advisory representative associated with Securus Wealth Management, LLC ("Securus"), engaged in a manipulative scheme to support the market price of the common stock of Gatekeeper USA, Inc. ("Gatekeeper"), which he thought would help Gatekeeper to obtain financing. Gatekeeper was a start-up company seeking private financing to sell and market a container monitoring device that had never been manufactured or sold. Its stock was thinly-traded on the over-the-counter grey market under the symbol GTKP. Richards learned from Gatekeeper's vice-president of finance that significant financing deals were dependent upon sustaining a sufficient market price for Gatekeeper's stock. Richards manipulated the price of Gatekeeper stock by causing his clients' accounts to purchase shares at higher prices when its price fell below a certain level. Richards caused his clients to invest over $1 million in shares of Gatekeeper stock during this period.

In furtherance of the scheme, Richards frequently marked the close by executing the last transaction in Gatekeeper stock on the days he traded. To affect the supply of Gatekeeper stock into the market and prevent downward pressure on the price, Richards convinced clients and other shareholders to not sell Gatekeeper stock and, when he could not prevent sales by clients, he placed orders simultaneously for other clients to buy Gatekeeper stock.

In breach of his fiduciary duty as an investment adviser, Richards also failed to disclose to clients significant conflicts of interest arising from his ownership of Gatekeeper shares, personal loans to Gatekeeper's officers, payment of Gatekeeper expenses, and his editing and providing content for Gatekeeper's shareholder communications, before he bought shares of Gatekeeper for them.

Respondent

1. Howard Richards, age 64, is a resident of Mound, Minnesota. He was an advisory representative associated with Securus from January 2001 through June 2015, and was also a registered representative associated with registered broker-dealers during the same period. At all relevant times, Richards held the following FINRA licenses: General Securities Representative

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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.

(Series 7), Futures Managed Funds (Series 31), Uniform Securities Agent State Law (Series 63) and Uniform Investment Adviser State Law (Series 65).

Other Relevant Entities

2. Securus Asset Management, LLC is a Minnesota limited liability company with its principal place of business in Plymouth, Minnesota. It has been registered with the Commission as an investment adviser since January 2006.

3. Gatekeeper USA, Inc. is a Nevada corporation, located in Lexington Park, Maryland. It is a start-up business with no revenue and holds a license to market and sell a container security monitoring device. Gatekeeper's stock is a penny stock that trades on the over-the-counter grey market and is not registered with the Commission.

Facts

Richards made early investments in Gatekeeper

4. Gatekeeper was formed as a result of a reverse merger with a grey market, non-reporting company on November 28, 2007. Around that time, Gatekeeper also acquired a license from a private company to market and sell a product called the Container Automated Monitoring System ("CAMS"), a container security monitoring device for cargo in the shipping industry. The CAMS device was a prototype and was never sold to anyone. Gatekeeper was a start-up company with no revenue. The purpose of its business was to market and sell the CAMS device.

5. From 2008 through 2009, Richards bought for himself approximately 113,000 shares of Gatekeeper for a total of approximately $200,000 in the over-the-counter grey market, and also bought Gatekeeper shares privately. During the same period, Richards purchased for his clients approximately 473,000 shares of Gatekeeper for a total of approximately $900,000. Richards and his clients thus became significant shareholders of Gatekeeper.

Richards knew that Gatekeeper was pursuing significant financing

6. From January 2010 through July 2013, Gatekeeper sought $10 to $20 million in financing through investment bankers to develop, manufacture and sell the CAMS device. Gatekeeper, however, ultimately was not successful and did not receive any financing. During this period, Richards communicated by email and phone with Gatekeeper's vice president of finance about the status of the financing efforts.

7. During the same period, Richards was aware that Gatekeeper's ability to obtain substantial financing was dependent upon sustaining a sufficient market price for its stock. First, Richards learned that Gatekeeper engaged an investment banking firm to conduct a $20 million PIPE offering to institutional investors and that the price of the offering was to be discounted off of the market price of Gatekeeper. Richards subsequently became aware that Gatekeeper was seeking to obtain $16 million in financing in exchange for debentures that were convertible to

free-trading shares of Gatekeeper from two other investment banking companies. Lastly, Richards was informed that $10 million in anticipated loans from an insurance company were to be collateralized by Gatekeeper stock.

Richards engaged in a manipulative scheme

8. From January 2010 through July 2013 ("the relevant period"), Richards engaged in a manipulative scheme in which he used his clients' accounts to support the market price of Gatekeeper. Richards bought Gatekeeper shares in client accounts on a discretionary basis in order to prevent the price of Gatekeeper's stock from declining when he observed sales pressure in the market, and to increase the price. Richards caused 97 of his advisory clients to pay a total of approximately $1.1 million for approximately 550,000 Gatekeeper shares during this period. Richards planned to personally profit and generate gains for his clients by selling Gatekeeper shares after Gatekeeper obtained sufficient financing to execute its business plans for the CAMS device.

9. During the relevant period, Richards frequently marked the close and executed the last transaction in Gatekeeper stock on the days that he traded. "Marking the close" involves placing orders at or near the close of market trading to artificially affect the closing price of a security.

10. During the relevant period, Richards also prevented sales of Gatekeeper shares that could place downward pressure on the market price. He determined the sources of selling pressure by tracking who held the public float in a spreadsheet he created from transfer agent records and by communicating with shareholders by phone and email. Richards repeatedly asked clients and other shareholders to not sell any Gatekeeper stock.

11. During the relevant period, when Richards could not prevent sales of Gatekeeper stock by his clients, he placed simultaneous orders for other clients to buy the same or a greater amount of shares when he placed the sale orders. Richards did this to prevent a decline in the market price of Gatekeeper stock.

12. During the relevant period, Richards often transmitted positive information about the status of Gatekeeper's financing to a non-client investor ("Investor A") and encouraged Investor A to buy Gatekeeper shares in the market during particular time periods. Investor A paid approximately $188,000 for 56,000 shares of Gatekeeper stock during this period.

Richards was aware that his buying dominated the market for Gatekeeper stock

13. During the relevant period, Richards was aware that his buying of Gatekeeper stock on behalf of his advisory clients dominated the thinly-traded market for Gatekeeper. Gatekeeper's stock had an average daily trading volume of approximately 1,500 shares during this period. Richards followed the volume and price of Gatekeeper stock daily. Richards' clients and Investor A were the only consistent buyers of Gatekeeper stock in the market.

14. In May 2012, Richards ghostwrote an email purportedly from Investor A to the president of Gatekeeper, stating that Richards and Investor A were "probably responsible for over 90% of the buy side trades in the stock since 2009," and that they were "growing weary of the endless parade of excuses for a lack of progress on funding."

Richards frequently sent contemporaneous emails describing his conduct

15. During the relevant period, Richards sent numerous emails from his email account at Securus to Gatekeeper's vice president of finance in which he described how his trading in his clients' accounts, along with the trading of Investor A, increased the reported closing price of Gatekeeper. Richards also discussed his efforts to prevent clients from selling Gatekeeper stock, and his practice of placing simultaneous client buy orders along with client sales orders in these emails.

Richards' conduct increased the market price for Gatekeeper stock

16. During the relevant period, Richards' clients' trading in Gatekeeper accounted for at least 38% of Gatekeeper's market volume, and at least 42% together with Investor A.

17. During the relevant period, Richards' clients and Investor A paid a median of $.35 per share higher than the preceding price paid for Gatekeeper stock by other traders. At times, Richards' clients paid up to 100% more for their shares of Gatekeeper stock than the immediately preceding traders paid. Richards documented the volume and amounts paid for shares of Gatekeeper stock on behalf of his clients in frequent emails to Gatekeeper's vice president of finance.

18. During the relevant period, the prices paid by Richards' clients and Investor A were frequently reported as the closing price for Gatekeeper stock. Trades of Richards' clients and Investor A were the last trades reported to the market on 197 days, or 85%, of the 233 days they traded. On at least 50 days, trades of Richards' clients marked the close within the last 15 minutes of the trading day.

19. Richards stopped trading Gatekeeper stock in his clients' accounts on July 26, 2013 after his supervisor, James Goodland, the president and then-CCO of Securus, instructed Richards not to buy any more Gatekeeper shares without his prior approval. After Richards stopped buying Gatekeeper stock for his clients, its price fell from $.80 per share to a range of $.15 to $.45 per share by early October 2013.

Richards made material misrepresentations and omissions to clients about the market for Gatekeeper stock

20. During the relevant period, Richards made material misrepresentations to clients about the market for Gatekeeper stock. In a January 2011 letter that he mailed to clients explaining why Gatekeeper's stock price had fallen to $1 "after it had been around $3 for months," Richards stated that Gatekeeper stock traded in low volumes on the Pink Sheets

(though it actually traded on the riskier grey market), that the over-the-counter market was a "target" for "stock manipulators" and that "in spite of orders to buy and sell at the market" a naked short seller "bypassed the normal order flow and forced an artificial close."

21. Richards misleadingly suggested that there was true market demand for Gatekeeper stock at a higher price, while he failed to disclose to his advisory clients that his buying in their accounts dominated the market for Gatekeeper stock. Richards also omitted to disclose his own manipulative trading that increased the reported share price. Richards' later correspondence with his clients continued to omit to disclose that his trading in their accounts was supporting the market price for Gatekeeper's stock.

Richards failed to disclose his significant conflicts of interest to clients

22. Between 2008 and 2009, Richards paid approximately $200,000 for 113,000 shares of Gatekeeper stock and bought additional shares privately.

23. During the relevant period, Richards also loaned approximately $141,000 to Gatekeeper's officers and the developer of the CAMS device. Richards also paid at least $57,000 towards Gatekeeper's expenses and insurance premiums, and edited and provided content for Gatekeeper's communications with shareholders. Among other things, Richards edited and provided content for a Gatekeeper newsletter that he sent to his clients in June 2012.

24. Although Richards orally disclosed his ownership interest to some clients before purchasing Gatekeeper shares on their behalf, he did not disclose his personal holdings of Gatekeeper stock to other clients until August 2010 when Richards sent a letter to clients who owned shares of Gatekeeper stock and disclosed his personal shares of Gatekeeper.

25. In addition, Richards did not disclose to his clients the significant amounts of money that he loaned Gatekeeper's officers and the developer of the CAMS device, his payment of Gatekeeper's expenses, and his role in editing and providing content for Gatekeeper's shareholder communications.

Violations

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

27. As a result of the conduct described above, Richards willfully aided and abetted and caused Securus' violations of Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

IV.

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

Accordingly, pursuant to Sections 15(b) and 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 Richards cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act.

B. Respondent Richards be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

D. Respondent shall pay disgorgement of $62,000, prejudgment interest of $7,000, and civil penalties of $75,000, to the Securities and Exchange Commission. Payment shall be made in the following installments: $69,000 shall be paid within 14 days of the entry of this order, $40,000 shall be paid within 180 days of the entry of this order, and $35,000 shall be paid within 364 days of the entry of this order. If any payment is not made by the date the payment is required by this

Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may 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 Richards 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 Anne C. McKinley, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson, Suite 900, Chicago, IL, 60604.

E. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest and civil penalties referenced in paragraph D above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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.76060 / September 30, 2015

Admin. Proc. File No. 3-16545

In the Matter of

Ruby Creek Resources, Inc.

ORDER DISMISSING PROCEEDING

On May 20, 2015, the Commission instituted an administrative proceeding against Ruby Creek Resources, Inc., and two other respondents under Section 12(j) of the Securities Exchange Act of 1934.[1] The Order Instituting Proceedings alleged that Ruby Creek had violated periodic reporting requirements and sought to determine, based on those allegations, whether it was "necessary and appropriate for the protection of investors to suspend . . . or revoke" the registration of Ruby Creek's securities.

On June 1, 2015, Ruby Creek filed a Form 15, seeking to terminate voluntarily the registration of its securities under Section 12(g) of the Exchange Act.[2] Under Exchange Act Rule 12g-4(a), an issuer's registration is terminated ninety days after the issuer files Form 15,[3] in this case, on August 31, 2015. The Division of Enforcement subsequently moved to dismiss the proceeding against Ruby Creek.[4]

We have determined to grant the Division's motion. Ruby Creek no longer has a class of securities registered under Section 12 of the Exchange Act. Because revocation and suspension

1 15 U.S.C. § *78l*(j). The other respondents defaulted, resulting in the revocation of the registration of their securities. *Composite Solutions, Inc.*, Initial Decision Release No. 825, 2015 WL 3929986 (June 26, 2015); *see also Composite Solutions, Inc.*, Securities Exchange Act Release No. 75635, 2015 WL 4709110 (Aug. 7, 2015) (finality notice).

2 17 C.F.R. § 240.12g-4(a) (providing for certification of termination of registration under Section 12(g), 15 U.S.C. § 78*l*(g)). Ruby Creek relied on Rule 12g-4(a)(1), which permits the termination of registration if the issuer certifies that the class of securities being deregistered is held of record by fewer than 300 persons. 17 C.F.R. § 240.12g-4(a)(1). In its Form 15, Ruby Creek certified that the approximate number of holders of record, as of June 1, 2015, was 158.

3 17 C.F.R. § 240.12g-4(a).

4 Ruby Creek has not responded to the Division's motion.

of registration are the only remedies available in a proceeding instituted under Section 12(j), we find it appropriate to dismiss this proceeding against Ruby Creek.[5]

IT IS therefore ORDERED that this proceeding is dismissed with respect to Ruby Creek Resources, Inc.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By Jill M. Peterson
Assistant Secretary

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[5] *See, e.g.*, *Tapslide, Inc.*, Exchange Act Release No. 67125, 2012 WL 2020908 (June 5, 2012) (dismissing proceeding against respondent who no longer had securities registered under Exchange Act Section 12); *TelcoBlue, Inc.*, Exchange Act Release No. 58061, 2008 WL 2574445 (June 30, 2008) (same).

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4213 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16878

In the Matter of

JAMES GOODLAND, AND SECURUS WEALTH MANAGEMENT, LLC

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, 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), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against James Goodland ("Goodland") and Securus Wealth Management, LLC ("Securus") (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 Administrative and Cease-And-Desist Proceedings, Pursuant toSections 203(e), 203(f) and 203(k) of the Advisers Act, 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 the Respondents' Offers, the Commission finds[1] that:

Summary

From January 2010 through July 2013, Securus, an investment adviser registered with the Commission, and Goodland, its President and Chief Compliance Officer, failed reasonably to supervise Howard Richards ("Richards"), an investment advisory representative associated with Securus whom Goodland directly supervised. Securus and Goodland also failed to adopt and implement an adequate system of internal controls with a view toward preventing and detecting violations of the Advisers Act.

During this period, Richards engaged in a manipulative scheme to support the market price of the common stock of Gatekeeper USA, Inc. ("Gatekeeper") to help Gatekeeper obtain financing. Gatekeeper was a start-up company whose stock was thinly-traded on the over-the-counter grey market under the symbol GTKP. Richards caused his clients to invest over $1 million in shares of Gatekeeper stock during this period. This trading was unusual for Securus, whose primary business involved investing in mutual funds on behalf of its clients. In furtherance of his scheme, Richards sent numerous emails from his Securus email account to an insider at Gatekeeper in which he discussed his scheme. In addition, Richards failed to disclose significant conflicts of interest to his advisory clients arising from his personal ownership of Gatekeeper shares and his close involvement with the company. Through these activities, Richards willfully violated the antifraud provisions of the Exchange Act and willfully aided and abetted and caused Securus' violations of the Advisers Act.

Securus failed reasonably to implement required policies and procedures for e-mail review and failed to develop reasonable policies and procedures to monitor trades for potential market manipulation. In addition, Securus failed to develop and implement reasonable policies, procedures or systems to monitor conflicts of interest and ensure that conflicts were fully disclosed to clients. Goodland failed adequately to respond to red flags concerning Richards' conflicts of interest, his unusual trading in client accounts and his numerous emails with a Gatekeeper insider. In particular, Goodland failed to complete required email reviews or adequately monitor Richards' trading in Gatekeeper stock.

Respondents

1. James Goodland, age 48, is a resident of Maple Grove, Minnesota. Goodland, who formed Securus in November 2000, has been its owner and President since its inception and was its Chief Compliance Officer through approximately December 2013. During all relevant times, Goodland has also been associated with a broker-dealer registered with the Commission and has held the following FINRA licenses: General Securities Representative (Series 7), General Securities Principal (Series 24) and Uniform Securities Agent State Law (Series 63).

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

2. Securus Asset Management, LLC is a Minnesota limited liability company with its principal place of business in Plymouth, Minnesota. It has been registered with the Commission as an investment adviser since January 2006. In June 2013, Securus had $175 million in assets under management, 600 clients and eight representatives. Since then, Securus has been reduced to essentially one representative, Goodland, whose clients' assets total less than $80 million.

Other Relevant Person and Entity

3. Howard Richards, age 64, is a resident of Mound, Minnesota. He was an advisory representative associated with Securus from January 2001 through June 2015, and was also a registered representative associated with registered broker-dealers during the same period. Goodland was Richards' direct supervisor.

4. Gatekeeper USA, Inc. is a Nevada corporation, located in Lexington Park, Maryland. It is a start-up business with no revenue and holds a license to market and sell a container security monitoring device. Gatekeeper's stock trades on the over-the-counter grey market under the symbol GTKP and is not registered with the Commission.

Facts

Background

5. Richards joined Securus as an advisory representative in January 2001, and had approximately 250 clients during the period of 2010 through 2013. Securus' and Richards' clients were mostly individuals.

6. During this period, Securus' advisory representatives, including Richards, invested approximately 98% of clients' assets in mutual funds. They rarely purchased individual stocks and bonds for clients.

7. Gatekeeper was formed as a result of a reverse merger with a grey market, non-reporting company on November 28, 2007. Around that time, Gatekeeper also acquired a license from a private company to market and sell a product called the Container Automated Monitoring System ("CAMS"), a container security monitoring device for cargo in the shipping industry. The CAMS device was a prototype and was never sold to anyone. Gatekeeper was a start-up company with no revenue. The purpose of its business was to market and sell the CAMS device.

8. From 2008 through 2009, Richards bought approximately 113,000 shares of Gatekeeper stock for a total of approximately $200,000 in the over-the-counter grey market, and also bought Gatekeeper shares privately. During the same period, Richards caused his clients to buy approximately 473,000 shares of Gatekeeper for a total of approximately $900,000. Richards and his clients thus became significant shareholders of Gatekeeper.

Richards' Misconduct

9. From January 2010 through July 2013 ("the relevant period"), Gatekeeper sought $10 to $20 million in financing through investment bankers to develop, manufacture and sell the CAMS device. Gatekeeper, however, ultimately was not successful and did not receive any financing. During this period, Richards frequently used his Securus email account and telephone to communicate with Gatekeeper's vice president of finance about the status of the financing efforts and learned that substantial anticipated Gatekeeper financing was dependent upon sustaining a sufficient market price for Gatekeeper stock.

10. During the relevant period, Richards engaged in a manipulative scheme in which he used his clients' accounts to support the market price of Gatekeeper. Richards bought Gatekeeper shares in client accounts on a discretionary basis in order to prevent the price of Gatekeeper's stock from declining when he observed sales pressure in the market, and to drive up the price. Richards caused 97 of his clients to pay a total of approximately $1.1 million for approximately 550,000 Gatekeeper shares during this period. Richards planned to personally profit and generate gains for his clients by selling Gatekeeper shares after Gatekeeper obtained sufficient financing to execute its business plans for the CAMS device.

11. During the relevant period, Richards frequently marked the close and executed the last transaction in Gatekeeper stock on the days that he traded. "Marking the close" involves placing orders at or near the close of market trading to artificially affect the closing price of a security.

12. During the relevant period, Richards also prevented sales of Gatekeeper shares that could place downward pressure on the market price. He determined the sources of selling pressure by tracking who held the public float in a spreadsheet he created from transfer agent records and by communicating with shareholders by phone and email. Richards repeatedly asked clients and other shareholders to not sell any Gatekeeper stock.

13. During the relevant period, when Richards could not prevent sales of Gatekeeper stock by his clients, he placed simultaneous orders for other clients to buy the same or greater amount of shares when he placed the sale orders. Richards did this to prevent a decline in the market price of Gatekeeper.

14. During the relevant period, Richards often transmitted positive information about the status of Gatekeeper's financing to a non-client investor ("Investor A") and caused Investor A to buy Gatekeeper shares during particular time periods. Investor A paid approximately $188,000 for 56,000 shares of Gatekeeper stock during this period.

15. During the relevant period, Richards sent numerous emails from his email account at Securus to Gatekeeper's vice president of finance in which he described how his trading in his clients' accounts, along with trading of Investor A, increased the reported closing price of Gatekeeper. Richards also discussed his efforts to prevent clients from selling Gatekeeper stock, and his practice of placing simultaneous client buy orders along with client sales orders in these emails.

16. During the relevant period, Richards' clients' trading in Gatekeeper stock accounted for at least 38% of the Gatekeeper stock market volume, and at least 42% together with Investor A.

17. During the relevant period, Richards' clients and Investor A paid a median of $.35 per share higher than the immediately preceding price for Gatekeeper stock paid by other traders. At times, Richards' clients paid up to 100% more for their shares of Gatekeeper stock than the immediately preceding traders paid. Richards documented the volume and amounts paid for shares of Gatekeeper stock on behalf of his clients in frequent emails to Gatekeeper's vice president of finance.

18. During the relevant period, the prices paid by Richards' clients and Investor A were frequently reported as the closing price for Gatekeeper. Trades of Richards' clients and Investor A were the last trades reported to the market on 197 days, or 85%, of the 233 days they traded. On at least 50 days, the trades of Richards' clients marked the close within the last 15 minutes of the trading day.

19. During the relevant period, Richards made material misrepresentations to clients about the market for Gatekeeper stock. For example, in a January 2011 letter that he mailed to clients explaining why Gatekeeper's stock price had fallen to $1 "after it had been around $3 for months," Richards stated that Gatekeeper stock traded in low volumes on the Pink Sheets (though it actually traded on the riskier grey market), that the over-the-counter market was a "target" for "stock manipulators" and that "in spite of orders to buy and sell at the market" a naked short seller "bypassed the normal order flow and forced an artificial close." Richards misleadingly suggested that there was true market demand for Gatekeeper stock at a higher price, while he failed to disclose that his buying in client accounts dominated the market for Gatekeeper stock. Richards also omitted to disclose his own manipulative trading that increased the reported share price. Richards' later correspondence with his clients continued to omit to disclose that his trading in their accounts was supporting the market price for Gatekeeper's stock.

20. Richards also failed to disclose his personal conflicts of interest in buying Gatekeeper stock for his clients. Among other things, Richards did not disclose his personal holdings of Gatekeeper stock to his clients until August 2010. Richards also failed to disclose to his clients that he had loaned approximately $141,000 to Gatekeeper's officers and the developer of the CAMS device, that he paid at least $57,000 towards Gatekeeper's expenses and insurance premiums, and that he had edited and provided content for Gatekeeper's communications with shareholders.

Red Flags Concerning Richards' Conduct

21. During the relevant period, Goodland was responsible for reviewing, approving and implementing Securus' compliance policies and procedures. As part of his supervisory responsibilities as Richards' direct supervisor, Goodland held bi-weekly meetings with Richards and other advisory representatives who were part of an investment committee to discuss client investments and compliance issues.

22. Richards told Goodland during the bi-weekly meetings that he personally owned Gatekeeper shares and was "building positions" in Gatekeeper stock in client portfolios on a discretionary basis. Goodland knew that Gatekeeper was a grey market stock, and that Richards' purchases of Gatekeeper stock were outside of Securus' normal investment strategies for its clients.

23. Richards provided Goodland with updates on the status of the Gatekeeper financing efforts. Goodland was aware that Richards obtained this information from Gatekeeper's vice president of finance.

Inadequate Email Reviews

24. Goodland, failed to adequately review Richards' emails. Even though Securus' written policies and procedures required monthly email monitoring and Securus provided Goodland with access to an email system and flagged emails for his review, Goodland did not review the flagged emails between 2010 and 2012. Instead, Goodland randomly selected and reviewed approximately 50 client emails about 7 or 8 times during the year, without focusing on any particular issues or documenting his review.

25. Even after Goodland received notifications in January and February 2013 that Securus had outstanding emails that had not been reviewed in the email system, Goodland did not personally review the emails and instead, delegated the review to another employee who reported to Goodland and was not a supervisor.

26. The email system flagged some emails between Richards and Gatekeeper's vice-president of finance about Gatekeeper's financing efforts, though it did not flag emails in which Richards discussed his manipulative trading of Gatekeeper stock in client accounts. Had Goodland timely and properly reviewed the flagged Gatekeeper emails, he likely would have recognized Richards' ongoing communications with a corporate officer about financing efforts as additional red flags and implemented additional oversight. If Goodland had conducted a heightened review of Richards' other emails concerning Gatekeeper, he likely would have detected Richards' manipulative tactics and prevented further violations.

27. Securus failed reasonably to implement its e-mail review policies and procedures to address whether supervisors were conducting e-mail review.

Securus Lacked Compliance Procedures for Conflicts of Interest

28. Securus' written compliance policies acknowledged that it had a duty as an investment advisor to "eliminate conflicts of interest, whether actual or potential, or make full and fair disclosure of all material facts of any conflicts so a client, or prospective client, may make an informed decision in each particular instance." Securus, however, had no policies or procedures requiring its representatives to disclose conflicts of interest to the firm or for the firm to perform any additional procedures to ensure that conflicts of interest were disclosed to clients. Rather, Securus relied upon Richards' voluntary disclosure of his ownership of Gatekeeper shares and took no additional actions. Securus and Goodland were not aware of Richards' other significant conflicts of interest and took no steps to determine whether Richards disclosed all material facts of his conflicts of interest to his clients before buying Gatekeeper shares for them.

Failure to monitor Richards' Gatekeeper trading in client accounts

29. After permitting Richards to continue trading Gatekeeper stock despite a known conflict of interest and the unusual nature of discretionary trading in a grey market stock for the firm's clients, Goodland did not adequately monitor Richards' repeated purchases of Gatekeeper stock in client accounts. Goodland did not implement any heightened procedures to monitor Richards' trading of Gatekeeper. Goodland reviewed trading in client accounts periodically, but focused on Gatekeeper transactions only when they were highlighted for closer review by trading compliance software that flagged trades automatically based on client suitability and concentration criteria. Securus had no policies or procedures to detect and prevent manipulative trading such as the tactics employed by Richards.

30. The only time Goodland conducted a review focusing on Gatekeeper trading was in July 2013, after Goodland learned that a client had complained about Richards' purchases of Gatekeeper stock. Goodland then calculated the percentage of public float owned by all of Richards clients and instructed Richards to not buy any more Gatekeeper shares without his prior approval.

31. After Richards stopped buying Gatekeeper stock for his clients, the price fell from $.80 per share to a range of $.15 to $.45 per share by early October 2013.

Violations

32. Section 203(e)(6) of the Advisers Act provides for the imposition of a sanction against an investment adviser who has failed reasonably to supervise, with a view to preventing violations of the securities laws, another person who commits such a violation, if such other person is subject to its supervision. Section 203(f) of the Advisers Act incorporates by reference Section 203(e)(6) and provides for the imposition of sanctions against persons associated with an investment adviser. As a result of the conduct described above, Securus and Goodland failed reasonably to supervise Richards with a view to detecting and preventing his violations of securities laws.

33. As a result of the conduct described above, Securus willfully violated and Goodland willfully aided and abetted and caused Securus' violations of Section 206(4) and Rule 206(4)-7 of the Advisers Act, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

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), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Goodland and Respondent Securus cease and desist from committing or causing any violations and any future violations of Section 206(4) and Rule 206(4)-7 of the Advisers Act.

B. Respondent Securus is censured;

C. Respondent Goodland be, and hereby is:

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

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

E. Respondent Goodland shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $30,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

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

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

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

Payments by check or money order must be accompanied by a cover letter identifying Goodland 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 Anne C. McKinley, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson, Suite 900, Chicago, IL, 60604.

F. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest and civil penalties referenced in paragraph E. above. Additionally, such civil money penalty may also be distributed by the fair fund established in In the Matter of Howard Richards, AP File No. 3-16877. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Goodland's 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 Respondent(s) 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, 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 Goodland, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Goodland 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 Goodland 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 Piwowar Dissented as to the Corporate Penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9933 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76030 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16852

In the Matter of

FOCUS MEDIA HOLDING LIMITED and JASON JIANG,

Respondents.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Focus Media Holding Limited ("Focus Media") and Jason Jiang ("Jiang", and collectively with Focus Media, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Cease and Desist Order ("Order"), as set forth below.

III.

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

Summary

1. These proceedings concern Focus Media's and its founder and Chief Executive Officer Jiang's negligent failure to disclose accurate information concerning Focus Media's partial sale of securities in its wholly-owned subsidiary Allyes Online Media Holdings Ltd. ("Allyes") to certain Allyes and Focus Media insiders at a favorable price, months before both the insiders and Focus Media sold their interests in Allyes to a private equity firm at nearly six times the price the Allyes and Focus Media insiders had paid.

Respondents

2. Focus Media is a Cayman Islands corporation headquartered in Hong Kong, with substantially all of its business operations located in mainland China. During the relevant time period, Focus Media's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act, and its American Depository Shares traded on the Nasdaq Global Market. Subsequently, on June 3, 2013, Focus Media Filed a Form 15 that provided notice of termination of its registration with the Commission.

3. Jason Jiang, a citizen of Singapore, is the founder of Focus Media, has been the Chairman of the board of directors of Focus Media since its founding, and, during the relevant time period, was CEO of Focus Media.

Background

4. Focus Media is a China-based advertising company that concentrates in what is often called Out-of-Home advertising. Such advertising includes traditional and digital displays in public places, such as building lobbies, elevators, stores, and outdoor locations. At the end of 2009, Focus Media had operations that included an LCD display network and poster frame network for selling ads in commercial and residential buildings; an "In-store" network for selling ads in retail spaces; selling advertising time on movie screens; outdoor billboards; and an internet advertising network. Focus Media conducted its internet advertising business through its wholly-owned Allyes subsidiary. In 2009, the Allyes internet advertising business accounted for 21.4% of Focus Media's total revenues.

5. On March 22, 2010, Focus Media publicly reported annual and fourth-quarter 2009 earnings through a Form 6-K filing. The filing also disclosed that during the first

[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.

quarter of 2010 Focus Media sold a part of its Allyes business in what was described as a "Management Buy-Out" ("MBO"): "Certain Allyes employees and management and directors and certain members of the Company's management and directors recently entered into a definitive agreement with the Company and Allyes in January 2010 to buy-out an aggregate 38% interest in Allyes from the Company." Jiang was the largest individual purchaser in the MBO. The MBO purchase price, as also disclosed in the Form 6-K, was $13.3 million, which represented an implied valuation for the entire Allyes entity of approximately $35 million. The stated reason for the MBO was that it was "part of initiatives being taken by the Company to incentivize management to enhance the future business model of Allyes and thereby to seek long-term sustainable growth for the Company and investors." Focus Media also stated that the purchase price was based upon, *inter alia*, an independent third-party valuation report.

6. On July 16, 2010, Focus Media filed an amended annual report for 2009 on a Form 20-F. The Form 20-F/A repeated the description of the MBO, and stated that the price paid in the MBO approximated fair value. In addition, the Form 20-F/A reiterated that the MBO was part of initiatives undertaken to incentivize management to enhance the future business model of Allyes and thereby increase shareholder value. Respondent Jiang signed the Form 20-F/A as Chairman and CEO of Focus Media.

7. Two weeks later, on July 30, 2010, Focus Media publicly announced that, a private equity firm ("Acquiror"), had agreed to acquire a controlling stake in Allyes from Focus Media and the other shareholders. The disclosed $124 million purchase price for Focus Media's remaining 62% interest in Allyes represented an implied valuation of $200 million for the entire Allyes entity.

8. As indicated by the following sequence of events, Focus Media's public disclosures inaccurately described the circumstances concerning the MBO and the Acquiror transactions.

9. In the fall of 2009, Focus Media and Allyes management were considering various structures for a restricted share plan, in order to incentivize Allyes management to continue working at Allyes (particularly in light of significant departures of senior Allyes personnel that had occurred in the preceding year) and assist in a turnaround of the business. It was contemplated that participants in such a plan could thereafter participate in any ultimate disposition (*i.e.*, sale or IPO) of Allyes. In a Power Point presentation received by Jiang and others on September 22, 2009, three restricted share issuance proposals were outlined, with a higher ultimate sales or IPO price for Allyes resulting in a higher incentive percentage of restricted share issuances: 6.7% for a disposition at $150 million, 8.4% for a disposition at $200 million, and 10% for a disposition at $250 million.

10. On October 15, 2009, Jiang and others received an email from an Allyes officer summarizing a proposed allocation, which the Allyes officer described as having been authorized by the Focus Media board, for an issuance of approximately 8.1 million restricted Allyes shares (equaling 7.5% of the outstanding post-issuance share balance), the majority of

which would be allocated to Allyes management and employees. Less than 10% of the newly issued shares were identified as being allocated to Focus Media management and employees, with the largest identified Focus Media recipient (Jiang) to hold 0.5% of Allyes. Unlike with what ultimately happened in the MBO, in this earlier proposal, restricted share recipients were to pay nothing for their shares. Focus Media records reflect that a majority of the Board's Compensation Committee members approved the share allocation plan shortly thereafter.

11. In October and November 2009, documents were circulated among Focus Media and Allyes personnel, including in some instances Jiang, describing a plan for an "A-Share IPO," referring to a public offering on the Shanghai Stock Exchange, to be launched potentially in 2011, pursuant to which plan management would hold 20% of the listed entity at the time of the eventual IPO.

12. Towards the end of November 2009, an Acquiror representative reached out to Allyes to discuss a possible acquisition of the company. A meeting was scheduled between senior representatives of Acquiror and Allyes for November 30, 2009. By December 1, 2009, Allyes and Acquiror executed a non-disclosure agreement concerning a potential transaction, and Allyes provided confidential financial information to Acquiror in connection with the potential transaction.

13. On December 4, 2009, Allyes management circulated to Jiang and others a draft presentation for the Focus Media board concerning the potential Allyes IPO. Unlike prior versions of draft IPO presentations, this version provided for management to abandon the 7.5% restricted equity plan previously approved by a majority of Focus Media's Compensation Committee. Instead, the presentation proposed that management purchase a 19% stake of Allyes based on a $35 million enterprise valuation. The presentation was circulated to the Focus Media board in advance of its December 6, 2009 board meeting.

14. On December 6, 2009, the Focus Media board met. There are two apparently "final," contradictory versions of the minutes. Neither set of minutes reflects any discussion of an IPO transaction for Allyes. Instead, one version of the board's minutes reflects that the management of Allyes and Focus Media "proposed that they intend to purchase up to 38% equity of Allyes," and that the "buy-out proposal" was approved, with Allyes and Focus Media management and employees authorized to purchase no more than 38% of Allyes at a valuation of no less than "Allyes current valuation USD 35 million." This set of board minutes, for a meeting days after Allyes and Acquiror entered into a non-disclosure agreement, is the first Focus Media document to refer to an MBO with a buyout of 38% of Allyes. Another version of the board's minutes from the same meeting does not mention the MBO at all.

15. On December 6, 2009, the same day as the Focus Media board meeting in which the MBO was apparently approved at an implied valuation of $35 million, internal Acquiror documents reflect Acquiror's understanding that Allyes management "has guided towards a valuation between $200M and $300M."

16. Later in December, Acquiror and Allyes conducted discussions concerning a possible acquisition of Allyes, which included a discussion of a potential acquisition price range of $150-200 million. Further deal discussions between the parties did not occur at that time and Acquiror business records reflect that this was at Allyes's request, because Allyes asked Acquiror to "hold off the deal" for the MBO to be finalized.

17. In contrast to what his participation in the Allyes restricted share plan would have been, initial Focus Media drafts for the MBO agreement reflect that approximately half of the 38% participation was to go to Jiang.

18. After various drafts of the MBO agreement circulated internally at Focus Media in January and February 2010, the Focus Media board met on March 15, 2010, and ratified the MBO. Although Focus Media's contemporaneous emails refer to the board's ratification of the MBO at the March 15, 2010 board meeting, the board minutes for that meeting do not themselves reflect any mention of the MBO.

19. On March 18, 2010, three days after the Focus Media board meeting in which the MBO was purportedly ratified, a senior officer of Focus Media called outside counsel to discuss possible representation of Focus Media in a sale of Allyes to Acquiror. That same day, Acquiror business records reflect that Allyes and Acquiror management had spoken again. Later that month, Acquiror records reflect its understanding that "[d]eal looks something like 200M equity, 160-ish E[nterprise] V[alue]," and that they had been informed of a desire to close in July "for understandable reasons."

20. Less than four months later on July 30, 2010, Focus Media publicly announced that Acquiror had agreed to acquire a controlling stake in Allyes from Focus Media and the other shareholders. The disclosed $124 million purchase price for Focus Media's remaining 62% interest in Allyes represented an enterprise valuation of $200 million for Allyes.

21. Although Focus Media and Jiang maintain that they had no knowledge that there had been any discussions between Allyes management and Acquiror regarding the sale of Allyes for $200 million before the MBO was approved, they ignored numerous red flags that should have alerted them to this situation.

Red Flags

The MBO Participants

22. Focus Media stated in its public filings that the purpose of the MBO was to incentivize Allyes management to assist in a turnaround of the business. However, as a result of the sale to Acquiror following the MBO, the largest beneficiary of the MBO was Jiang by virtue of his percentage share.

23. Although Focus Media and Jiang attributed the size of Focus Media

management's participation in the MBO (greater than 40%) to Allyes management's insistence that Focus Media management share the risk of the incentivization program, the fact that a program intended to incentivize Allyes management resulted in such substantial short-term gains to the Focus Media CEO warranted deeper scrutiny into whether a potential deal may have been available to Allyes at the time the structure of the MBO was first under consideration. The need for such scrutiny was heightened with respect to subsequent public filings because a Focus Media director became aware that Jiang had approved payment of a $2.6 million finder's fee to an Allyes officer for bringing the Acquiror deal to Focus Media. Jiang approved the fee without full disclosure to the Focus Media Board.

24. Similarly, although the stated purpose of the MBO was to incentivize Allyes management, two of the MBO participants were British Virgin Island-incorporated entities purportedly owned by individuals who had been retained by Allyes as consultants—not employees—in November 2009 shortly before the MBO. There is no indication in Focus Media's records that these consultants actually performed work on behalf of Allyes, and Focus Media's records do not reflect any inquiry by any member of the Focus Media board, including Jiang, concerning the basis for providing those individuals with the opportunity to purchase MBO shares. Moreover, Jiang, having been asked by an Allyes representative to lend a BVI entity money so that it would be able to purchase the shares, funded the participation of one of the BVI entities. Jiang's loan was subsequently repaid in cash, by that Allyes representative after the Acquiror transaction closed.

The Price Difference Between the MBO and the Acquiror Transaction

25. Although Focus Media received an appraisal supporting the $35 million MBO valuation, contemporaneous internal discussions regarding an ultimate sale or IPO of Allyes in the range of $150 to $250 million should have led Focus Media and Jiang to question the company's reliance on that valuation only months before Allyes was indeed sold to Acquiror for $200 million.

The Failure to Notice and Act on Evidence of Prior Communications with Acquiror

26. After the Focus Media officer became aware in March 2010 that negotiations were occurring with Acquiror, there is no indication that Focus Media took any steps to determine when those discussions had first started, and what the content of those discussions had been. In addition, in July 2010, another Focus Media officer failed to notice a reference to the pre-MBO December 1, 2009 non-disclosure agreement between Allyes and Acquiror in a deal-related document being circulated by email.

The Lack of Appropriate Corporate Formalities

27. Focus Media's records do not indicate at what date the company bound itself to the MBO, and the agreement was still being circulated for signature to certain purchasers up until July 28, 2010. One of the participants did not fund the MBO until late June 2010, one week after Acquiror executed a Term Sheet, purportedly because nobody had asked for the

money. And a number of Focus Media employees who ended up receiving proceeds arising from the sale to Acquiror of interests purchased in the MBO, were not parties to the MBO agreement.

28. The lack of formality in executing and funding the MBO, together with the undocumented receipt of proceeds by Focus Media employees, should have subjected the MBO and the ultimate sale to Acquiror to greater scrutiny into whether there was any connection between the two events.

29. Moreover, and as explained above, Focus Media's board minutes concerning the sale of the Allyes asset in the MBO are both inconsistent and incomplete. With respect to the Focus Media board meeting of December 6, 2009, the company's records contain two purportedly "final" versions of board minutes, one mentioning board approval of the MBO and one not mentioning the MBO at all. With respect to the Focus Media board meeting of March 15, 2010, the company's board minutes do not mention the MBO at all, even though other records reflect that the board voted on and approved the transaction during that meeting. With respect to a Focus Media board meeting of July 10, 2010, at which the potential sale to Acquiror was purportedly discussed, the company's records do not contain any board minutes from that meeting.

30. Certain of Focus Media's SEC filings, including filings signed by Jiang, concerning the MBO and the sale of Allyes to Acquiror were materially misleading in that they contained unqualified statements that the MBO was undertaken at a price approximating fair value and in order to incentivize management to seek long-term sustainable growth. At the time, however, Focus Media and Jiang could have accessed information indicating the inaccuracy of those statements. Had they inquired further into the circumstances surrounding the MBO based on the red flags described above, they would have uncovered the following information: (i) that the MBO was finalized after Acquiror and Allyes had engaged in discussions concerning a sale of Allyes in December at a $200 million price that was multiples of the MBO price; and (ii) that consultants and other non-disclosed parties took part in the MBO. Focus Media's material misrepresentations and omissions were repeated in numerous company filings, including filings related to the secondary offering of ADRs into the market on September 7, 2010.

31. Jiang's and Focus Media's failure to exercise an appropriate level of care in scrutinizing the MBO resulted in the Focus Media Board receiving materially inaccurate information regarding the MBO.

Violations

32. As a result of the conduct described above, Focus Media and Jiang violated Section 17(a)(2) of the Securities Act, which prohibits obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they

were made, not misleading.[2]

33. As a result of the conduct described above, Focus Media 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.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act, Respondents Focus Media and Jiang cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) of the Securities Act. Pursuant to Section 21C of the Exchange Act, Respondent Focus Media cease and desist from committing or causing any violations and any future violations of Section 13(b)(2)(A) of the Exchange Act.

B. Respondent Focus Media shall within 30 days of the entry of this Order, pay a civil money penalty in the amount of $34,600,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

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

(2) Respondent Focus Media 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 Focus Media 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

[2] A violation of Section 17(a)(2) may be established by a showing of negligent conduct. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

Payments by check or money order must be accompanied by a cover letter identifying Focus Media as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, New York, New York 10128.

C. Respondent Jiang shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $9,690,000; disgorgement of $9,690,000; and prejudgment interest on the amount to be disgorged of $1,647,865.43 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717 and Commission Rule of Practice, Rule 600. Payment must be made in one of the following Payment must be made in one of the following ways:

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

(2) Respondent Jiang 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 Jiang 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 Jiang as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, New York, New York 10128.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest and/or penalties referenced in paragraphs B and C above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agrees that in any Related Investor Action, they shall not argue that Respondents 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' payments of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agrees 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, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523 with respect to Respondent Jiang, the findings in this Order are true and admitted by Respondent Jiang, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Jiang 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 Jiang 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. 9934 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76031 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16868

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against PNC Capital Markets LLC ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, formed in Pennsylvania and headquartered in Pittsburgh, Pennsylvania, is registered with the Commission as a broker-dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which an obligor failed to disclose that it filed five audited financial reports between two and thirteen months late, failed to file certain required operating data, and failed to file the required notices of late filings;

- A 2011 negotiated securities offering in which an issuer failed to disclose that, just prior to the offering, it filed four annual financial reports between 325 and 1,457 days late, and failed to file the required notices of late filings; and

- A 2012 negotiated securities offering in which an issuer failed to disclose that, just prior to the offering, it filed three annual financial reports between 155 and 885 days late, and failed to file the required notices of late filings.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $500,000 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 PNC Capital Markets LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9935 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76032 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16869

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Prager & Co., LLC ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, formed in Delaware and headquartered in San Francisco, California, is registered with the Commission as a broker-dealer and municipal advisor.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2011 negotiated securities offering in which an obligor failed to disclose that it filed two annual financial reports between 36 and 73 days late, failed entirely to file another annual report for one fiscal year, filed audited financial statements for one fiscal year 47 days late, and failed to file required notices of late filings for each of those; and

- 2010 and 2012 competitive securities offerings in which an obligor failed to disclose that it had filed three audited financial statements between 11 months and 3 years late, had not filed other required continuing disclosure information for those same years at all, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and

procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the Securities and Exchange Commission 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 Prager & Co., LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9954 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76051 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16866

In the Matter of

Duncan-Williams, Inc.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Duncan-Williams, Inc. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, incorporated in Tennessee and headquartered in Memphis, Tennessee, is registered with the Commission as a broker-dealer.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which an issuer failed to disclose that it filed four annual financial reports between two and ten months late, and failed to file a notice of late filing for each of those;

- A 2012 negotiated securities offering in which an issuer failed to disclose that it failed to file one annual financial report it had previously undertaken to make, filed three annual financial reports between three and twelve months late, and failed to file a notice of late filing for each of those; and

- A 2011 negotiated securities offering in which an issuer failed to disclose that it filed two annual financial reports between two and six months late, and failed to file a notice of late filing for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $250,000.00 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 Duncan-Williams, Inc. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

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. 9955 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76052 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16867

In the Matter of

EDWARD D. JONES & CO., L.P.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Edward D. Jones & Co., L.P. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) 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

Summary

1. This matter involves violations of an antifraud provision of the federal securities laws in connection with Respondent's underwriting of certain municipal securities offerings. Respondent, a registered broker-dealer, conducted inadequate due diligence in certain offerings and as a result, failed to form a reasonable basis for believing the truthfulness of certain material representations in official statements issued in connection with those offerings. This resulted in Respondent offering and selling municipal securities on the basis of materially misleading disclosure documents. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.[2]

2. The violations discussed in this Order were self-reported by Respondent to the Commission pursuant to the Division of Enforcement's (the "Division") Municipalities Continuing Disclosure Cooperation Initiative.[3] Accordingly, this Order and Respondent's Offer are based on the information self-reported by Respondent.

Respondent

3. Respondent, formed in Missouri and headquartered in St. Louis, Missouri, is registered with the Commission as a broker-dealer and investment adviser.

Due Diligence Failures

4. Pursuant to Rule 15c2-12 of the Exchange Act, before purchasing or selling municipal securities in connection with an offering, underwriters are required to obtain executed continuing disclosure agreements from the issuers and/or obligated persons with respect to such municipal securities. In order to comply with the requirements of Rule 15c2-12, the continuing disclosure agreement must include an undertaking by the municipal issuer and/or obligated person, for the benefit of investors, to provide an annual report containing certain financial information and operating data to the Municipal Securities Rulemaking Board's ("MSRB") Electronic Municipal Market Access system,[4] as well as timely notice of certain specified events

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

[2] 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)).

[3] See Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

[4] Previously, Rule 15c2-12 required such information to be provided to the appropriate nationally recognized municipal securities information repositories. In December 2008, Rule 15c2-12 was amended to designate the

pertaining to the municipal securities being offered and timely notice of any failure to submit an annual report on or before the date specified in the continuing disclosure agreement.

5. Rule 15c2-12(f)(3) requires that a final official statement set forth any instances in the previous five years in which an issuer of municipal securities, or obligated person, failed to comply in all material respects with any previous continuing disclosure undertakings.

6. Respondent acted as either a senior or sole underwriter in a number of municipal securities offerings in which the official statements essentially represented that the issuer or obligated person had not failed to comply in all material respects with any previous continuing disclosure undertakings. In fact, certain of these statements were materially false and/or misleading because the issuer or obligated person had not complied in all material respects with its previous continuing disclosure undertakings. Among the offerings in which the official statements contained false or misleading statements about prior compliance were the following:

- A 2013 negotiated securities offering in which an issuer failed to disclose that it failed to file an audited financial report, filed another audited financial report over four months late, and failed to file required notices of late filings for each of those. This failure to disclose was not subsequently cured by the issuer filing a supplement to the official statement approximately four months after the offering disclosing the late filings;

- A 2012 negotiated securities offering in which an obligor, just prior to the offering, filed three annual financial reports which were between two and 50 months late, but represented in the offering that it had not failed to materially comply with its continuing disclosure obligations without disclosing the late reports, and failed to file required notices of late filings for each of those; and

- A 2012 negotiated securities offering in which an issuer failed to disclose that it filed four annual financial reports between one month and over three years late, and failed to file required notices of late filings for each of those.

7. Respondent failed to form a reasonable basis through adequate due diligence for believing the truthfulness of the assertions by these issuers and/or obligors regarding their compliance with previous continuing disclosure undertakings pursuant to Rule 15c2-12.

Legal Discussion

8. Section 17(a)(2) of the Securities Act makes it unlawful "in the offer or sale of any securities . . . directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77q(a)(2) (2012). Negligence is sufficient to establish a violation of Section 17(a)(2). See Aaron v. SEC, 446 U.S. 680, 696-97 (1980). A misrepresentation or omission is

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MSRB's Electronic Municipal Market Access system as the central repository for ongoing disclosures by municipal issuers, effective July 1, 2009.

material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. See Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

9. An underwriter may violate the antifraud provisions of the federal securities laws if it does not have a reasonable basis for believing the truthfulness of material statements in offering documents in connection with a securities offering, as a result of inadequate due diligence. "By participating in an offering, an underwriter makes an implied recommendation about the securities [that it] . . . has a reasonable basis for belief in the truthfulness and *completeness* of the key representations made in any disclosure documents used in the offerings." Dolphin & Bradbury, Inc. v. SEC, 512 F.3d 634, 641 (D.C. Cir. 2008) (emphasis added) (quoting Municipal Securities Disclosure, Exchange Act Release No. 26100, 53 Fed. Reg. 37778, 37787 (Sept. 28, 1988) ("1988 Proposing Release")); see also City Securities Corp., Exchange Act Release No. 70056, 2013 WL 3874855, at *1-2 (July 29, 2013) (finding underwriter violated anti-fraud provisions by failing to conduct due diligence related to issuer's statements regarding its compliance with previous continuing disclosure undertakings).

10. An underwriter "occupies a vital position" in a securities offering because investors rely on its reputation, integrity, independence, and expertise. See Dolphin & Bradbury, 512 F.3d at 641 (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787). While broker-dealers must have a reasonable basis for recommending securities to customers, underwriters have a "heightened obligation" to take steps to ensure adequate disclosure. Id. (quoting 1988 Proposing Release, 53 Fed. Reg. at 37787 n.74).

11. Rule 15c2-12 was adopted in an effort to improve the quality and timeliness of disclosures to investors in municipal securities. In recognition of the fact that the disclosure of sound financial information is critical to the integrity of not just the primary market, but also the secondary markets for municipal securities, Rule 15c2-12 requires an underwriter to obtain a written agreement, for the benefit of the holders of the securities, in which the issuer undertakes (among other things) to annually submit certain financial information. See 17 C.F.R. § 240.15c2-12(b)(5)(i) (2015); see also Municipal Securities Disclosure, Exchange Act Release No. 34961, 59 Fed. Reg. 59590, 59592 (Nov. 17, 1994). Critical to any evaluation of an undertaking to make disclosures is the likelihood that the issuer or obligated person will abide by the undertaking. See id. at 59594. The disclosure requirements of Rule 15c2-12 provide an incentive for issuers and obligated persons to comply with their undertakings, allowing underwriters, investors, and others to assess the reliability of the disclosure representations. See Municipal Securities Disclosure, 59 Fed. Reg. at 59595.

12. As a result of the conduct described herein, Respondent willfully violated Section 17(a)(2) of the Securities Act.

Cooperation

13. In determining to accept Respondent's offer, the Commission considered the cooperation of Respondent in self-reporting the violations.

Undertakings

14. Respondent has undertaken to:

a. Retain an independent consultant (the "Independent Consultant"), not unacceptable to the Commission staff, to conduct a review of Respondent's policies and procedures as they relate to municipal securities underwriting due diligence. The Independent Consultant shall not have provided consulting, legal, auditing or other professional services to, or had any affiliation with, Respondent during the two years prior to the institution of these proceedings. Respondent shall cooperate fully with the Independent Consultant and the Independent Consultant's compensation and expenses shall be borne by Respondent.

b. Require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement. The agreement will also provide that, within 180 days of the institution of these proceedings, the Independent Consultant shall submit a written report of its findings to Respondent, which shall include the Independent Consultant's recommendations for changes in or improvements to Respondent's policies and procedures.

c. Adopt all recommendations contained in the Independent Consultant's report within 90 days of the date of that report, provided, however, that within 30 days of the report, Respondent shall advise in writing the Independent Consultant and the Commission staff of any recommendations that Respondent considers to be unduly burdensome, impractical or inappropriate. With respect to any such recommendation, Respondent need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedures or system designed to achieve the same objective or purpose. As to any recommendation on which Respondent and the Independent Consultant do not agree, Respondent and the Independent Consultant shall attempt in good faith to reach an agreement within 60 days after the date of the Report. Within 15 days after the conclusion of the discussion and evaluation by Respondent and the Independent Consultant, Respondent shall require that the Independent Consultant inform Respondent and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Respondent considers to be unduly burdensome, impractical, or inappropriate. Within 10 days of this written communication

from the Independent Consultant, Respondent may seek approval from the Commission staff to not adopt recommendations that the Respondent can demonstrate to be unduly burdensome, impractical, or inappropriate. Should the Commission staff agree that any proposed recommendations are unduly burdensome, impractical, or inappropriate, Respondent shall not be required to abide by, adopt, or implement those recommendations.

d. Certify, in writing, compliance with the undertakings set forth above in paragraphs 14(a)-(c). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, with a copy to the Office of Chief Counsel of the Division, no later than the one-year anniversary of the institution of these proceedings.

e. Respondent shall cooperate with any subsequent investigation by the Division regarding the subject matter of this Order, including the roles of other parties.

f. For good cause shown, the Commission staff may extend any of the procedural dates relating to these 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 the last day.

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 8A of the Securities Act and Section 15(b) 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 17(a)(2) of the Securities Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 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 Edward D. Jones & Co., L.P. 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 Ghazil Gaunt, Chief, Municipal Securities and Public Pensions Unit, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110-1424.

C. Respondent shall comply with the undertakings enumerated in Paragraphs 14(a)-(d), above.

By the Commission.

Brent J. Fields
Secretary

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

Commissioner
Not particip

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIE S ACT OF 1933
Release No. 9956 / September 30, 2015

TRATIVE PROCEEDING
-16853; 3-16854; 3-16855; 3-16856; 3-16857;
-16859; 3-16860; 3-16861; 3-16862; 3-16863;
16865; 3-16866; 3-16867; 3-16868; 3-16869
16871; 3-16872; 3-16873; and 3-16874

In the Matter of **Certain Underwriters Participating in the Municipalities Continuing Disclosure Cooperation Initiative,** **Respondents.**	**ORDER UNDER RULES 262(b)(2), 405, 505(b)(2)(iii)(C), 506(d)(2)(ii), AND 602(e) OF THE SECURITIES ACT OF 1933 GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF RULES 262(a)(4)(ii), 505(b)(2)(iii), 506(d)(1)(iv), AND 602(c)(3) OF THE SECURITIES ACT OF 1933, AND GRANTING WAIVERS FROM BEING INELIGIBLE ISSUERS**

I.

In March 2014, the Division of Enforcement (the "Division") announced the Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative"), a s reporting program intended to address potentially widespread violations of the federal s laws resulting from misrepresentations in municipal bond offering documents about pri compliance with continuing disclosure obligations.[1]

Pursuant to the MCDC Initiative, the Division agreed to recommend that the and Exchange Commission ("Commission") accept settlement offers from underwr reported certain violations and that agreed to consent to certain standardized settle

The MCDC Initiative resulted in a large number of underwriters and othe self-reporting potential non-scienter based violations of the federal securities la generated much-needed attention within the municipal underwriter community disclosure compliance, the disclosure process, and due diligence. The MCDC allowed the Commission to address an industry-wide problem, in part throu other significant remedial undertakings by the participants, while avoiding

[1] See Division of Enforcement, Securities and Exchange Commission, Municipalities C Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuin initiative.shtml (last modified Nov. 13, 2014).

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9956 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File Nos. 3-16853; 3-16854; 3-16855; 3-16856; 3-16857; 3-16858; 3-16859; 3-16860; 3-16861; 3-16862; 3-16863; 3-16864; 3-16865; 3-16866; 3-16867; 3-16868; 3-16869 3-16870; 3-16871; 3-16872; 3-16873; and 3-16874

In the Matter of **Certain Underwriters Participating in the Municipalities Continuing Disclosure Cooperation Initiative,** **Respondents.**	**ORDER UNDER RULES 262(b)(2), 405, 505(b)(2)(iii)(C), 506(d)(2)(ii), AND 602(e) OF THE SECURITIES ACT OF 1933 GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF RULES 262(a)(4)(ii), 505(b)(2)(iii), 506(d)(1)(iv), AND 602(c)(3) OF THE SECURITIES ACT OF 1933, AND GRANTING WAIVERS FROM BEING INELIGIBLE ISSUERS**

I.

In March 2014, the Division of Enforcement (the "Division") announced the Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative"), a self-reporting program intended to address potentially widespread violations of the federal securities laws resulting from misrepresentations in municipal bond offering documents about prior compliance with continuing disclosure obligations.[1]

Pursuant to the MCDC Initiative, the Division agreed to recommend that the Securities and Exchange Commission ("Commission") accept settlement offers from underwriters that self-reported certain violations and that agreed to consent to certain standardized settlement terms.

The MCDC Initiative resulted in a large number of underwriters and other participants self-reporting potential non-scienter based violations of the federal securities laws and has generated much-needed attention within the municipal underwriter community about continuing disclosure compliance, the disclosure process, and due diligence. The MCDC Initiative has allowed the Commission to address an industry-wide problem, in part through cooperation and other significant remedial undertakings by the participants, while avoiding the expenditure of

[1] See Division of Enforcement, Securities and Exchange Commission, Municipalities Continuing Disclosure Cooperation Initiative, http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml (last modified Nov. 13, 2014).

significant resources typically associated with identifying and conducting full investigations of potential securities law violations.

II.

The Commission has issued several separate orders ("MCDC Orders") instituting administrative and cease-and-desist proceedings against certain municipal underwriters who participated in the MCDC Initiative (the "MCDC Underwriters").[2] These proceedings are consistent with the previously announced terms of the MCDC Initiative and are brought pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") (or, alternatively, Section 15B of the Exchange Act for underwriters solely registered with the Commission as municipal securities dealers) for willful violations of Section 17(a)(2) of the Securities Act for failure to conduct adequate due diligence on certain municipal securities offerings. Specifically, the MCDC Underwriters failed to form a reasonable basis for believing the truthfulness of certain material representations by municipal issuers in official statements issued in connection with those offerings. The MCDC Orders, which state that they are being issued pursuant to the MCDC Initiative, require that the respondents cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and undertake to retain an independent consultant to conduct a compliance review and take reasonable steps to implement the consultant's recommendations, among other things. The MCDC Orders trigger a number of disqualifications from exemptions available under the Securities Act for the MCDC Underwriters, and for certain issuers which have MCDC Underwriters as subsidiaries ("MCDC Issuers").

III.

Waivers of Disqualification Under Rule 262 of Regulation A and Rules 505 and 506 of Regulation D

Rule 262 of Regulation A and Rules 505 and 506 of Regulation D provide for disqualification from exemptions from registration under the Securities Act for certain offerings if, among other things, the relevant entity is subject to a Commission order pursuant to Section 15(b) or 15B(c) of the Exchange Act that places limitations on that entity's activities, functions, or operations, including the retention of an independent consultant. See 17 C.F.R. §§ 230.262(a)(4)(ii), 230.505(b)(2)(iii), and 230.506(d)(1)(iv)(B).

The Commission has the authority to waive the Regulation A and D disqualifications upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied. See 17 C.F.R. §§ 230.262(b)(2), 230.505(b)(2)(iii)(C), and 230.506(d)(2)(ii).

Ineligible Issuer Waiver

Under Clause (1)(vi) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of well-known seasoned

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[2] The list of MCDC Underwriters subject to this Order is included in an Appendix to this Order.

issuer status, if "[w]ithin the past three years (but in the case of a decree or order agreed to in a settlement, not before December 1, 2005), the issuer or any entity that at the time was a subsidiary of the issuer was made the subject of any judicial or administrative decree or order arising out of a governmental action that: (A) Prohibits certain conduct or activities regarding, including future violations of, the anti-fraud provisions of the federal securities laws . . ." See 17 C.F.R. § 230.405(1)(vi).

Under the second paragraph of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer. See 17 C.F.R. § 230.405(2).

Waiver from Regulation E Disqualification

Regulation E provides an exemption from registration under the Securities Act, subject to certain conditions, for securities issued by certain small business investment companies and business development companies. Rule 602(c)(3) makes this exemption unavailable for the securities of an issuer if, among other things, any underwriter of the securities to be offered is subject to an order of the Commission entered pursuant to Section 15(b) of the Exchange Act. See 17 C.F.R. § 230.602(c)(3). Rule 602(e) provides, however, that the disqualification shall not apply if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption from registration pursuant to Regulation E be denied. See 17 C.F.R. § 230.602(e).

Good Cause

In light of the participation of the MCDC Underwriters in the MCDC Initiative and their agreement to consent to its terms, assuming the MCDC Underwriters comply with the terms of the MCDC Orders, and in light of the benefits of the MCDC Initiative discussed herein, the Commission has determined that good cause exists for not denying the various exemptions from registration discussed herein, and for MCDC Issuers to receive waivers from being ineligible issuers that results from the entry of the MCDC Orders.

IV.

Based on the foregoing, the Commission has determined that pursuant to Rules 262(b)(2), 505(b)(2)(iii)(C), 506(d)(2)(ii), and 602(e) of the Securities Act and Paragraph (2) of the definition of ineligible issuer in Rule 405 of the Securities Act, the requisite showings of good cause have been made.

Accordingly, IT IS ORDERED, pursuant to Rules 262(b)(2), 505(b)(2)(iii)(C), 506(d)(2)(ii), and 602(e) of the Securities Act, and Paragraph (2) of the definition of ineligible issuer in Rule 405 of the Securities Act, that waivers from the application of the disqualification provisions of Rules 262(a)(4)(ii), 505(b)(2)(iii), 506(d)(1)(iv)(B), and 602(c)(3) of the Securities Act, and waivers from being ineligible issuers under Rule 405 of the Securities Act, resulting from the entry of the MCDC Orders against the MCDC Underwriters are hereby granted, as reflected in the attached appendices. Nothing in this Order shall effect any pre-existing disqualification or ineligibility under the above provisions and nothing in this Order shall be interpreted to waive or limit any conditions or undertakings which are in place as a result of any prior waiver granted to any MCDC Underwriter or MCDC Issuer. Failure to comply with terms of the MCDC Orders would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Because of the unique nature of the MCDC Initiative, this Order and the circumstances under which it was issued shall not be relied upon by any entity that may seek a waiver in the future from the disqualifications discussed herein.

By the Commission.

Brent J. Fields
Secretary

Appendices: MCDC Underwriters
MCDC Issuers

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

The MCDC Underwriters

Ameritas Investment Corp.
BB&T Securities, LLC
Comerica Securities, Inc.
Commerce Bank Capital Markets Group
Country Club Bank
Crews & Associates, Inc.
Duncan-Williams, Inc.
Edward D. Jones & Co., L.P.
Estrada Hinojosa & Company, Inc.
Fifth Third Securities, Inc.
The Frazer Lanier Company, Incorporated
J.J.B. Hilliard, W.L. Lyons, LLC
Joe Jolly & Co., Inc.
Mesirow Financial, Inc.
Northland Securities, Inc.
NW Capital Markets Inc.
PNC Capital Markets LLC
Prager & Co., LLC
Ross, Sinclaire & Associates, LLC
UBS Financial Services, Inc.
UMB Bank, N.A. Investment Banking Division
U.S Bank Municipal Securities Group, a Division of U.S. Bank National Association

MCDC Issuers

BB&T Corporation (BB&T Securities, LLC)
Comerica Incorporated (Comerica Securities, Inc.)
Commerce Bancshares, Inc. (Commerce Bank Capital Markets Group)
Fifth Third Bancorp (Fifth Third Securities, Inc.)
The PNC Financial Services Group, Inc. (PNC Capital Markets LLC)
UBS AG (UBS Financial Services, Inc.)
UMB Financial Corporation (UMB Bank, N.A. Investment Banking Division)
U.S. Bancorp (U.S Bank Municipal Securities Group, a Division of U.S. Bank National Association)

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9957 / September 30, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76055 / September 30, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31853 / September 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16875

In the Matter of **Edward T. Borg and Brian J. Mulkeen** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Edward T. Borg and Brian J. Mulkeen (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, the 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 in which the Commission is a party, and without admitting or denying the findings contained in the Order, 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 Administrative and Cease-and-Desist Proceedings, pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

Edward Borg, a former owner, officer and registered representative of a small now-defunct broker-dealer, All Funds, Inc. ("All Funds"), periodically manipulated the market for Natural Alternatives International, Inc.'s ("NAII") common stock between 2003 through 2011. Borg engaged in manipulative trading to support the price of NAII stock and to give the false appearance of investor interest. He directed trading in several of his customers' accounts, personally invested heavily in NAII and had several of his customers invest heavily in NAII, often in high concentrations (more than 90% of the account's total value) and frequently on margin. In connection with one All Funds customer, Borg recommended that she invest in NAII almost exclusively, which was not suitable in light of her investment objectives. During this period, Borg personally owned as much as 22.5 percent of NAII's outstanding stock, and customers at All Funds, combined with Borg's personal holdings, owned as much as 55 percent of the outstanding shares of NAII. Borg did not report any of his holdings as required by the federal securities laws until March 9, 2012, when he filed a Schedule 13G, and Forms 3 and 4—all of which understated the number of shares he beneficially owned.

Borg made cross-trades and matched trades in thinly-traded NAII stock at prices that he typically determined (usually at the offer) between customer accounts at All Funds where he essentially controlled trading in the accounts. He also executed numerous wash sales and matched orders, which distorted the trading volume for NAII, supported the price of NAII, and made the stock appear to be more liquid than it really was.

Before All Funds closed in 2012, a number of Borg's customers moved their accounts to LPL Financial LLC ("LPL"), where Borg became a registered representative, and tried to continue his manipulation of NAII stock. After leaving LPL, Borg arranged for many of his customers to transfer their accounts to TD Ameritrade ("TDA"). Although Borg was no longer a registered representative, he convinced several of his customers to give him authority to trade on their behalf in their accounts at TDA. Borg controlled the trading in their accounts until TDA refused to process orders Borg placed in his former customers' accounts and asked Borg and most of his

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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.

former customers to close or transfer their accounts due to TDA's concerns about the propriety of the trading in those accounts. At both LPL and TDA, Borg placed telephone calls in which he impersonated several of his customers (in recorded calls) to maintain control of NAII stock and to prevent LPL or TDA from selling the customers' shares of NAII in the market.

Although Borg did not report any of his holdings in NAII until 2012, three of his largest customers (the "investment group") reported their holdings in NAII in 2001. The investment group was a "person" subject to Section 13(d)(1) and members of the investment group explicitly affirmed that they were members of a group in that filing and amendments to it. A group is deemed to acquire the beneficial ownership of all of its members. Consequently, the Schedule 13D did not accurately report the number of shares beneficially owned by the group because Borg was an undisclosed member of the group and shares he personally owned were not reported.

The first two members of the investment group filed a Schedule 13D on November 5, 2001. The Schedule 13D stated:

> The persons filing this Report now believe that (a) the Common Stock is significantly under-valued, (b) steps taken by the Company to date to enhance stockholder value have been insufficient . . . .
>
> The persons filing this Report are examining all of their options with respect to the possibility of taking actions which they believe will enhance stockholder value. Such actions could include proposing that management pursue a financial transaction to improve stockholder value, including a merger, reorganization or liquidation, encouraging, participating or leading a proxy contest to change the Company's Board of Directors and/or encouraging, participating in or making a tender offer to acquire control of the Company.

Borg did not report his beneficial ownership of NAII stock at this time.

Later, after he personally owned more than 10% of NAII's stock (starting in 2005), Borg should have reported all of his purchases and sales of NAII stock even though the acquisitions and dispositions were equal. Anyone reviewing Borg's Form 4 filings (if he had filed them) would have observed that he was frequently buying and selling NAII stock, with the number of shares he sold often approximating the number of shares he bought. Since NAII was a relatively illiquid company, the Form 4 filings would have shown that Borg's trades were a significant portion of the total trading volume for NAII, which would have raised questions about Borg's trades and the true liquidity of the stock.

Borg's manipulation of the market for NAII and other misconduct described above went unchecked because Borg's long-time associate, Brian Mulkeen, was his designated supervisor at All Funds and failed to supervise him in any meaningful way. Mulkeen reviewed and approved all of Borg's personal trades as well as the trades that Borg directed on behalf of his customers at All Funds. Notwithstanding repeated red flags that Borg was engaging in wash trades among his personal accounts at All Funds and matched orders among his customers' accounts, Mulkeen failed to take any action. In addition, Mulkeen failed to follow-up on red flags of questionable suitability for at least one customer who had an extreme concentration of NAII in her account. Finally, in the course of his review of Borg's personal trading in NAII, Mulkeen learned that Borg was the beneficial owner of substantial amounts of NAII and told Borg to file ownership reports for NAII. However, Mulkeen took no action when Borg failed to file any of these reports during the next four years.

Respondents

1. **Edward T. Borg**, age 63, is currently a resident of Jupiter, Florida. Before he moved to Florida in 2008, Borg lived in Congers, New York. From December 1974 through February 2012, he was an owner, officer and registered representative for All Funds, Inc., a brokerage firm established by his father. He worked as a registered representative for LPL from September 2011 until April 2012. After he left LPL, he retired, but obtained trading authority over a number of his customers' accounts at TDA until TDA refused to allow Borg to trade for his prior customers and asked Borg and most of his customers to transfer or close their accounts. In 1979, the National Association of Securities Dealers, Inc. ("NASD") suspended Borg for 60 days, censured him and fined him $5,000 jointly and severally with his father, All Funds, and Brian Mulkeen (who was found to have failed to exercise reasonable supervision over Borg) for excessive trading in an account in which Borg also made unsuitable investment recommendations.

2. **Brian J. Mulkeen**, age 59, is a resident of Monroe, New York. He was President, Comptroller, Chief Compliance Officer, and Borg's direct supervisor at All Funds, where he worked from December 1976 until September 2011. In addition, Mulkeen was an employee of Balanced Estate Agency, another company that Borg inherited from his father, which sold insurance and provided real estate placement services. When All Funds closed, he moved to LPL until October 2012 when he moved to Invest Financial Corporation, where he currently works as a registered representative.

Other Relevant Entities

3. **Natural Alternatives International, Inc.**, a Delaware corporation with its headquarters in San Marcos, California, was founded by its current CEO, Mark LeDoux, in 1980. It formulates, manufactures, and markets nutritional supplements. It provides private-label manufacturing services to companies that market and distribute vitamins, minerals, nutritional supplements and other health care products. Its common stock is registered pursuant to Section 12(b) of the Exchange Act and listed on NASDAQ under the symbol NAII, which closed at $5.78 on June 26, 2015.

4. **All Funds, Inc.**, a New York corporation, was founded on April 16, 1956 by Edward Borg, Sr., who died in 1988. It was registered as a broker-dealer with the Commission from May 7, 1956 to February 7, 2012, when its notice of withdrawal from registration as a broker or dealer became effective, and it was dissolved on July 6, 2012. It was an introducing firm with a fully disclosed clearing agreement with National Financial Services LLC. ("NFS").

Background

A. As a Beneficial Owner, Borg Controlled almost 55 % of the Outstanding Shares of NAII

5. Borg first learned of NAII when he read a study about people who used beta-alanine, an amino acid produced and distributed by NAII, to allow them to exercise longer. He thought that this product could become popular so he reviewed NAII's financial statements and annual reports. He believed that NAII was undervalued and should be taken private or acquired by another company.

6. Over time, Borg purchased shares of NAII for himself and a number of his customers, resulting in All Funds' customers and Borg owning up to 55 percent of the outstanding stock of NAII. Borg's customers generally approved of investments in NAII based upon Borg's recommendation without discussion of specific trades. In some instances, customers only learned of their investment in NAII after Borg had already purchased NAII stock for them. Some customers also discovered that Borg gradually sold all of the securities they owned to buy NAII until it was the only security they owned. For every customer, Borg had the power to dispose of shares of NAII, and therefore possessed the requisite investment power as determined under Rule 13d-3(a)(2) to make him the beneficial owner of such shares for purposes of Section 13(d) of the Exchange Act.

B. Borg Developed a Selective Ownership Reporting Strategy

7. Two of Borg's largest customers, Customer A and Customer A's Trust, acquired more than 5% of NAII's common stock by August 13, 2001. Borg told Customer A that he should disclose his ownership of NAII. Borg had his attorneys prepare a Schedule 13G to sign, which Customer A signed and sent back to Borg, who caused it to be filed with the Commission. Borg, who is a trustee of the trust, had another trustee sign the same Schedule 13G on behalf of Customer A's Trust. Borg did not sign the Schedule, and the Schedule did not include Borg's holdings in NAII or disclose his involvement with the investment group. In the Schedule 13G, Customer A's Trust reported that it owned 224,000 shares of NAII common stock or 3.9% of the outstanding shares of the company, and Customer A reported that he owned an additional 180,700 shares of NAII or 3.2% of the outstanding shares of the company, for a total of 7.1% of the outstanding shares of NAII.

8. To draw attention to NAII as an attractive take-over target, Customer A and Customer A's Trust filed a Schedule 13D (instead of a Schedule 13G) with the Commission, which was amended four times from 2001 through 2006, including an amendment signed on December 5, 2001, adding Customer B to the investment group. The group also filed Forms 3 and 4 because the group eventually owned more than 10% of NAII's outstanding stock. Despite the fact that he personally owned 22 percent of NAII's outstanding stock between 2001 and 2006 (and, for purposes of Exchange Act Rule 13d-3(a)(2), beneficially owned even more), Borg did not sign any

of these filings or disclose his holdings in NAII or his involvement with the investment group, although Borg decided which documents to file and when to file them.

9. In the Schedule 13D, signed on October 29, 2001, Customer A disclosed that he had purchased additional shares of NAII, bringing his total to 208,200 shares or 3.6% of NAII. However, the most significant information included in that Schedule was that the group stated that, if management failed to act, then the group might take any of the following actions:

> [P]roposing that management pursue a financial transaction to improve stockholder value, including a merger, reorganization, or liquidation, encouraging participating or leading a proxy contest to change the Company's Board of Directors and/or encouraging participating in or making a tender offer to acquire control of the Company.

C. Borg Manipulated the Market for NAII

1. Borg Supported the Price of NAII through Matched Orders and Cross-trades Between Customers at All Funds

10. From 2003 through 2011, Borg executed NAII trades between customers at All Funds to avoid having his customers trade with investors in the open market. So, if one customer wanted to sell NAII, Borg tried to find another customer to buy those shares. In this manner, the order did not go to the market for execution at a price he did not control. Instead, Borg typically set the price for the purchase order and for the sell order that he crossed, typically at the offer price. Borg also matched some trades by using limit orders for one or both of his customers. For large orders, Borg often used the after-hours market to execute trades because that gave him greater control over the trade.

2. Borg Executed 1,062 Manipulative Trades to Make the Market for NAII Appear to be More Liquid than It Was and to Support the Price and Volume

11. From 2003 through 2011, Borg manipulated the market for NAII stock by executing 843 matched orders and 219 wash sales. "A matched order is an 'order to buy and sell the same security, at about the same time, in about the same quantity, and at about the same price.'" SEC v. Masri, 523 F Supp.2d 361, 367 n8 (SDNY 2007) (quoting Black's Law Dictionary 1124 (7^{th} ed. 1999)); see also Exchange Act Section 9(a)(1) (unlawful to enter any order for a security knowing that another order for the same security has been or will be entered at substantially the same time and of substantially the same size and price to create a false or misleading appearance of active trading). Wash sales "are transactions involving no change in beneficial ownership." Voss v. SEC, 222 F.3d 994, 996 (D.C. Cir. 2000) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 205 (1976)); see also Exchange Act Section 9(a)(1)) (unlawful to effect any transaction that involves no change in beneficial ownership to create a false or misleading appearance of active trading). These trades inflated the trading volume for NAII and made the stock appear to be more liquid than it really was. Borg engaged in these trades for the purpose of

creating a false or misleading appearance of active trading in NAII and knew that his trading would have this result.

12. Over the years, Borg's manipulative trades included more investors. In October 2003, Borg used a simple strategy of wash sales to trade NAII between his taxable account and his Keogh account. In December 2003, Borg began to match trades with his wife's accounts. In 2005, Borg added a corporate entity that he owned and controlled to trade with himself. In 2006, Borg started using customer accounts that he controlled to place matched orders. He refined this strategy in 2009 to include multiple accounts to execute matched trades.

D. Borg Made Unsuitable Investment Recommendations to One Customer and Purchased Extreme Concentrations of NAII for Other Customers

13. One of Borg's customers at All Funds, who was unsophisticated in financial matters, opened an account with Borg in 1992. When she opened her account, she invested in Treasury bills and corporate bonds in accordance with her primary investment objective, which was income. Her secondary objective was safety. By 2008 she was retired, with a total net worth of approximately $400,000 (essentially her home and the land it is on) and typically earned $10,000 a year. By January 1, 2009, at Borg's recommendation, she sold her fixed income securities and purchased NAII, which has never paid any dividend, and was the only security in her IRA account. By January 31, 2010, she owned 53,220 shares of NAII in another, taxable account (94% of the total value) because Borg had sold all her Treasury bills and most of her equities, including: General Electric, Microsoft, and Time Warner. By July 23, 2012, this customer had a margin debt of $260,626 and received a margin call from TDA. Until she received this margin call, she had not understood the risk of investing all her funds, plus funds borrowed on margin, in a single thinly-traded stock. Borg sold 21,200 shares of NAII to satisfy the call. He subsequently made an undocumented loan to her of $140,000 to pay off her margin balance so she could transfer her account from TDA to Charles Schwab without having to sell additional shares of NAII. This customer has not made a trade in her account at Charles Schwab. Between 2008 and 2010, Borg recommended that this customer sell her investments and purchase NAII as the exclusive holding in her accounts. These recommendations were unsuitable in light of her investment objectives. Borg knew that recommending substantial purchases of NAII was unsuitable for the customer's needs and failed to disclose the risks of having a concentrated position in this single, thinly traded security.

14. Another of Borg's customers, three brothers with one account, invested $200,000 with Borg approximately 30 years ago. They did not monitor the account and gave Borg complete freedom to invest that money, which was a small portion of their net worth. They understood that Borg would make speculative investments that could be "home runs." They did not realize that the account: (1) had margin debt in excess of $100,000; (2) had decreased significantly in value, to approximately $81,000, before it was transferred from All Funds; or (3) held 19,815 shares of NAII, which was the only security in the account.

15. Similarly, Borg purchased highly concentrated positions of NAII (more than 90% of the account value) for several members of his wife's family, who had accounts at All Funds.

E. NFS Refused to Renew Its Clearing Agreement with All Funds

16. Toward the end of 2010, NFS began to increase the margin requirement for NAII because All Funds' customers had acquired such a concentrated position in NAII. To satisfy NFS' higher margin requirements, Borg made cross trades between customer accounts for six or seven weeks. However, Borg's trading did not alleviate NFS' concerns because it did not reduce the overall concentration of NAII shares held in All Funds' customer accounts. To satisfy NFS's concern, Borg would have had to sell shares of NAII for himself and/or his customers, which he appears to have been unwilling to do, or he would have needed to obtain additional funds or securities from his customers, which he appears to have been unable to do. Consequently, on December 23, 2010, NFS informed All Funds that NFS would not renew its contract to clear for All Funds when the clearing agreement expired in December 2011. Borg decided to close All Funds and withdraw its registration as a broker or dealer. He also decided to move his customers to LPL where he and Mulkeen accepted employment as registered representatives. Mulkeen primarily handled the transfer of accounts, which took several months, from September 2011 through January 2012.

F. Borg Was Unable to Continue His Manipulation of NAII at LPL

17. Borg became a registered representative at LPL on September 16, 2011, while All Funds was transferring customer accounts. Ultimately, Borg became the registered representative for 86 accounts at LPL, almost all of which held concentrated positions in NAII. In fact, a number of customers held NAII as the only position in their accounts.

18. A few months after All Funds completed the transfer of customer accounts to LPL, Borg's supervisor at LPL became concerned with the concentration of NAII in Borg's customers' accounts. He confronted Borg on March 5, 2012, because he was concerned that Borg had not disclosed his own "large position in NAII" and had a customer account for a trust for which Borg was a trustee, which had a significant position in NAII—224,200 shares, representing 98% of the total value of the account.

19. After their meeting, Borg's supervisor informed LPL management that he was no longer willing to supervise Borg. Consequently, LPL decided to terminate Borg's association with the firm, effective on April 18, 2012. LPL also initiated an internal review of Borg and his accounts. On November 1, 2012, LPL filed an amended U5 with FINRA reporting unspecified improprieties in Borg's customer accounts, including unauthorized discretionary trading by Borg and the impersonation of customers after Borg left LPL. LPL provided a copy of the amended U5 to Borg so he could provide a response, but Borg did not provide any response.

20. On March 9, 2012, Borg, filed a Schedule 13G for his ownership of more than 5% of NAII and Forms 3 and 4 for his ownership of more than 10% of NAII. In each of these filings, Borg acknowledged that the filing was several years past due. Each of these filings also

understated the number of shares Borg beneficially owned because, among other things, he failed to include shares held by the Borg Trust, whose trading he controlled, and shares held by a company he owned and controlled. None of the filings disclosed that he was a member of an investment group he formed in 2001, and which, including the shares Borg beneficially owned, held more than 10% of NAII from December 5, 2001 through March 9, 2012.

21. When Borg left LPL and retired, he persuaded a number of his customers at LPL to transfer their accounts to TDA. Two sisters living in Italy did not transfer their accounts. In July 2012, the sisters had margin calls in each of their LPL accounts. On July 23, 2012, Borg called LPL in two separate calls and impersonated each sister. For one sister, Borg placed a day only limit order to sell 8,000 shares of NAII at $5.40. For the other, he placed a day only limit order to sell 8,500 shares of NAII at $5.56. The execution of these orders resulted in sales that resolved the margin issue in their accounts and kept LPL from selling NAII to cover the margin deficiency.

G. Borg Was Unable to Continue His Manipulation of NAII at TDA

22. A small group of Borg's former customers gave Borg authority to trade on their behalf in the accounts that they transferred to TDA. Borg also placed orders for several trust accounts at TDA as a trustee for those trusts. Soon, TDA, like LPL, became concerned with the concentration of NAII in trust accounts over which Borg had control as trustee and in the accounts of his former customers.

23. In July 2012, TDA refused to accept orders from Borg when he tried to place them in his former customers' accounts. TDA also sent account termination letters to Borg and his former customers notifying them that they had 30 days to transfer or close their accounts. The letter stated that, if the customers did not transfer or close their accounts, TDA would liquidate the holdings in the accounts and remit the proceeds to the account owners.

24. Borg transferred his accounts and his wife's accounts from TDA. However, several customers, including his wife's family, decided to transfer their accounts to another brokerage firm. Borg could no longer trade in their accounts.

25. As TDA's deadline for transfer or liquidation approached, Borg became increasingly concerned that some customers were not going to transfer their accounts and fearful that TDA might sell their shares of NAII. The sale of a large number of shares at the same time could negatively affect the price of the stock, potentially triggering margin calls leading to additional sales, which might further decrease the price of NAII stock. While attempting to transfer former customers' accounts to another brokerage firm, Borg made several telephone calls in which he impersonated several former customers. When TDA confronted Borg and told him that they had been monitoring his phone calls and knew that he was impersonating customers, Borg, in a recorded call, lied and said he had never impersonated anyone.

26. Two of Borg's impersonation calls demonstrate his attempt to use multiple trade orders to create a false appearance of trading activity combined with an effort to increase the price of NAII stock. In one call, Borg placed two back-to-back orders to buy NAII stock through market

orders. First, he placed an order to buy 1,200 shares of NAII as a market order. Then, he immediately placed a second order to buy 400 more shares of NAII as another market order. The TDA telephone broker placed the orders but asked Borg why he had placed two small market orders, which each had a $44.99 commission, instead of one order with a single commission. The broker noted that the caller, Borg, had been placing multiple buy orders on the stock and warned him that this could be viewed as market manipulation. Borg responded by telling the broker that NAII stock had already traded 4,000 shares that day and was only up $.02, so his order should not be considered manipulative. Borg's response shows that he was closely monitoring NAII trades and was aware of the impact of the trades on the price of NAII stock.

27. In the other call, Borg placed four back-to-back orders for NAII stock for the same customer. First, Borg placed a day only limit order to buy 1,000 shares of NAII at $6.00. Then, Borg immediately placed another day only limit order to buy 500 shares of NAII at $6.10. When that order was entered, Borg immediately placed a third day only limit order to buy 500 shares of NAII at $6.15. Finally, Borg placed another day only limit order to buy 300 shares of NAII at $6.17. None of these orders were executed because TDA had restricted trading in that customer's account.

H. Lax Supervision at All Funds Led to a Failure to Prevent or Detect Borg's Manipulative Trading in NAII, Borg's Unsuitable Recommendations to a Customer, and Borg's Failure to Report His Holdings in NAII

28. Borg was an owner of a small brokerage firm that his father founded and where he served as the only producing broker of significance, generating more than 80% of All Funds' revenue. No one at All Funds prevented or detected his manipulation of the market for NAII and his other misconduct previously described because his long-time associate, Brian Mulkeen, was his designated supervisor at All Funds and failed to supervise him with a view to preventing the violations of the securities laws described above. Mulkeen reviewed and approved all of Borg's personal trades as well as the trades that Borg directed on behalf of his customers at All Funds. Notwithstanding repeated red flags that Borg was engaging in wash trades among his personal accounts at All Funds and matched orders among his customers' accounts, Mulkeen failed to take appropriate action. In addition, Mulkeen failed to follow-up on red flags of questionable suitability for at least one customer who had an extreme concentration of NAII in her account. Finally, in the course of his review of Borg's personal trading in NAII, Mulkeen learned that Borg was the beneficial owner of substantial amounts of NAII and told Borg to file ownership reports for NAII. However, Mulkeen took no action when Borg failed to file any of these reports during the next four years.

29. Mulkeen was responsible for approving all trade orders before transmitting them for execution. Mulkeen also was responsible for reviewing customer accounts for suitability.

30. All Funds' written supervisory procedures specifically prohibited brokers from effecting "wash" transactions. All Funds' supervisory manual stated (in pertinent part):

> Wash Transactions are prohibited. Entering a buy and sell order for the same security for the same customer or the same beneficial owner could be termed a "wash sale" and is not permissible. All trades are reviewed daily by Brian Mulkeen.

Mulkeen failed to follow this procedure and approved hundreds of wash sales.

31. By December 2003, Borg began to place matched orders with his wife's accounts. In 2006, Borg started using customer accounts over which he had de facto control to execute matched trades. Mulkeen reviewed all of these matched orders and approved them. If Mulkeen had reasonably followed up on the red flags reflecting Borg's wash trades and matched orders, it is likely that he would have prevented and detected Borg's manipulation of NAII, which violated Securities Act Section 17(a) and Exchange Act Sections 9(a)(1) and 10(b) and Rule 10b-5 thereunder.

32. Further, Mulkeen failed reasonably to conduct adequate suitability reviews of a customer's account. During a period of over two years, Mulkeen failed to address red flags in the customer's account indicating that Borg was liquidating all of her investments to purchase NAII. If Mulkeen had followed up on these red flags, it is likely that he would have prevented and detected Borg's unsuitable recommendations, which violated Exchange Act Section 10(b) and Rule 10b-5 thereunder.

33. Because Mulkeen reviewed every order and all account statements, including orders and account statements of Borg's personal trading, he knew the number of shares of NAII that Borg owned through accounts at All Funds. By 2008, Mulkeen knew that Borg owned more than five percent of NAII. Mulkeen told Borg he should contact his attorneys to report his holdings. However, Borg never reported his holdings in NAII while he worked at All Funds. During that four year period, as Borg increased his holdings in NAII over ten percent, Mulkeen took no action to ensure Borg complied with the federal securities laws and report the number of shares he beneficially owned in NAII. If Mulkeen had reasonably followed up on his direction that Borg report his holdings in NAII, it is likely that Mulkeen would have prevented or detected Borg's violations of Exchange Act Sections 13(d) and 16(a) and Rules 13d-1, 13d-2 and 16a-3 thereunder.

<u>Violations</u>

34. As a result of the conduct described above, Borg willfully violated Section 17(a) of the Securities Act, and Sections 9(a)(1) and 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities, and Sections 13(d) and 16(a) of the Exchange Act and Rules 13d-1, 13d-2 and 16a-3 thereunder.

35. As a result of the conduct described above, pursuant to Sections 15(b)(4)(E) and 15(b)(6) of the Exchange Act, Mulkeen failed reasonably to supervise Borg with a view to preventing and detecting Borg's willful violations of Section17(a) of the Securities Act, and

Sections 9(a)(1), 10(b), 13(d) and 16(a) of the Exchange Act and Rules 10b-5, 13d-1, 13d-2 and 16a-3.

Undertakings

36. Borg has undertaken, immediately upon the entry of this Order, to forgo entering any orders to buy or sell any security for the accounts of other individuals, except his wife and children.

37. Borg has undertaken: (i) within ten (10) days of the entry of this Order, to report his current holdings in NAII to the Commission, as required by Sections 13 and 16 of the Exchange Act and the rules promulgated thereunder, by filing an accurate and complete Schedule 13D or amended Schedule 13G, as appropriate; and (ii) going forward to timely file Forms 4 and 5, and any other forms, statements or reports, to the extent those forms become due after the entry of this Order.

38. In determining whether to accept Borg's Offer, the Commission has considered his undertakings in paragraphs 36 and 37 above.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Borg

1. Respondent Borg cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, and Sections 9(a)(1), 10(b), 13(d) and 16(a) of the Exchange Act and Rules 10b-5, 13d-1, 13d-2 and 16a-3 thereunder.

2. Respondent Borg 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) 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

(c) 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.

3. Any reapplication for association by Borg 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.

4. Respondent Borg shall, within 30 days of the entry of this Order pay disgorgement of $145,727.50, prejudgment interest of $48,575.19 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 SEC Rule of Practice 600. Payment must be made in one of the following ways:

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

(b) 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

(c) 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; and

(d) Payments by check or money order must be accompanied by a cover letter identifying Borg 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.

5. Respondent Borg shall pay a civil money penalty of $1,300,000 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). Payment shall be made in the following installments: $325,000 within thirty (30) days of the entry of this Order, $487,500 within 180 days of the entry of this Order, and $487,500 within 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:

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

(b) 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

(c) 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:

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HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169; and

(d) Payments by check or money order must be accompanied by a cover letter identifying Borg 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.

6. 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, Borg agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of his payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Borg agrees that he shall, within 30 days after entry of a final order

granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Borg 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.

7. Respondent shall comply with the undertakings enumerated in Paragraphs 36 and 37 of Section III above.

B. Mulkeen

1. Respondent Mulkeen be, and hereby is 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.

2. Any reapplication for association by Mulkeen 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.

3. Respondent Mulkeen shall, within 30 days of the entry of this Order, pay a civil money penalty of $50,000 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:

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

(b) 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

(c) 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; and

(d) Payments by check or money order must be accompanied by a cover letter identifying Mulkeen 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.

4. 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, Mulkeen agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of his payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Mulkeen agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Mulkeen 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, 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 Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by each 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 each 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