FIRMA Regulatory Update
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Editor's Note: The tumultuous economy continues to provide challenges and opportunities for all of us within the financial services arena. How we perform will be related to the amount of information we receive. We are all certain that additional regulation is on the way; however no one is quite sure of the specifics. In this issue of the Reg Update I have included a couple of speeches from the SEC in hopes of providing some light on upcoming regulatory matters. The IRS Cost Basis Accounting law will not become effective for a couple of years; however I have provided a discussion on this issue because it will take time to implement this law correctly. Recent FINRA guidance on the unregistered resales of restricted securities is also included, along with the PCAOB expiration of relief for use of non-registered accounting firms. As always, should you have specific items you would like to be presented/discussed in the Regulatory Update, please send your requests to the attention of the FIRMA Forum Editor, or myself.

SEC – Speech by Commissioner Luis A. Aguilar at the "SEC Speaks 2009" Washington, D.C.

Background

On February 6, 2009 SEC Commissioner Luis A. Aguilar provided a speech during the "The SEC Speaks in 2009" series in Washington, D.C. Commissioner Aguilar provided comments on the future of the SEC and how it will function during the financial crisis. One of the key items that are addressed is the need to provide transparency to investors and to ensure that there is accountability in the industry.

Information

Good afternoon everyone. Thank you for the warm reception and thank you Buddy Donohue for the kind introduction. At a time when discussions in the boardroom and at the kitchen table are dominated by conversations questioning the strength of the American financial system and its regulatory structure, there is no question that the financial services industry is in crisis. This crisis requires that the leaders of industry and government quickly identify challenges, articulate an action plan, and implement the response. I believe that the driving principle for any regulatory reform is to re-establish accountability and transparency to investors.

It is my privilege to speak to you today to offer my thoughts on our way forward. It is true that the words I am about to speak are my own, and do not necessarily reflect the views of the Commission or my fellow Commissioners or the Commission staff.

Reinvigorating the Financial Regulatory Structure to Increase Transparency and Public Accountability to the Investor

There is no debate. Our financial system is in a crisis and investors are feeling the pain. However, this crisis presents a tremendous opportunity, or a mandate, for us to better the

system. We must remember why the capital markets exist, which is to allow all Americans to participate in the ownership of our economy, and to provide efficient capital to anyone with a good idea and an entrepreneurial spirit, so they have a chance to make that idea a reality.

We must act now to re-establish transparency and accountability to investors by looking to Congress and the SEC for immediate action. First, I will quickly highlight the Congressional action required to close regulatory loopholes and adequately fund the SEC. Second, I will discuss internal shifts in policy and practice the SEC should undertake in order to:

- Empower Enforcement and Examination staff; and
- Implement proposals to enhance the voice of investors in shaping future policies.

Third, I will discuss what the SEC can do to enhance investors' ability to demand transparency and accountability.

<u>Congressional Action</u>

A. Congressional action is required to close regulatory loopholes

First, Congress needs to reconnect the Commission's powers to its mission to protect investors, provide for efficient markets, and facilitate capital formation. There are enormous areas of the securities markets that lack appropriate regulation, including over-the-counter derivatives, hedge funds, and municipal securities.

In a recent speech, I outlined specific steps Congress should take in each of these areas, and I will not repeat those proposals today. I just urge Congress to act promptly.

B. Congressional Action Required to Adequately Fund the SEC

Second, I recently also proposed that Congress take action to ensure that the SEC is independently funded and, thus, adequately resourced to advance its mission going forward.

> Budget Allocation
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> To underscore that proposal, I think it is important for everyone to fully appreciate the dramatic programmatic consequences resulting from the SEC's budget having been held to flat or declining dollars for the past four years. This has had the untoward effect of limiting the ability to hire and retain adequate staff, limiting technological development, and limiting the ability to initiate new programs and investigations.
>
> The SEC's entire budget allocation is a disproportionately small amount in comparison to the agency's mission. With often less than $900 million in hand and approximately 3,500 staff, the SEC is tasked with regulating tens of thousands of entities including public companies, investment advisers, broker-dealers, transfer agents, exchanges, credit rating agencies, and several SROs.

> By contrast, it has been reported that the FDIC has a staff of 5,000 to oversee 8,300 FDIC insured banks with a budget in the range from $1.2 to $2.2 billion dollars. Moreover, the FDIC is independently funded and thus, has control over its own budget and long term projects.
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> To ensure that the SEC is able to advance its mission, it is imperative that the SEC have a dedicated stream of funding that is adequate to meet the challenges faced by our capital markets today and the guaranteed funding to be able to anticipate the challenges of the future.

C. Congress Should Refrain from Diminishing Current Investor Protections
Beyond funding matters, as we enter a period of increased momentum for legislative action, one area to watch closely is the regulation of broker-dealers who provide investment advisory services. I would not want to diminish any current investor protections, particularly in this time of crisis. It is a fundamental and longstanding principle recognized by Congress, the Supreme Court, the Commission, and the industry, that an investment adviser is a fiduciary and as such must avoid conflicts of interests with clients and as a fiduciary is prohibited from overreaching or taking unfair advantage of a client's trust. For those of us who have spent time in the investment adviser industry, we view the fiduciary relationship as the foundation of the adviser/client relationship.

Recently, there has been a great deal of discourse about "harmonizing" the regulations of broker-dealer versus investment advisers. I think the better way to frame the issue is to ask "how should broker-dealers who provide investment advice be regulated."

Historically, broker-dealers that simply effected transactions as directed by their clients did not provide investment advice and would not have been considered investment advisers. Today, as broker-dealers increasingly provide advice to their clients, we should consider whether the higher standards and fiduciary duties of advisers should also be applied to these broker-dealers.

<u>SEC Shifts in Policy and Practice</u>
In addition to Congressional action to strengthen the SEC, the SEC must take its own actions to ensure greater transparency and accountability to investors. In a recent speech to the North American Securities Administrators Association, I made several suggestions for immediate actions including eliminating the Commission's penalty pilot program and I applaud Chairman Shapiro for taking this step. Given my time constraints, I am just going to highlight a few recommendations today to:

- Empower Exam and Enforcement staff; and
- Implement proposals to enhance the voice of investors in shaping future Commission policies.

A. Empower Exam and Enforcement Staff
One immediate need is to build our exam and enforcement staffs back to full capacity. We will also need to be prepared for our future needs. Once Congress acts in the areas of

over-the-counter derivatives and hedge fund advisers, it will be necessary to expand our exam staff by adding individuals with specialized expertise so that the Commission can quickly deploy staff to work in these areas to quickly collect information, identify issues, and assess risks.

We also need to better empower our staff. I commend Chairman Shapiro for her focus on expediting the formal order process. One proposal to empower our staff that I would like to highlight is my recommendation for the Commission to delegate the power to issue an order of private investigation to the Enforcement Division Director and Heads of the Regional Offices in circumstances that do not present extraordinary issues. This would streamline the process and I have asked Chairman Schapiro to consider such an action.

B. Retail investor participation in Commission business

Before I turn to what we can do to increase investor power to demand transparency and accountability, I have two final recommendations to make regarding what the SEC can do to enhance public accountability.

First, as we seek to improve our regulatory process and adopt better rules, I think it is important to provide retail investors with an active voice in our policymaking.
In a recent speech to members of the Investment Company Institute, I called for the establishment of an advisory committee consisting primarily of retail investors to provide advice and guidance to the SEC. I strongly believe direct retail investor input would be helpful toward restoring the confidence of retail investors in the SEC. It'll send a powerful message to investors that the SEC is their advocate.

Second, I recently called for an SEC staff study of the consequences on regulation and the capital markets of the relative decrease in direct investor ownership of securities, and relative increase in direct institutional ownership. Put another way, investors increasingly own operating companies, the engines of our economy, only indirectly through institutions, and I think we should look carefully at what this means. These trends in ownership and market participation raise very important questions for financial regulation, including how these trends affect shareholder voting, and capital raising techniques.

Enhancing investors' ability to demand transparency and accountability

What I have just discussed are a number of steps that the SEC and Congress can take to restore accountability to the capital markets and financial services. But the government cannot, and should not, do this alone. The private sector has a vital role.

When it comes to the private sector, the Commission often is focused primarily on disclosure requirements. That approach is incomplete. Even if quality information is available to investors, it often is difficult to digest and, even if the information is digested, investors don't always have a lot of meaningful options to act on the information, other than selling their shares.

Selling shares is often not optimum or desirable and I believe that the Commission should facilitate "corporate governance improvements" so that investors can have a greater say in the way their companies are run.

A. Improved corporate governance through shareholder proxy access
There are a few things that the Commission can do to improve corporate governance, but my top recommendation is swift and bold action to give shareholders access to their company's proxy statement. The legal and practical reasons for doing so are overwhelmingly compelling.

As a legal matter, shareholders have the right to appoint the directors, and have the right to nominate directors and make proposals in shareholder meetings. These rights should not be frustrated by the Commission's proxy rules.

Practically speaking, shareholders can do a lot to align company management's incentives with the public interest. We just have to give them the tools. As former Commissioner Harvey Goldschmid rightly noted, "Shareholders, under our free-market system, not only supply capital, but have the right economic instincts. If they understand the system, they want corporate efficiency, honesty, productivity, and profitability. In a macro sense, these shareholder interests are consistent with the nation's economic needs."

Proxy access has been an issue before the Commission at various times since the 1940s. In just the past few years, the Commission has proposed three rules, and held four roundtables related to the proxy process and proxy access. We have collected a great body of valuable information about the topic and can act quickly. Now is the time, with an energized new chairman and a spirit throughout the country for renewed accountability, to finally take seriously the modern realities of proxy voting, and give meaning to the fundamental shareholder right to appoint directors.

In turning our focus to proxy access, all past proposals should be carefully scrutinized to make sure they do not frustrate effective shareholder access to improve corporate governance. For example, as to the 5% ownership condition in the Commission's 2007 proposed rule, I find compelling the objections that claim this threshold is too high to permit effective exercise of shareholder power, especially as to large cap companies.
I think there is evidence that there are serious problems with the corporate governance in this country. The incredible growth in relative CEO pay in modern times strikes me as a bright red flag. The ability of management to extract excessive compensation to the detriment of shareholders seems to be a clear result of weak corporate governance.

We cannot afford not to take advantage of the prior work of the Commission on the subject of proxy access. Weak corporate governance extracts a toll on our markets in terms of efficiency and integrity, and can be self-reinforcing. Giving shareholders a more effective voice is a strong tool for improving corporate governance.

B. Improve shareholder participation under e-Proxy

A second way the SEC should act to enhance accountability to investors is addressing the empirical problems in the implementation of e-proxy. As many of you are aware, the number of shareholders who voted through companies using the notice and access model dropped dramatically. Retail investor voting, in particular, plummeted. Some reports indicated less than 5 percent of individual investors voted at meetings held by companies that used e-proxy in late 2007 and early 2008. Other statistics compared the level of participation by the same investors before and after the notice and access model was put in place, and found decreases of over 30% for large investors, and over 60% for smaller investors. For these investors, access clearly didn't equal delivery.

I recognize that there are significant cost savings to issuers who use e-proxy, but we should make sure that cost savings come without compromising effectiveness and adversely impacting an investor's exercise of their rights. That seems to have happened here, and we need to fix e-Proxy or scrap it.

I know that the Division of Corporation Finance is aware of this situation. I strongly suggest we move quickly to reconsider e-Proxy, improving it if possible, repealing it if necessary, but with the goal of restoring investor participation.

In closing, I would like to again express my thanks to all of you. The proposals I have outlined today, and in my prior public statements, are all aimed at enhancing transparency and accountability to investors, and are important reforms. But it is the individuals such as yourselves who will be the key to any success we achieve in implementation.

SEC: Speech by Director Andrew J. Donohue at the Mutual Fund Directors Forum

Background

On January 13, 2009 Andrew J. Donohue, Director, Division of Investment Management, SEC gave a speech at the Mutual Fund Directors Forum Third Annual Directors' Institute. In his speech Director Donohue addressed the accomplishments of 2008. These included: Summary Prospectus; Money Market Funds; Interactive Data; and the facilitation of Rulemaking and Exemptive Applications. The remainder of his speech focused on the priorities for 2009. It is this section of his speech that is outlined below.

Information

Once again I am pleased to be the keynote speaker for the Mutual Fund Directors Forum's annual Directors' Institute. A lot has happened in the intervening twelve months since I last addressed this group. A credit crunch negatively impacted liquidity across a broad spectrum of the market. Among other things, this led to a freeze in the auction rate preferred market, difficulties at money market funds, and thorny issues associated with portfolio valuation. In spite of these challenges, I am pleased to say that we achieved some important accomplishments. In the time that I have with you this evening, I would like to discuss significant 2008 accomplishments and highlight some of the issues that I see as Division of Investment Management priorities for 2009. However, before I

continue, let me give the standard disclaimer that my remarks represent my own views and not necessarily the views of the Commission, individuals Commissioners or my colleagues on the Commission staff.

Priorities for 2009

The Division has several priorities for 2009. These include consideration of the money market fund model and its regulation, adoption of an ETF rule, reform of the existing books and records requirement for investment advisers and funds, adoption of soft dollar guidance for fund directors, consideration of shareholder report reform, and further consideration of Rule 12b-1. In the limited time that I have this evening, however, I would like to focus my discussion on one priority that I believe is particularly relevant for this audience.

Director Outreach Initiative

In 2007 I asked the staff to undertake an examination of independent directors' duties. As you know, the Investment Company Act imposes a variety of statutory responsibilities on the independent directors of registered investment companies. These duties involve situations where a conflict is likely to arise and include directives that expressly require approval by the independent directors in order for a particular action to be lawful, such as annual approval of a mutual fund's advisory contract and annual selection of the fund's independent accountant.

In addition to statutory responsibilities imposed by the Act itself, the Commission has ten exemptive rules that impose specific responsibilities on independent directors. These rules exempt registered investment companies from the prohibitions in the Act and allow them to engage in otherwise unlawful activity.

Our examination of independent director duties — informally designated as the "Director Outreach Initiative" — has twin goals. First, to gain from independent directors a better understanding of how they discharge their current responsibilities and suggestions for any improvements. Second, if the determination is made that independent director effectiveness could be enhanced; to make recommendations to the Commission for its consideration regarding rules that the Commission might propose to increase such effectiveness. This initiative has sought to focus the attention and resources of the independent directors on those matters most critical to their mission to oversee conflicts.

We employed a three-pronged approach to conduct the Director Outreach Initiative. First, staff reviewed relevant statutory and regulatory provisions that require the affirmative action of the independent directors. This review identified the use of different language (particularly in the rule text) and different requirements imposed on the independent directors based on the activity to be performed. Moreover, our review of the statutory, regulatory and state law duties imposed on mutual fund directors, and in particular independent directors, has yielded a greater understanding of how these duties have evolved since 1940 when the Act was enacted. Second, to date my staff and I have attended more than 25 board meetings of independent directors at mutual fund complexes of varying size (Chairman Cox and Commissioner Casey separately participated in two of

these meetings). This has allowed the Division to obtain direct insight from independent directors. Third, industry participants, including the Mutual Fund Directors Forum, submitted written recommendations for possible ways to improve director effectiveness. The recommendations from these industry participants provided additional thoughtful insight.

The Director Outreach Initiative has afforded the staff significant insight regarding the role of independent directors. As a result, the Division is contemplating certain recommendations for the Commission's consideration. In particular, the Division is analyzing whether to recommend modifications to the current requirements imposed on independent directors in order to recognize situations where independent directors, while maintaining ultimate responsibility for fund oversight, may delegate certain responsibilities consistent with the valid exercise of their business judgment. The Division is also analyzing whether the general requirements imposed on independent directors in the ten exemptive rules can be unified. In particular, the staff believes that unifying the standards and requirements in each of these rules may promote consistency thereby avoiding overlapping and time-consuming requirements that currently must be fulfilled as a predicate to relying on a particular rule.

My staff continues to work diligently on this initiative. I am hopeful that we will see the fruits of this labor later this year.

Annual Review of the Investment Adviser Contract

The final topic that I would like to address before I conclude lies at the heart of the Directors' Institute. Specifically, you have gathered for this conference in order to focus on the vitally important annual review of the investment adviser contract, commonly known as the "15(c) process."

As many of you may recall, my theme last year was the annual review of the investment adviser contract, commonly known as the "15(c) process," including any suggestions for conducting it. I will not rehash my earlier remarks. However, I believe it is important to recognize that the challenges you face conducting your annual review in 2009 have increased from those you encountered in 2008. In particular, market events in 2008 likely have driven fund expense ratios up, fund performance down, and have impacted investment adviser profitability. Also, many funds likely face additional cost constraints. These changes since last year succinctly demonstrate that the 15(c) process is not static, but rather, is dynamic.

Each year, fund directors approach the 15(c) process as one of the most vital tasks they perform on behalf of fund investors. Indeed, the importance of this process has been repeatedly recognized by the Commission, most recently in 2004 when it adopted a final rule that requires a registered investment company to provide disclosure in its report to shareholders regarding the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of advisory contracts during the most recent fiscal half-year. This rule requires a registered investment company to provide disclosure in its report to shareholders regarding the factors relating to both the

board's selection of the investment adviser and its approval of the advisory fee and any other amounts to be paid under the advisory contract. In addition, the rule requires certain other enhanced disclosures, including: a) the nature, extent, and quality of the services to be provided by the adviser; b) the investment performance of the fund and the adviser; c) the costs of the services to be provided and profits to be realized by the adviser and its affiliates from the relationship with the fund; d) the extent to which economies of scale would be realized as the fund grows; and e) whether fee levels reflect these economies of scale for the benefit of fund investors. Moreover, if any of the enumerated factors is not relevant to the board's evaluation of the investment advisory contract, the discussion must note this and explain the reasons why that factor is not relevant.

Given the market events of 2008, this year the 15(c) process will be even more critically important. This is because in addition to the typical issues regularly reviewed as part of this process, fund directors will likely want to consider carefully additional information or issues that may not have been present in previous reviews. For example, for a fund with an expense cap that has experienced an increase in its expense ratio due to a decline in asset values or redemptions, is it appropriate to modify or eliminate the expense cap? What standard will the board employ to determine any such modification? Similarly, many funds use funds in a "peer group" as a benchmark to analyze fees charged and expense ratios incurred. Boards should be mindful in evaluating funds within a peer group that the funds that historically may have comprised this peer group may no longer be a member of that group or have comparable assets under management. The challenges you face in evaluating certain data regarding peer funds, especially historical expense ratio and other cost data, are not insignificant. As such, in the presence of extreme conditions, directors should be sensitive to the limitations of comparable data. While this sensitivity is always important, it will be particularly essential in the coming year. I have no doubt that you will focus on all relevant issues in your analysis as you conduct your robust and thoughtful review in 2009. I commend your continuing efforts acting on behalf of investors.

Conclusion

It has been a busy year for the Division, for the fund industry and for fund directors since I last met with you. Much has been accomplished, but there is plenty more work to do. As we transition into the new year and begin to focus on 2009 priorities, I look forward to the continued cooperation and support we have received from fund directors, including the helpful insight provided by the Mutual Fund Directors Forum and its many members. I encourage each of you to share with me and my staff any thoughts you have generally about the fund industry and specifically about your duties as independent directors and suggestions for what, if anything, the Commission should consider or can do to make the performance of these duties more effective.

SEC – Open Letter to CEO of SEC-Registered Firms

Background

On December 2, 2008 SEC Director of the Office of Compliance Inspections and Examination Lori Richards sent an open letter to the CEOs of SEC-Registered Firms. In

an open letter CEOs are reminded of the critical role played by their firms' compliance programs in assuring that their operations comply with the law and rules for industry participation and to ensure that the interests of customers or clients are protected.

The letter to the CEOs of broker-dealers, investment advisers, investment companies and transfer agents, follows SEC Chairman Christopher Cox's remarks at the SEC's recent CCOutreach National Seminar. A copy of the letter is outlined below. This should serve notice that the regulatory agencies will most likely be critical of any reductions associated with risk management and compliance activities.

Information

Dear CEO of SEC-Registered Firm:

During this time of financial and market turmoil, the Office of Compliance Inspections and Examinations of the Securities and Exchange Commission reminds leaders of SEC-registered firms, including broker-dealers, investment advisers, investment companies and transfer agents, of the critical role played by your firm's compliance programs in helping to meet your obligations under the securities laws. Your firm's compliance function is critical to assure that your operations comply with the law and rules for industry participation and to ensure that the interests of your customers, clients and shareholders are protected. Moreover, compliance is a vital control function that helps to protect the firm from conduct that could negatively impact the firm's business and its reputation.

While many firms are considering reductions and cost-cutting measures, we remind you of your firm's legal obligation to maintain an adequate compliance program reasonably designed to achieve compliance with the law. As SEC Chairman Cox noted recently, "[E]xperience has taught us again and again that giving short shrift to regulatory compliance subjects a company's investors, employees, management, directors, and every other stakeholder to unacceptable risks….[C]ompliance programs have made huge strides in recent years in becoming more formalized and more robust…. Now more than ever, companies need to take a long-term view on compliance and realize that their fiduciary responsibility requires a constant commitment to investors. That means sustaining their support for compliance during this market turmoil, and beyond it as well."
http://www.sec.gov/news/speech/2008/spch111308cc.htm

Firms must be vigilant and proactive in preventing, detecting and correcting problems that could occur. Firms should pay attention to ensuring that their interactions with investors meet high standards, that sales and trading practices are appropriate, that financial, valuation and risk controls are followed, and that all disclosure obligations are met -- as well as meeting all other obligations in conformity with the securities laws.
By fulfilling their obligations, regulated firms in the financial services industry can help to restore and bolster public confidence in the fairness and integrity of our markets and market participants. Providing adequate resources to compliance programs and functions and ensuring that CCOs and compliance personnel are integrated into the activities of the firm are essential to that process.

Thank you for your focus on this important matter.

IRS: Cost Basis Reporting Law

Background
As part of the Emergency Economic Stabilization Act of 2008, H.R. 1424 which was signed into law by President Bush on October 3, 2008, the Cost Basis Reporting requirement by brokers is also now law.

The details of the cost basis reporting provisions as enacted are essentially the same as the version included in the May 8, 2008 House version of the Housing Act with only minor changes. Significantly, the three-tier staggered effective dates for cost basis reporting as enacted are: stock acquired on or after Jan. 1, 2011; open-end and closed-end mutual funds and dividend reinvestment plan (or similar arrangements) (DRIP) shares acquired on or after Jan. 1, 2012; and debt instruments, options and other IRS-selected securities acquired on or after Jan. 1, 2013. These effective dates leave only two years or so to prepare for cost basis reporting for stock.

Cost basis reporting presents a number of challenges and risks for brokers. The most significant is tax penalty risk if the basis and holding period information reported on Form1099-B is incorrect. There are separate penalties for 1099s provided to the IRS and 1099s provided to taxpayers, and they aggregate to $100 per incorrect 1099 (with an annual maximum of $350,000 per year before interest). If the error is due to intentional disregard, the combined penalties are 10 percent of the amount that should have been reported (without any maximum limit). Avoiding the stigma and potential amount of these penalties requires greater accuracy and attention to detail in broker cost basis and holding period computations that underlie the 1099 information.

Outlined below are the various sections that are germane to the Cost Basis Reporting requirement.

Information
<u>SEC. 403. BROKER REPORTING OF CUSTOMER'S BASIS IN SECURITIES TRANSACTIONS</u>.
(a) In General-
    (1) BROKER REPORTING FOR SECURITIES TRANSACTIONS- Section 6045 is amended by adding at the end the following new subsection:
(g) Additional Information Required in the Case of Securities Transactions, etc-
    (1) IN GENERAL- If a broker is otherwise required to make a return under subsection (a) with respect to the gross proceeds of the sale of a covered security, the broker shall include in such return the information described in paragraph (2).
    (2) ADDITIONAL INFORMATION REQUIRED-

(A) IN GENERAL- The information required under paragraph (1) to be shown on a return with respect to a covered security of a customer shall include the customer's adjusted basis in such security and whether any gain or loss with respect to such security is long-term or short-term (within the meaning of section 1222).

(B) DETERMINATION OF ADJUSTED BASIS- For purposes of subparagraph (A)--

(i) IN GENERAL- The customer's adjusted basis shall be determined--

(I) in the case of any security (other than any stock for which an average basis method is permissible under section 1012), in accordance with the first-in first-out method unless the customer notifies the broker by means of making an adequate identification of the stock sold or transferred, and

(II) in the case of any stock for which an average basis method is permissible under section 1012, in accordance with the broker's default method unless the customer notifies the broker that he elects another acceptable method under section 1012 with respect to the account in which such stock is held.

(ii) EXCEPTION FOR WASH SALES- Except as otherwise provided by the Secretary, the customer's adjusted basis shall be determined without regard to section 1091 (relating to loss from wash sales of stock or securities) unless the transactions occur in the same account with respect to identical securities.

(3) COVERED SECURITY- For purposes of this subsection--

(A) IN GENERAL- The term `covered security' means any specified security acquired on or after the applicable date if such security--

(i) was acquired through a transaction in the account in which such security is held, or

(ii) was transferred to such account from an account in which such security was a covered security, but only if the broker received a statement under section 6045A with respect to the transfer.

(B) SPECIFIED SECURITY- The term `specified security' means--

(i) any share of stock in a corporation,

(ii) any note, bond, debenture, or other evidence of indebtedness,

(iii) any commodity, or contract or derivative with respect to such commodity, if the Secretary determines that adjusted basis reporting is appropriate for purposes of this subsection, and

(iv) any other financial instrument with respect to which the Secretary determines that adjusted basis reporting is appropriate for purposes of this subsection.

(C) APPLICABLE DATE- The term `applicable date' means--

(i) January 1, 2011, in the case of any specified security which is stock in a corporation (other than any stock described in clause (ii)),
(ii) January 1, 2012, in the case of any stock for which an average basis method is permissible under section 1012, and
(iii) January 1, 2013, or such later date determined by the Secretary in the case of any other specified security.

(4) TREATMENT OF S CORPORATIONS- In the case of the sale of a covered security acquired by an S corporation (other than a financial institution) after December 31, 2011, such S corporation shall be treated in the same manner as a partnership for purposes of this section.
(5) SPECIAL RULES FOR SHORT SALES- In the case of a short sale, reporting under this section shall be made for the year in which such sale is closed.

(h) Application to Options on Securities-
(1) EXERCISE OF OPTION- For purposes of this section, if a covered security is acquired or disposed of pursuant to the exercise of an option that was granted or acquired in the same account as the covered security, the amount received with respect to the grant or paid with respect to the acquisition of such option shall be treated as an adjustment to gross proceeds or as an adjustment to basis, as the case may be.
(2) LAPSE OR CLOSING TRANSACTION- In the case of the lapse (or closing transaction (as defined in section 1234(b)(2)(A))) of an option on a specified security or the exercise of a cash-settled option on a specified security, reporting under subsections (a) and (g) with respect to such option shall be made for the calendar year which includes the date of such lapse, closing transaction, or exercise.
(3) PROSPECTIVE APPLICATION- Paragraphs (1) and (2) shall not apply to any option which is granted or acquired before January 1, 2013.
(4) DEFINITIONS- For purposes of this subsection, the terms `covered security' and `specified security' shall have the meanings given such terms in subsection (g)(3).
(3) EXTENSION OF PERIOD FOR STATEMENTS SENT TO CUSTOMERS-
(A) IN GENERAL- Subsection (b) of section 6045 is amended by striking `January 31' and inserting `February 15'.
(B) STATEMENTS RELATED TO SUBSTITUTE PAYMENTS- Subsection (d) of section 6045 is amended--
(i) by striking `at such time and', and
(ii) by inserting after `other item.' the following new sentence: The written statement required under the preceding sentence shall be furnished on or before February 15 of the year following the calendar year in which the payment was made.
(C) OTHER STATEMENTS- Subsection (b) of section 6045 is amended by adding at the end the following: `In the case of a consolidated reporting statement (as defined in regulations) with respect to any customer, any statement which would otherwise be required to be furnished on or before

January 31 of a calendar year with respect to any item reportable to the taxpayer shall instead be required to be furnished on or before February 15 of such calendar year if furnished with such consolidated reporting statement.

(b) Determination of Basis of Certain Securities on Account by Account or Average Basis Method- Section 1012 is amended--

(1) by striking `The basis of property' and inserting the following:

(a) In General- The basis of property,

(2) by striking `The cost of real property and inserting the following:

(b) Special Rule for Apportioned Real Estate Taxes- The cost of real property, and

(3) by adding at the end the following new subsections:

(c) Determinations by Account-

(1) IN GENERAL- In the case of the sale, exchange, or other disposition of a specified security on or after the applicable date, the conventions prescribed by regulations under this section shall be applied on an account by account basis.

(2) APPLICATION TO CERTAIN FUNDS-

(A) IN GENERAL- Except as provided in subparagraph (B), any stock for which an average basis method is permissible under section 1012 which is acquired before January 1, 2012, shall be treated as a separate account from any such stock acquired on or after such date.

(B) ELECTION FUND FOR TREATMENT AS SINGLE ACCOUNT- If a fund described in subparagraph (A) elects to have this subparagraph apply with respect to one or more of its stockholders--

(i) subparagraph (A) shall not apply with respect to any stock in such fund held by such stockholders, and

(ii) all stock in such fund which is held by such stockholders shall be treated as covered securities described in section 6045(g)(3) without regard to the date of the acquisition of such stock.

A rule similar to the rule of the preceding sentence shall apply with respect to a broker holding such stock as a nominee.

(3) DEFINITIONS- For purposes of this section, the terms `specified security' and `applicable date' shall have the meaning given such terms in section 6045(g).

(d) Average Basis for Stock Acquired Pursuant to a Dividend Reinvestment Plan-

(1) IN GENERAL- In the case of any stock acquired after December 31, 2010, in connection with a dividend reinvestment plan, the basis of such stock while held

as part of such plan shall be determined using one of the methods which may be used for determining the basis of stock in an open-end fund.
(2) TREATMENT AFTER TRANSFER- In the case of the transfer to another account of stock to which paragraph (1) applies, such stock shall have a cost basis in such other account equal to its basis in the dividend reinvestment plan immediately before such transfer (properly adjusted for any fees or other charges taken into account in connection with such transfer).
(3) SEPARATE ACCOUNTS; ELECTION FOR TREATMENT AS SINGLE ACCOUNT- Rules similar to the rules of subsection (c)(2) shall apply for purposes of this subsection.
(4) DIVIDEND REINVESTMENT PLAN- For purposes of this subsection--
(A) IN GENERAL- The term `dividend reinvestment plan' means any arrangement under which dividends on any stock are reinvested in stock identical to the stock with respect to which the dividends are paid.
(B) INITIAL STOCK ACQUISITION TREATED AS ACQUIRED IN CONNECTION WITH PLAN- Stock shall be treated as acquired in connection with a dividend reinvestment plan if such stock is acquired pursuant to such plan or if the dividends paid on such stock are subject to such plan.

(c) Information by Transferors To Aid Brokers-
(1) IN GENERAL- Subpart B of part III of subchapter A of chapter 61 is amended by inserting after section 6045 the following new section:

SEC. 6045A. INFORMATION REQUIRED IN CONNECTION WITH TRANSFERS OF COVERED SECURITIES TO BROKERS.
(a) Furnishing of Information- Every applicable person which transfers to a broker (as defined in section 6045(c)(1)) a security which is a covered security (as defined in section 6045(g)(3)) in the hands of such applicable person shall furnish to such broker a written statement in such manner and setting forth such information as the Secretary may by regulations prescribe for purposes of enabling such broker to meet the requirements of section 6045(g).

(b) Applicable Person- For purposes of subsection (a), the term `applicable person' means--
(1) any broker (as defined in section 6045(c)(1)), and
(2) any other person as provided by the Secretary in regulations.

(c) Time for Furnishing Statement- Except as otherwise provided by the Secretary, any statement required by subsection (a) shall be furnished not later than 15 days after the date of the transfer described in such subsection.
(2) ASSESSABLE PENALTIES- Paragraph (2) of section 6724(d), as amended by the Housing Assistance Tax Act of 2008, is amended by redesignating subparagraphs (I) through (DD) as subparagraphs (J) through (EE), respectively, and by inserting after subparagraph (H) the following new subparagraph:

(I) section 6045A (relating to information required in connection with transfers of covered securities to brokers),

(3) CLERICAL AMENDMENT- The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6045 the following new item:

Sec. 6045A. Information required in connection with transfers of covered securities to brokers.

(d) Additional Issuer Information To Aid Brokers-

(1) IN GENERAL- Subpart B of part III of subchapter A of chapter 61, as amended by subsection (b), is amended by inserting after section 6045A the following new section:

SEC. 6045B. RETURNS RELATING TO ACTIONS AFFECTING BASIS OF SPECIFIED SECURITIES.

(a) In General- According to the forms or regulations prescribed by the Secretary, any issuer of a specified security shall make a return setting forth--

(1) a description of any organizational action which affects the basis of such specified security of such issuer,

(2) the quantitative effect on the basis of such specified security resulting from such action, and

(3) such other information as the Secretary may prescribe.

(b) Time for Filing Return- Any return required by subsection (a) shall be filed not later than the earlier of--

(1) 45 days after the date of the action described in subsection (a), or

(2) January 15 of the year following the calendar year during which such action occurred.

(c) Statements To Be Furnished to Holders of Specified Securities or Their Nominees- According to the forms or regulations prescribed by the Secretary, every person required to make a return under subsection (a) with respect to a specified security shall furnish to the nominee with respect to the specified security (or certificate holder if there is no nominee) a written statement showing--

(1) the name, address, and phone number of the information contact of the person required to make such return,

(2) the information required to be shown on such return with respect to such security, and

(3) such other information as the Secretary may prescribe.

The written statement required under the preceding sentence shall be furnished to the holder on or before January 15 of the year following the calendar year during which the action described in subsection (a) occurred.

(d) Specified Security- For purposes of this section, the term `specified security' has the meaning given such term by section 6045(g)(3)(B). No return shall be required under this section with respect to actions described in subsection (a) with respect to a specified

security which occur before the applicable date (as defined in section 6045(g)(3)(C)) with respect to such security.

(e) Public Reporting in Lieu of Return- The Secretary may waive the requirements under subsections (a) and (c) with respect to a specified security, if the person required to make the return under subsection (a) makes publicly available, in such form and manner as the Secretary determines necessary to carry out the purposes of this section--

(1) the name, address, phone number, and email address of the information contact of such person, and

(2) the information described in paragraphs (1), (2), and (3) of subsection (a).

(2) ASSESSABLE PENALTIES-

(A) Subparagraph (B) of section 6724(d)(1), as amended by the Housing Assistance Tax Act of 2008, is amended by redesignating clause (iv) and each of the clauses which follow as clauses (v) through (xxiii), respectively, and by inserting after clause (iii) the following new clause:

(iv) section 6045B(a) (relating to returns relating to actions affecting basis of specified securities),

(B) Paragraph (2) of section 6724(d), as amended by the Housing Assistance Tax Act of 2008 and by subsection (c)(2), is amended by redesignating subparagraphs (J) through (EE) as subparagraphs (K) through (FF), respectively, and by inserting after subparagraph (I) the following new subparagraph:

(J) subsections (c) and (e) of section 6045B (relating to returns relating to actions affecting basis of specified securities),

(3) CLERICAL AMENDMENT- The table of sections for subpart B of part III of subchapter A of chapter 61, as amended by subsection (b)(3), is amended by inserting after the item relating to section 6045A the following new item:

Sec. 6045B. Returns relating to actions affecting basis of specified securities.

(e) Effective Date-

(1) IN GENERAL- Except as otherwise provided in this subsection, the amendments made by this section shall take effect on January 1, 2011.

(2) EXTENSION OF PERIOD FOR STATEMENTS SENT TO CUSTOMERS- The amendments made by subsection (a)(3) shall apply to statements required to be furnished after December 31, 2008.

FINRA – Unregistered Resales of Restricted Securities: FINRA Reminds Firms of Their Obligations to Determine Whether Securities are Eligible for Public Sale

Background

Firms play a critical role in helping prevent illegal, unregistered resales of restricted securities into the public markets. It is a violation of the federal securities laws for a firm to offer or sell a security without an effective registration statement or an applicable exemption from the Securities Act of 1933 (Securities Act). In addition, such sales may violate NASD Rules 2710 (Corporate Financing Rule – Underwriting Terms and

Arrangements), 2720 (Distribution of Securities and Affiliates – Conflicts of Interest) and 2810 (Direct Participation Programs).

All firms must have procedures reasonably designed to avoid becoming participants in the potential unregistered distribution of securities. The nature of those procedures and the required level of firm inquiry concerning the customer and the source of the securities will depend on the particular circumstances. In addition, firms may not rely solely on others, such as clearing firms, transfer agents, or issuers' counsel, to fulfill these obligations. Firms' specific obligations are discussed in more detail below.

The Securities Act prohibits the sale of securities unless the sale is made pursuant to an effective registration statement, or falls within an available exemption from registration. Before selling securities in reliance on an exemption, a firm must take reasonable steps to ensure that the transaction qualifies for the exemption, regardless of whether the sale is for its own accounts or on behalf of customers. This includes taking whatever steps necessary to ensure that the sale does not involve an issuer, a person in a control relationship with an issuer, or an underwriter with a view to offer or sell the securities in connection with an unregistered distribution.

Section 4(1) of the Securities Act provides an exemption for the routine trading of already-issued securities. It does not, however, exempt sales by an issuer, or a control person of the issuer, or an underwriter or dealer. Section 4(2) of the Securities Act exempts sales made by an issuer not involving a public offering. Whether a sale is one that involves a public offering, however, is a question of fact which requires an inquiry regarding the surrounding circumstances, including such factors as the relationship between the seller and the issuer, and the nature, scope, size, type and manner of the offering. Section 4(4) of the Securities Act provides an exemption for unsolicited brokers' transactions. However, this exemption is available only if a broker is not aware, after a reasonable inquiry, of circumstances indicating that the selling customer is participating in a distribution of securities.

Information

Recently, FINRA has investigated and brought several enforcement actions concerning unregistered distributions. A common theme in these cases was that firms resold large amounts of low-priced equity securities in over-the-counter transactions. Among the allegations in these cases are that the inquiries necessary to uncover the facts of the unregistered distribution were not done or were inadequate, and the firms lacked proper supervisory controls to ensure that their written procedures were being followed. More specifically, in some instances, firms failed to take steps to determine when or how their customers had received the share certificates at issue, whether their customers were control persons of the issuers, or what percentage of the outstanding shares of these companies their customers owned. In some instances, physical certificates for shares were repeatedly deposited into accounts and then sold by firms that participated in unregistered distributions.

Red Flags and the Duty to Make an Inquiry

Firms typically serve as the channel of distribution through which issuers, affiliates and promoters can access the public securities markets. Firms that do not adequately supervise or manage their role in such distributions run the risk of participating in an illegal, unregistered distribution. As recent investigations have shown, problems can arise when firms fail to recognize or take appropriate steps when confronted with "red flags" that signal the possibility of an illegal, unregistered distribution.

The following are examples of red flags (these are by no means comprehensive and should not be considered a "roadmap" for compliance purposes):

- A customer opens a new account and delivers physical certificates representing a large block of thinly traded or low-priced securities;
- A customer has a pattern of depositing physical share certificates, immediately selling the shares and then wiring out the proceeds of the resale;
- A customer deposits share certificates that are recently issued or represent a large percentage of the float for the security;
- Share certificates reference a company or customer name that has been changed or that does not match the name on the account;
- The lack of a restrictive legend on deposited shares seems inconsistent with the date the customer acquired the securities or the nature of the transaction in which the securities were acquired;
- There is a sudden spike in investor demand for, coupled with a rising price in, a thinly traded or low-priced security;
- The company was a shell company when it issued the shares;
- A customer with limited or no other assets under management at the firm receives an electronic transfer or journal transactions of large amounts of low-priced, unlisted securities;
- The issuer has been through several recent name changes, business combinations or recapitalizations, or the company's officers are also officers of numerous similar companies;
- The issuer's SEC filings are not current, are incomplete, or nonexistent.

As noted above, these examples are merely illustrative. There are many other situations that may signal that a firm should take a closer look at the circumstances of a proposed resale transaction.

Regarding the duty of firms to determine whether restricted securities are eligible for public sale, the SEC has said that:
[A] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."

The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may

ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.

The problem becomes particularly acute where substantial amounts of a previously little known security appear in the trading markets within a fairly short period of time and without the benefit of registration under the Securities Act of 1933. In such situations, it must be assumed that these securities emanate from the issuer or from persons controlling the issuer, unless some other source is known and the fact that the certificates may be registered in the names of various individuals could merely indicate that those responsible for the distribution are attempting to cover their tracks.

Inquiry Obligations under Securities Act Rule 144

A firm that distributes securities for its own account or on behalf of a customer may be considered a statutory underwriter. Securities Act Rule 144 establishes a non-exclusive "safe harbor" from being deemed an underwriter if the securities are sold in compliance with its requirements. Unregistered securities that are not freely transferable are considered "restricted securities" when they are acquired in a private transaction or are acquired by a control person of the issuer.

The SEC recently revised Rule 144 and made substantial changes to the requirements governing resales of restricted securities. The amendments, which became effective on February 15, 2008, continue to impose a one-year holding period prior to any public resale on restricted securities of companies that are not subject to the Exchange Act reporting requirements. The amendments eliminated the sales volume and manner of sale limitations on resales made by non-affiliates. Revised Rule 144 also includes more stringent restrictions on the resale of shares issued by shell companies. Accordingly, firms should review whether the company that issued the subject shares was a shell company when the shares were issued.

Before reselling restricted securities, firms must take reasonable steps to ensure that the transaction complies with Rule 144 or another available exemption. The factors set forth in the Notes to Rule 144(g) serve as a pragmatic guideline in determining what questions firms should ask their customers before engaging in an unregistered resale of securities:

- How long has the customer held the security?
- How did the customer acquire the securities?
- Does the customer intend to sell additional shares of the same class of securities through other means?
- Has the customer solicited or made any arrangement for the solicitation of buy orders in connection with the proposed resale of unregistered securities?
- Has the customer made any payment to any other person in connection with the proposed resale of the securities? and

- How many shares or other units of the class are outstanding, and what is the relevant trading volume?

Firms should also try to physically inspect share certificates, if possible, as an opportunity to identify red flags and deter risks from forgery and fraudulent certificates.

Supervisory Procedures and Controls for Unregistered Resales of Securities

NASD Rule 3010 (Supervision) requires a firm to establish a supervisory system and corresponding written procedures to supervise its businesses and associated persons' activities. Accordingly, firms that accept delivery of large quantities of low-priced OTC securities, in either certificate form or by electronic transfer, and effect sales in these securities, should have written procedures and controls in place to prevent participation in an illegal, unregistered distribution of securities.

To help firms evaluate their procedures for supervising these resale transactions, FINRA has reviewed the procedures of a number of large, medium and small firms. The procedures noted below are not intended to be a comprehensive roadmap for compliance and supervision with respect to unregistered resales of restricted securities, but rather highlight measures that some firms are using to ensure better compliance with their obligations. While a particular practice may work well for one firm, the same approach may not be effective or economically feasible for another. Firms must adopt procedures and controls that are effective given their size, structure and operations.

The procedures we surveyed varied depending on the firms' business models; nevertheless, the most comprehensive ones tended to include a mandatory, standardized process that requires formal approval of the proposed resale transaction and thorough accompanying documentation that:

- Clearly communicates each step in the review, approval and post-approval process through the various stages of background inquiry, information gathering, required documentation, review, final approval, execution and recordkeeping of the transaction;
- Assigns clear "ownership" of each step of the transaction review, approval and execution process to the responsible representative, principal, legal or compliance specialist, business unit or department; and
- Is easily accessible to the personnel involved in the process, often through internal Web-based applications that are clear, instructive and encourage process standardization.

Standardized procedures should be accompanied by supervisory controls to ensure that a reasonable and meaningful investigation of the surrounding circumstances is conducted and that the information obtained is evaluated to identify whether a proposed resale transaction could amount to an illegal, unregistered distribution of a restricted security on behalf of an underwriter, an issuer, or a control person of the issuer. As a general matter, the procedures and controls should apply to not only proposed resales, but also the transfer of securities from one account to another by journal or book entry.

Among the compliance procedures FINRA reviewed are:

A. Initial Assessment and Review

A number of firms had procedures that required a comprehensive initial review of the proposed resale, which includes gathering information concerning how, when, and under what circumstances a customer obtained the securities; whether the securities are registered pursuant to an effective Securities Act registration statement; how much of the stock is owned by or under the control of the customer; whether the stock was paid for by the customer; what relationship, if any, the customer has with the issuer or its control persons; and how much stock has been sold by the customer. Some procedures also contained brief descriptions of how holders of unregistered securities may acquire them, such as via private placements, corporate reorganizations, business combinations and stock options plans, and explained that the requirements for resales of such securities can vary depending on the nature of the transaction and the status of the seller, i.e., whether the seller is considered an affiliate of the issuer.

Some firms prohibited their representatives from accepting large blocks of securities in certificate form or required supervisory approval before a transfer of restricted securities would be accepted.

Many firms required the results of the initial review to be documented and held the persons performing the review accountable for completion of the fact-gathering and documentation process. As part of this process, firm procedures required the use of questionnaires completed by the selling customer regarding the proposed resale transaction, form letters completed by the customer and registered representative, and other standardized documentation depending on the transaction.

Some firms deferred the documentation requirements to the person or department responsible for approval. Most firms required the completed documentation to be reviewed for any unusual circumstances and for completeness before submitting it for formal approval of the transaction. This assessment may also alert the firm to unusual or suspicious circumstances that may trigger other compliance procedures (such as Anti-Money Laundering (AML) reporting) or additional approvals given the size or nature of the transaction.

B. Formal Review and Approval

Most of the procedures we reviewed required formal approval by a person, unit or department that is independent of the initial assessment and review of the proposed resale transaction. The person or department responsible for such approval was required to document the steps taken and was accountable for the final approval.

For many firms, the final approval process is more than a verification of the adequacy of the documentation. It included an investigation of the customer's and issuer's background; a formal process to confirm the seller's affiliation status and the conditions upon which the shares can be resold; verification that the issuer is current in its filings and the issuer's information is publicly available; and a thorough review of the opinion of counsel, restricted stock legend, offering materials or prospectus, and other documents

for reasonableness of the information and representations. It also took into account any previous sales by the customer through any accounts at the firm.

Approval from a designated principal or legal and compliance specialist generally is required in these instances before executing or submitting the trade for execution. The approval document also specifies whether there are any conditions to the resale, such as volume, manner of sale or other applicable requirements.

C. Recordkeeping Obligations and Post-Approval Review

Because of the manner of sale and other requirements that apply to unregistered resales of restricted securities by affiliates, some firms' procedures included steps to monitor executions of approved transactions to ensure they comply with applicable volume or manner of sale requirements. Other firms have a process in place, post approval of the resale transaction, to examine repeated resales by the same account or accounts under common control and to review and monitor aggregated resales in the same securities.

Some procedures we reviewed did not assign specific recordkeeping obligations. Other procedures designated a registered representative at the firm as the person responsible for retaining all documents related to the resale as opposed to having another entity such as the firm's legal or compliance group or securities transfer unit designated as primarily responsible for document retention or, at least, to receive and retain copies of the documentation related to the resale.

Other Considerations

A. Reliance on Third Parties

In considering their obligations, firms should be aware that there are limitations on their ability to discharge those obligations by relying on others. FINRA, the SEC and the courts have repeatedly held that firms cannot rely on outside counsel, clearing firms, transfer agents, issuers, or issuer's counsel to discharge their obligations to undertake an inquiry. Moreover, the fact that securities have been issued by a transfer agent without a restrictive legend, or have been put into trading status by a clearing firm, does not mean that those securities can be resold immediately and without limitation under the Securities Act.

B. AML Compliance

A firm must also ensure that its AML compliance program adequately addresses red flags that may be associated with unregistered resales conducted through the firm.

In recent investigations, FINRA has found that firms that participated in unregistered resales of restricted securities also may have ignored a number of red flags that indicate not only that the resale was part of an unregistered distribution, but also that action may have been required under AML reporting requirements. Failure to conduct appropriate inquiry and respond to red flags may have consequences under both the federal securities laws and AML requirements.

Conclusion
Firms must have written procedures that are reasonably designed to avoid becoming participants in the illegal, unregistered resale of restricted securities into the public markets. As noted above, these procedures and the required level of firm inquiry depend on the facts and circumstances of the proposed resale. FINRA urges firms to pay careful attention to these obligations and the implementation of these procedures.

PCAOB – Registration Relief Expired December 31, 2008

Information
The Public Company Accounting Oversight Board registration relief issued by the SEC on December 12, 2006 expired at the end of 2008. The SEC order granting relief permitted non-public broker dealer firms to have their balance sheets and income statements audited by independent public accounting firms not registered with the PCAOB. This relief expired on December 31, 2008.

Firms whose fiscal year ends December 31, 2008, or earlier may continue to rely on the December 12, 2006, SEC Order to conduct the 2008 annual financial audit of their income statement and balance sheet. Their fiscal year 2009 and subsequent audits must, however, be conducted by a PCAOB-registered accounting firm.

Firms whose fiscal year ends after December 31, 2008, must comply with the section of the Sarbanes-Oxley Act of 2002 that requires that their financial statements be audited by a PCAOB-registered accounting firm.