Examining the Efficiency and Effectiveness of the U.S. SECURITIES AND EXCHANGE COMMISSION

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CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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The U.S. Chamber of Commerce, which represents the interests of more that 3 million businesses and organizations of every size, sector and region, strongly believes that the U.S. capital markets are the lifeblood of our economy.

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

Since its inception, the U.S. Chamber's Center for Capital Markets Competitiveness (CCMC) has led a bipartisan effort to modernize and strengthen the outmoded regulatory systems that have governed our capital markets. Ensuring an effective and robust capital formation system is essential to every business from the smallest start-up to the largest enterprise.

ABOUT THE AUTHOR

This report examines the efficiency and effectiveness of three core functions of the U.S. Securities and Exchange Commission (SEC) along with several broad issues related to the organizational structure and management of the agency. The Chamber engaged Jonathan Katz to conduct this study and prepare this report. Katz served as Secretary of the SEC for almost 20 years. During his tenure he served under the leadership of seven Chairmen, four Acting Chairmen, and nineteen Commissioners. While at the SEC, Katz actively participated in numerous initiatives to improve agency operations and efficiency.

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Executive Summary

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) works to ensure that our nation's capital markets are the most fair, efficient, and innovative in the world. Unquestionably, the current challenges facing our markets call for modernization of our broader financial services regulatory structure—a critical component of which will be enabling regulators to provide more effective and predictable oversight.

To that end, in 2008 the Chamber's CCMC initiated a study of certain core operations of the U.S. Securities and Exchange Commission (SEC) that are critical to ensuring an efficient and effective capital market regulatory system:

- **Staff no-action letters** provide an opportunity for companies and financial services professionals to obtain informal guidance from SEC staff on the legality of new financing or compliance approaches.
- **Exemptive orders** provide investment companies (e.g. mutual funds) with exemptions from statutory requirements when a fund can demonstrate that the requirement is not necessary for the protection of investors.
- **Self-regulatory organization (SRO) rule orders** enable stock exchanges and other SRO's to change their rules of operation and supervision of members and to offer new products or services that promote responsible innovation and enable U.S. markets to compete with foreign markets.

Regulated persons and entities believe that obtaining guidance or key decisions from the SEC through these processes is increasingly difficult and unpredictable. This jeopardizes investor protection and is a barrier to responsible market innovation. The recommendations related to these functions aim to clarify review standards, institute firm statutory response deadlines, and increase the transparency of these processes.

Six of the report's recommendations address overarching issues related to the organizational structure and management shortcomings of the agency. These recommendations are intended to improve management coordination, increase consistency and communication across operating divisions, and strengthen the role of the five-member Commission in key areas. Recommendations in this area include the realignment of key operating divisions, the establishment of a Chief Operating Officer for the SEC, as well as the formation of a new Coordinating Council to ensure better coordination and more uniform regulation across the SEC's divisions.

The study focuses on recommendations that can be implemented under current SEC jurisdiction and can increase the agency's ability to effectively allocate regulatory resources in the short-term. The study findings are based on more than 60 interviews with a broad range of experts, including Chamber members, securities law practitioners, and current and former SEC staff.

In general, the study showed that when these core SEC procedures are successful, the success is often attributed to the ability of the SEC staff to act creatively and informally without the need to initiate a rulemaking process or require official agency action by the Commission. Conversely, critics of the SEC frequently point to the informality of certain processes, the limited role of the Commission, and the disregard for the legal requirements of the Administrative Procedure Act (APA) as weaknesses in the regulatory system. These critics contend that policy should be the responsibility of the Presidential appointees, and its adoption should be consistent with applicable law.

Our analysis confirmed that there is an element of truth in both positions. The Chamber believes that the SEC should not rely exclusively on enforcement actions to ensure regulatory compliance. An effective regulator should promote a culture of compliance by assisting parties in determining what must be done. Free markets must have the capacity to bring responsible innovation to the marketplace. Testing new ideas against regulations developed decades ago requires the use of efficient and effective regulatory processes. The interests of improving capital formation must always be balanced against the need to ensure investors and consumers are adequately protected.

The recommendations that follow attempt to balance many conflicting interests that are inherent in these processes—informal flexibility and formal procedures, the roles of SEC Commissioners and SEC staff, regulatory speed and exhaustive scrutiny, and, most importantly, encouraging responsible innovation and capital formation without sacrificing investor protection.

A common attribute of these proposals is a belief that effective changes can be incremental rather than comprehensive and that techniques that work well in one division or in one process may be applicable to other divisions or functions of the SEC. Many of these recommendations also reflect a view that the root cause of delay is not SEC staff inefficiency, overly bureaucratic methods, or a lack of resources. Rather, our findings indicate that a combination of factors contributes to delays or the unwillingness to provide guidance or warranted exemptions. These factors include:

- The lack of strong agency-wide management principles that promote and reward prompt action;
- A rewards system in which prompt and well-reasoned regulatory action does not outweigh the consequences of a mistake or an unintended outcome; and
- A perception that the SEC staff is expected to "know the unknowable" and must not only answer the question presented, but must also identify and consider the implications of related questions not directly presented.

SUMMARY OF RECOMMENDATIONS

STRENGTHENING MANAGEMENT, STRUCTURE, AND OVERSIGHT

The size, structure, and complexity of the U.S. capital markets and financial companies have grown substantially in the past 30 years. While the size of the SEC has increased significantly over that time, its organizational and management structure has not changed to reflect these developments. Reorganization of key divisions and a better system for managing operations are needed. The ability of the five-member Commission to set policy must also be strengthened.

RECOMMENDATION 1—The Division of Trading and Markets and the Division of Investment Management should be realigned into a Division of Investor Protection and Retail Financial Services Regulation and a Division of Market Oversight and Operations. The Examination Programs of the Office of Compliance, Inspections, and Examinations (OCIE) should be assigned to these new divisions.

RECOMMENDATION 2—The SEC should create an accelerated conditional approval process for new investment products or services.

RECOMMENDATION 3—The five-member Commission should play a greater ongoing role in the interpretation and application of regulatory policy. This may require Congressional action to amend the Government in the Sunshine Act (Sunshine Act) that was passed in 1976 that, among other requirements, mandates that every portion of every meeting of an agency shall be open to public observation. Although the Act was developed to create greater openness in government, it has had the unintended consequence of restricting valuable communications between Commissioners and SEC Staff.

RECOMMENDATION 4—The SEC should create a Chief Operating Officer (COO) position with sufficient authority to oversee daily operations throughout the SEC.

RECOMMENDATION 5 —The SEC should establish a coordinating council, chaired by the COO, to resolve issues or disagreements involving more than one division or office.

RECOMMENDATION 6—The SEC should expand the breadth of its staff expertise. Legal and accounting expertise should be complemented with staff experts in capital markets operations and the business operations of regulated entities as well as financial economics.

RECOMMENDATION 7—The SEC should develop a knowledge management program to transfer information and expertise between divisions, preserve the knowledge and experience of departing staff, and provide future staff with ready access to materials explaining and documenting the analysis and reasons for actions taken or not taken.

IMPROVING THE EXEMPTIVE ORDER PROCESS

Because of the structure of the Investment Company Act of 1940, an important responsibility of the Division of Investment Management is reviewing and granting companies exemptions from statutory requirements when the division concludes that such an exemption is "appropriate and in the public interest." The authority of the division to grant exemptions from specific statutory requirements is provided in 33 sections of the Investment Company Act.

The exemptive application process is vital to an effective regulatory program. It provides the financial services industry with a vehicle to innovate in ways unforeseen when the Investment Company Act was passed in 1940. It enables the SEC, as the regulator, to permit responsible innovation in a limited and controlled way. It can create and impose unique conditions on the innovator to protect investors and limit adverse consequences to the market. These conditions can be developed through negotiation with the applicant to ensure that they are not so burdensome that the exemption is no longer attractive. The statutory notice and comment requirement provides transparency to this negotiated process and enables third parties, including current and potential investors, to participate in the decision. This is sensible and collaborative regulation that has stood the tests of time.

The ability of the Commission's staff to review and responsibly act on the hundreds of applications that it receives each year is critical to the effectiveness and vitality of its regulatory system. The time and resources it takes to review and act on these requests is also an important measurement of regulatory effectiveness. For more than 20 years, reducing the time to obtain an exemptive order has been a goal of the division and the agency.

RECOMMENDATION 1—An expedited process should be created for routine exemptive applications that mirror prior exemptive orders.

RECOMMENDATION 2—Incomplete applications should be rejected with standard rejection letters, or "bedbug letters," consistent with published standards explaining the grounds for rejecting deficient filings.

RECOMMENDATION 3—Internal compliance deadlines should be adopted for staff review and action, and apply to applicant responses or revisions based upon staff comments.

RECOMMENDATION 4—Expanding the use of exemptive rules could substantially reduce the number of routine applications. Rule-writing authority for exemptive rules should be reassigned to the same staff that acts on exemptive applications.

IMPROVING THE SELF-REGULATORY AGENCY RULE FILING PROCESS

Self-Regulatory Organizations (SRO), such as our securities exchanges, must have all rule changes reviewed and approved by the SEC. This process is a major responsibility of the Division of Trading and Markets. In 2006 the division reviewed 1,014 filings, and in 2007 it reviewed 1,143. SEC oversight of SRO rules is the legal cornerstone that legitimizes the assignment of

classic governmental powers to private nongovernmental entities. During the past 10 years, two fundamental changes in the structure of SROs highlight the importance of this process and provoke questions as to its continuing efficacy and impact on U.S. capital markets. One change is the transformation of stock exchanges from not-for-profit, member-owned entities into demutualized for-profit public companies, competing with each other and competing globally with other capital markets. The second change is the consolidation of most, but not all, traditional regulatory functions into a single regulatory organization, the Financial Industry Regulatory Authority (FINRA).

For more than 15 years, many SRO's have criticized the rule filing process as too slow and too intrusive, severely affecting a stock exchange's ability to innovate or compete with trading systems not subject to this authority. SEC staff has frequently responded by arguing that regulatory delay is often caused by filings that are inadequate or incomplete. While the Securities Exchange Act of 1934 specifies a rigorous review and approval time schedule, it is rarely followed.

RECOMMENDATION 1—In 2006, 127 filings (12.5%) were rejected, and in 2007, 138 filings (12%) were rejected by the SEC staff as incomplete or incorrectly filed. These high rejection levels demonstrate that an expectation gap between the Commission and SROs exists. The division should formulate a standard that articulates the grounds for rejecting a filing as improperly filed. The division should also require its staff to send a rejection letter to the SRO identifying which items on Form 19b-4 are deficient.

RECOMMENDATION 2—Waivers of statutory time limits should be the exception, not the norm. All requests for waivers of statutory deadlines should require senior-level approval and should be time limited.

RECOMMENDATION 3—The five-day pre-filing requirement should be eliminated.

RECOMMENDATION 4—The Commission should re-delegate to the staff the authority to abrogate SRO filings that are deemed effective upon filing.

RECOMMENDATION 5—The SEC should order hearings on SRO filings that raise complex issues that cannot be resolved following the notice and comment period. Division staff should have responsibility for reviewing all papers submitted in response to the order for hearing and for submitting a recommendation to the Commission. An administrative law judge should be assigned only for exceptionally complex matters.

RECOMMENDATION 6—The SEC should create an optional conditional approval process to encourage SRO innovation.

IMPROVING THE NO-ACTION LETTER PROCESS

Throughout the history of the SEC, the ability of the financial services industry and public companies to solicit informal guidance from the staff has been cited as a strength of the agency. Regulated entities often seek guidance on the correct interpretation of the securities laws and regulations and on its applicability to new financing transactions, disclosure of emerging

developments, and satisfactory regulatory compliance methods. In recent years, the number of no-action letters issued by the staff has declined, and the time and expense of obtaining one has increased.

The SEC staff uses a wide variety of methods to provide informal interpretive guidance. While the forms of guidance may have different legal significance, there is little formal differentiation between formats. Inconsistencies in significance and use exist between SEC divisions. While informal guidance may result in the creation of *de facto* regulatory policy, the five-member Commission plays a very limited role.

RECOMMENDATION 1—The Commission should rationalize the current system of informal guidance by reducing the number of vehicles it uses to provide guidance. Each operating division should develop a web-based system of Compliance and Disclosure Interpretations (CDI), which should replace Staff Legal Bulletins, FAQs, summaries of staff comment letters, small entity compliance guides, and interpretive letters.

RECOMMENDATION 2—The Commission should publish guidelines distinguishing the use of no-action letters and exemptive orders.

RECOMMENDATION 3—The practice of issuing no-action letters of general applicability should be discontinued in favor of exemptive orders or emergency orders, as appropriate.

RECOMMENDATION 4—Each division should post on the SEC Website a list of the staff members, with e-mail addresses and phone numbers, who are authorized to provide informal assistance on specified topics, with all substantive responses promptly posted on the web-based CDI system, following supervisory review.

RECOMMENDATION 5—Each division should attempt to provide a final response to a no-action request within 90 days of receipt. To promote compliance, each division should be required to send a quarterly advice memorandum to the Commission identifying all requests pending for 90 days or longer. The memo would identify the issues presented that must be resolved and provide a target date for resolution. The division should also indicate if it is unlikely that a no-action letter will be issued.

RECOMMENDATION 6—A no-action letter should be viewed as informal guidance rather than a method of setting regulatory policy. Because it is often difficult to distinguish interpretation from policy on a prospective basis, the Commission should annually issue interpretive statements that review, adopt, and codify significant staff positions contained in no-action letters. These releases could also be used to withdraw or revise a no-action position previously taken, based upon new facts or an analysis of how it has been interpreted. The Commission should issue these interpretive statements following an opportunity for public notice and comment. The original recipient of a no-action letter could continue to rely upon the assurances provided in the letter. Any revisions or changes reflected in the Commission interpretative release would apply prospectively to third parties.

Introduction

The U.S. Securities and Exchange Commission (SEC) was created in 1934, during the Great Depression, as part of a comprehensive federal regulatory structure designed to restore public confidence in the financial system and to establish national economic stability. The SEC's initial responsibility was to promote investor confidence in the integrity of financial markets by requiring public companies to fully and truthfully disclose material information about their operations and finances, and by requiring financial intermediaries and the nation's stock exchanges to be registered and to adhere to standards of fair dealing and honesty. Since 1934, Congress has enacted new or amended laws to expand and supplement the authority of the SEC to deal with new problems or changing conditions. Ten years ago Congress amended the securities laws and explicitly charged the SEC with promoting capital formation, as well as investor protection.

For most of its history the SEC has been considered an exemplary government agency and an effective and respected regulator of U.S. capital markets. Numerous countries around the world have adopted its "disclosure-based" regulatory philosophy to promote a vibrant market-based economy.

Today, nearly 80 years after the Great Crash of 1929, a dramatic financial crisis has again affected investor confidence and sharply focused national and global attention on the U.S. financial services regulatory structure. With the current crisis the SEC has become the target of widespread criticism—to an extent that is virtually unprecedented in its history. Its effectiveness is being publicly challenged and, possibly for the first time since its creation, there is public discussion of completely revamping the federal regulatory system, including the transfer of substantial amounts of SEC authority to another federal agency or to a newly created agency. Critics are suggesting that the SEC and other regulatory agencies have struggled to keep pace with the capital markets, that they lack critical expertise, resources or legal authority, or have simply failed to perform their duties in a competent manner. It is highly likely that serious consideration will be given to a comprehensive restructuring of the federal regulatory structure. At a minimum, the SEC will be expected to examine carefully the adequacy of its regulatory methods.

Because the current financial crisis is closely associated with the dramatic and unexpected failure of two major financial companies registered and regulated by the SEC, and more recently by the revelation of a historic fraud by a person regulated by the SEC, an examination of SEC regulatory effectiveness will undoubtedly focus on its enforcement and inspection programs.

The U.S. Chamber of Commerce believes that a careful and thorough analysis of the SEC is inevitable and much needed. However, policy-makers should not make the mistake of judging SEC effectiveness solely on its enforcement and inspection programs. The SEC performs other duties that are critical components of its regulatory mission and vital to fulfilling its twin missions of protecting investors and facilitating capital formation. While these programs have not been charged with comparable regulatory failures they have been the subjects of criticism, albeit in a less dramatic way. The SEC has been criticized for many years for its inability to make timely decisions on issues that are critical to bringing innovative products to market or to executing entrepreneurial business strategies that satisfy regulatory requirements. Due to the dominance of the U.S. capital markets, this slowness has by-and-large been tolerated and has not been viewed as presenting a competitive disadvantage that could not be managed.

It would be unfortunate if a thorough examination of SEC operations resulted in changes in operations that increased delays in the performance of critical, routine regulatory operations or resulted in undue reluctance to act. The SEC has been most effective when it has acted intelligently and creatively interpreting and enforcing the securities laws.

Furthermore, our capital markets need effective and progressive regulatory policy. In the months and years of recovery ahead, it will be critical for our public companies, financial firms, investment companies, national exchanges, and other market participants to have the ability to operate with agility and bring innovative products to the marketplace. An effective regulator of capital markets can never rely solely upon "regulation by enforcement" or by limiting innovation for fear of a mistake. If the SEC in its current state, or as a new or revamped agency, is to be effective it must adopt and implement programs that promote and assist regulated entities in complying with the law.

The recommendations contained in this report do not reflect a strategy of advocating for more or less regulation. Instead, they are intended to promote effective regulation. An effective regulatory system should recognize that delaying action or prolonging a process will not necessarily result in a better decision—only a slower decision. While several of the recommendations are incremental in scope, they deal with critical regulatory functions and, if implemented, will improve the operating efficiency and regulatory effectiveness of the SEC. The SEC can restore public confidence in its actions, and in the soundness of capital markets, by making correct decisions, by making them promptly and confidently, and by providing clear and sound guidance to all market participants and regulated entities.

Management and Operations

The structure of the Securities and Exchange Commission (SEC) has changed very rarely in its 75 year history. Since its creation, it has been organized into semiautonomous divisions, roughly corresponding to the discrete segments of the financial services industry and the distinct laws that the SEC enforces. For much of the SEC's history, the industry segments were clearly separated, and the regulatory apparatus and processes of each division reflected the differences in regulatory approaches embodied in the different federal securities laws.

For example, the Division of Corporation Finance has followed the disclosure-based regulatory approach of the Securities Act of 1933 and the periodic disclosure provisions of the Securities Exchange Act of 1934. The Division of Investment Management followed a more complex hybrid regulatory approach, as it applied both the disclosure-based requirements of the Securities Act and the prophylactic/prohibitory requirements of the Investment Company Act of 1940 and the Investment Advisors Act of 1940. For many years, investment management staff was included in a Division of Corporate Regulation, along with the staff assigned to enforce the Public Utility Holding Company Act of 1935, the most intrusive and merit-based of the federal securities laws.

Until 1971, each division was largely self-contained, including staff performing disclosure reviews, drafting regulations, providing interpretive guidance, conducting inspections of some regulatory entities, and conducting investigations and bringing administrative enforcement actions.

A series of organizational changes occurred in 1972. The Division of Enforcement was established as a separate division, with the transfer of investigative and enforcement functions from the other divisions. The Division of Investment Company Regulation (now Investment Management) was also created. An Office of the Executive Director was reestablished; it had been dormant since 1961, after being created in 1954. Following this flurry of activity, the agency organization remained largely static until 1994,[1] when the Office of Compliance, Inspections, and Examinations (OCIE) was created by the reassignment of the inspections staff from the Divisions of Market Regulation and Investment Management.

Although the organizational structure of the SEC has not changed dramatically in the past 35 years, the industry it regulates is vastly different. And the legal authority of the SEC has

1. The notable exception was the recurring attempts to create an economic analysis and planning office, first as the Directorate of Economic and Policy Analysis (DEPA) and later as the Office of the Chief Economist / Office of Economic Analysis (OEA). Other smaller offices were periodically created, such as Consumer Affairs (now Investor Education), International Affairs, Inspector General, and Risk Assessment.

expanded dramatically. Comments supporting the need for an SEC reorganization arose frequently in interviews for this report. It is an important and timely subject, warranting serious consideration by the new SEC leadership. While a discussion of a complete reorganization of the SEC is beyond the scope of this report, one recommendation is included. The Divisions of Trading and Markets and Investment Management should be realigned along functional lines to correspond to the fundamental changes that have occurred in retail financial services. The recommendation would merge the regulation of retail financial advisory services to create a single regulatory structure for broker-dealers and investment advisors. A second division would have responsibility for market oversight and prudential regulation. The examination functions of OCIE would be reconsolidated into these two divisions.

While no recommendations are made concerning realignment of other offices and divisions, five recommendations are made that concern the overall management and operations of the entire SEC. These are included because they address concerns raised in the other chapters of this report, as well as the rest of the SEC's operations.

RECOMMENDATION 1—The Division of Trading and Markets and the Division of Investment Management should be realigned into a Division of Investor Protection and Retail Financial Services Regulation and a Division of Market Oversight and Operations. The examination programs of OCIE should be assigned to these new divisions.

Throughout its history, the SEC has followed an organizational model that roughly parallels the functional distinctions of the financial services industry. The problem is that the financial services industry has changed dramatically in the past 30 years but the organization of the SEC has not. Today the financial services industry in the United States is highly integrated. A single entity, typically organized as a holding company with separately incorporated and registered subsidiaries, provides a complete suite of investment products and services. The public increasingly works through a single point of contact. The SEC organizational structure must be changed to parallel these changes in the industry, with one division responsible for regulation of retail services to the public and one division with comprehensive responsibility for oversight of securities markets and prudential regulation of the finances and operations of all entities and subsidiaries regulated by the SEC.

One division should be created that has responsibility for regulation of all retail investment products and services and all professionals. When a retail investor meets with a "financial adviser or consultant," they may believe that the same laws and professional standards apply regardless of the designation or company letterhead. This is not correct. The Investment Advisers Act and the Exchange Act impose different legal and fiduciary obligations. One regulatory system imposes restrictions on the sale of securities by related parties and the other does not. One system imposes minimum operating capital requirements and the other does not. One system requires individuals to pass qualification exams and the other does not.

The person may be self-employed or an employee of a multi-national corporation, with an elaborate supervisory system. The professional may be compensated through annual fees based

upon assets under management, or transaction-based commissions or fees paid not by the investor but by the mutual fund or other investment product sold.

While many of these differences are explicitly embedded in the different laws and can only be harmonized through Congressional action, the current organization of the Commission exacerbates the problem. Efforts to reduce or eliminate these differences have traditionally been hampered by "turf wars" between divisions and offices. Under the proposed structure one office would be responsible for Exchange Act regulation of "registered representatives" and Investment Adviser Act regulation of investment advisers.

The clear separation between retail broker-dealers and investment advisors began to disappear in 1975, with the elimination of fixed commission rates. As the business model of full-service broker-dealers moved away from a transaction-based compensation system to an assets-under-management compensation system, the foundation for the long-standing regulatory separation of broker-dealers and investment advisors crumbled. However, the SEC continues to treat the largely overlapping functions as entirely separate groups. The attendant problems are well known to anyone familiar with SEC regulation. Consolidating regulatory responsibility into a single division would remove a major impediment to fundamental rationalization of inconsistent regulatory standards.

In a similar way, the growth of exchange-traded funds as an alternative to mutual funds has blurred distinctions between discrete investments in the secondary market and investments in mutual funds. Coherent and consistent SEC regulation should be structured so that a single division is responsible for all retail investment services offered.

A separate division should have sole responsibility for oversight of secondary market operations, as well as the responsibility for oversight of the back-office and capital adequacy of regulated entities. Within this division, there should be a greatly expanded capacity to oversee the debt markets. The SEC has historically focused its resources on the equity markets, reflecting its view that large institutions dominate the debt markets and these "professional" markets can be largely self-policing. Events of the last several years have demonstrated the limitations of the self-policing model. Furthermore, as the baby-boom generation ages and shifts its collective investment portfolio from equity into fixed-income securities, greater regulatory oversight will become more important.

A critical component of this recommendation is the reconsolidation of the examination functions of OCIE into the new divisions. When OCIE was created, it was envisioned that a separate unit devoted to examinations would provide greater visibility. It was also thought that a merger of the two autonomous examination programs would create synergies and improve efficiency. While the first goal, greater visibility, has been achieved, there is disagreement on the hoped-for synergies.

More important, there have been deleterious unintended consequences. The separation of the on-site examinations staff from the regulatory policy divisions has deprived these divisions of critical real-time information. As one former division director commented, "The division has lost its

eyes and ears. I used to be able to read an article in the *Wall Street Journal* in the morning and have an examination team from the New York office onsite in the afternoon. That's no longer possible." Today, it is more likely that information from an examination will be the basis for a formal order of investigation. While this may be appropriate in many instances, it is another reflection of the shift at the SEC from a "regulatory compliance" paradigm to a "regulation by enforcement" paradigm.

There is an additional important potential benefit to this organizational structure. In 2009, it is highly likely that Congress and the administration will consider reorganizing the federal regulatory system for financial services. One component of any reorganization may be a consolidation of the SEC with the Commodity Futures Trading Commission (CFTC). While the two agencies are often viewed as regulatory equals, in fact, they are not. The SEC is almost eight times larger than the CFTC in number of employees and size of budget. The Division of Enforcement of the SEC alone is more than twice the size of the entire CFTC.[2]

If the two agencies are merged, it would be advantageous to consolidate the staff into functional divisions. This would reduce the possibility of new "turf wars" and promote a coordinated regulatory strategy. The proposed reorganization would make this functional consolidation simpler, as the two divisions proposed roughly parallel the existing CFTC organization of three operating divisions—the Division of Market Oversight, the Division of Clearing and Intermediary Oversight, and the Division of Enforcement.

Appendix A to this report contains sample organization charts for the two proposed divisions. These are merely proposals to facilitate implementation of this recommendation and do not reflect an SEC / CFTC consolidation.

RECOMMENDATION 2—An expedited conditional approval process for new investment products or services should be created.

The U.S. capital markets and America's investors reap substantial benefits when new investment products and services are developed. The days when an individual saved through a bank savings account, invested by buying individual stocks from a broker, and retired with a defined benefits pension offered by an employer are largely over. Today, the typical American often saves in a money market fund, invests in mutual funds, and prepares for retirement by investing in an individual retirement account, a 401k, or an employer-sponsored defined contribution program. Investment vehicles such as money market funds and exchange-traded funds are examples of beneficial innovation that required SEC regulatory relief. Because of the substantial benefits that result from these innovations, an effective regulatory process that fulfills its legal obligations and applies sound and prudent judgment in exercising discretion should also appreciate and reflect the substantial benefits of timely action to promote responsible innovation.

The reorganization proposed would consolidate into one division responsibility for the review of all new investment products and services offered to the general public. This would include self-regulatory organization (SRO) filings for exchange-traded products and mutual fund

2. In 2008, the CFTC had a budget of approximately $116 million and a staff of 458 people (full-time equivalent positions or FTE). The SEC in 2008 had a budget of approximately $906 million and a staff of approximately 3500 FTE.

exemptive applications required to offer a new product or service. It would reflect the changes in the investment world that have blurred or eliminated the lines that once distinguished an exchange-traded product from a mutual fund.

The review process for new products or services to investors must be fundamentally different from the process for considering applications for routine or technical relief. The regulatory burden on the staff to understand a new untested product or service is substantial. It involves not merely an understanding of the proper interpretation of an existing rule or the need to apply it to an existing fund. It also requires an understanding of a product or service that doesn't yet exist. This understanding must encompass not just regulatory principles, but investment goals and objectives, risk characteristics, implications for secondary markets in the product, and consideration of what material information will be disclosed to potential investors. The market turmoil of the past year is demonstrable proof that even highly sophisticated, trained professionals can misunderstand the risks of a new or untested investment product.

Increasingly, new products and services are no longer regulated under a single statute or by a single office or division within the SEC. Each statute that the SEC applies reflects somewhat different regulatory principles that do not always apply in harmony. The staff responsible for each statute typically focuses on the statute they work with and have views that reflect that statute. If the new product requires an exemptive application under the Investment Company Act, the SEC must find that the untested product satisfies a rigorous legal standard—that the relief is "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the title." If an SRO submits the new product as a rule filing, the SEC must balance the multitude of competing goals of the Exchange Act. If a new product appears to be covered by both statutes, the two divisions may be more concerned with establishing their authority over the matter than addressing the underlying regulatory questions.

Under this environment of untested and complex products, overlapping and often-inconsistent legal authority, and different offices with different regulatory perspectives, the staff has an especially difficult challenge when an application for a new product or service is received. Simply put, the professional consequences to any staff member of making an incorrect decision invariably outweigh the benefits of making a correct decision. Given the enormous potential impact of a mistake on the capital markets and individual investors, this imbalance between the rewards for innovative action and the penalties for a mistake is unavoidable.

How can these competing and equally important goals be balanced? Virtually no one interviewed for this report advocated the imposition of a fixed deadline for staff action. At the same time, many people described their frustration with a process that is so open ended that processing periods may span five to seven years. A regulatory process that delays the development and marketing of new products for such long periods is not effective.

The approach recommended can be applied to both exemptive applications and SRO filings. It involves the creation of an optional alternative process that would provide expedited approval of the filing on a conditional or time-limited basis. Virtually every person interviewed

agreed that new product applications are delayed because of the difficulty of anticipating the regulatory implications of the product or service and the burden this places on the staff to assess whether the statutory finding could be made. In effect, the order would acknowledge the experimental nature of the filing and the difficulty in assessing whether something that is not yet in operation will satisfy the requirements of the federal securities laws. It would provide approval conditionally and defer final approval until an appropriate point in the future. Rather than guessing what the impact is, the SEC could make its decision on the basis of actual experience.

Applicants could apply for a conditional exemptive order under an alternative expedited review process.

A conditional order would have to be structured to provide the applicant with sufficient time so that it could justify the time and expense required to develop a new product, market it, and operate it profitably. Furthermore, the conditionality of the order would have to be structured and limited sufficiently so that an applicant could assess realistically the likelihood of permanent approval and the requirements that would have to be met to obtain final approval. Conversely, the SEC would have to be comfortable that it retains sufficient authority under the order to take necessary regulatory action in the event that the product or service fails to provide the necessary investor protections required by the law. The following proposal attempts to satisfy both of these legitimate and important concerns.

Applications under this process would be filed initially as drafts, with confidential treatment provided for an initial period of time. In the filing, the applicant would request consideration and action under this alternative review process. The application would propose and justify a suitable period of time for the conditional order to be effective, such as five years. The application would identify all legal issues that might affect the ability of the Commission to find that the relief requested is necessary and appropriate. The applicant would also identify how these issues could be evaluated during the conditional period.

These issues would be identified as issues in the *Federal Register* notice prepared by the staff. Following the expiration of the comment period, the staff would have a period of time to examine all comments submitted and determine whether approval should be recommended to the Commission. If the staff determines not to recommend approval, the applicant would be notified and provided an option of withdrawing the application or requesting that the staff submit the matter to the Commission. The Commission would retain the discretion to approve the conditional order, order a hearing on the request, or defer action.

The conditional approval order would be effective for a specified period of time. The order would also specify the issues that the Commission would consider prior to granting permanent

approval. The Commission could also require as a condition of the order, that the applicant must collect data or keep certain records that would be submitted to the Commission with a request for a permanent approval.

Six months before the expiration of the conditional order, the applicant would be required to submit an application for a permanent approval order. If the application is timely filed, the conditional order would continue in effect until such time as the Commission takes action on the application. Final Commission action would be based upon satisfactory compliance with the issues identified in the conditional order. If the Commission determines not to grant the final order, the applicant would be permitted to rely upon the conditional order for a sufficient time to wind down or cease offering the subject product or service. This period of time would be consistent with the statutory requirements of protecting investors.

The use of this process would be at the option of the applicant. It would be optional because an applicant may decide that the developmental costs are too great to expend if the Commission's approval may be rescinded or because the possibility of termination after five years makes it impossible to successfully market the product or service to investors.

Conversely, an applicant may find this alternative attractive compared with the prospect of spending five years negotiating approval with no assurance of success. An applicant may conclude that there is a great deal of potential interest in the product or service and that five years of operation will demonstrate the efficacy of the concept—particularly if prompt action will provide a substantial economic incentive as the "first mover" in a new market.

Should streamlined regulatory review of new products and services be a priority for the SEC?

In 2008 the American capital markets suffered from repeated financial failures and crises. As the year ended, the SEC became the target of widespread criticism, to an extent that is virtually unprecedented in its history. It is highly likely that serious consideration will be given to a comprehensive restructuring of the federal regulatory structure. At a minimum, the SEC will be expected to seriously examine the adequacy of its regulatory methods. At a time when critics are calling for more regulation, why should the SEC consider streamlining its procedures or reducing the amount of time required for action?

The answer to this challenge is simple. This recommendation does not represent deregulation or less regulation. It represents effective regulation. The federal securities laws charge the SEC with responsibility for protecting investors and promoting capital formation. These are not incompatible or inconsistent goals. An effective regulatory system should achieve both. An effective regulatory system should also recognize that delaying action or prolonging a process will not result in a better decision; only a slower decision. The SEC can restore public confidence in its actions, and in the soundness of capital markets, by making correct decisions, by making them quickly and confidently, and by providing clear and sound guidance to the public and the industry it regulates. While the recommendations contained in this report may seem arcane and small in scope, they are designed to enable the SEC to achieve the important and fundamental goals stated in the federal securities laws, protecting investors and facilitating capital formation.

RECOMMENDATION 3—The five-member commission should play a greater ongoing role in the interpretation and application of regulatory policy.

For much of its early history, the Commission met almost daily and acted on virtually every decision that had to be made. Several changes in the laws over time caused a significant diminution in the responsibilities of the five presidentially appointed commissioners. The Reorganization Plan 10 of 1950 (Reorg Plan 10)[3] shifted executive functions, such as administration, budget, personnel, and staffing, from the Commission to the chairman, who would serve as a chief executive officer (CEO) for the agency. In 1962, Congress amended the Exchange Act to permit the Commission to delegate discrete responsibilities, other than rulemaking, to its staff.[4] Over the years, the Commission has delegated to the staff the vast majority of daily decisions, with the notable exception of decisions concerning enforcement investigations and legal action.

An often-overlooked but highly significant legal change was the Government in the Sunshine Act (Sunshine Act) enacted in 1975.[5] The Sunshine Act is a procedural law that ostensibly does not change the legal responsibilities of the Commission. It merely requires Commission deliberations to be conducted in public meetings, unless the subject of the deliberations is included in one of the 10 categories excepted from the public meeting requirement.

Virtually every commissioner who has served since the act's passage in 1975 has commented or expressed frustration over the Commission's inability to meet confidentially with the staff to discuss division operations, activities, and decisions. The inevitable consequence of this limited role for the Commission has been the transfer of a significant amount of responsibility for setting policy from the commissioners, acting as a collegial bipartisan body, to the division directors, who personally report directly to the chairman. As one commissioner suggested sarcastically at a Commission meeting, "The securities bar doesn't want to know what I think; they want to know what the chief counsel thinks."

Over the years, the SEC has attempted to address this problem to the extent possible without violating the Sunshine Act. These efforts have included the use of advice and information memos to the Commission;[6] periodic briefing memos or "term sheets"; and occasional nonpublic Commission briefing meetings, in which the staff makes a presentation, but the Commissioners are required to refrain from engaging in a discussion, "joint deliberations," or expressing opinions.

A common theme in the discussion of no-action letters, exemptive applications, and SRO filings has been the reestablishment of a policy role for the Commission. While it is hoped that each recommendation, if adopted, would be successful in reestablishing the Commission as the final authority on regulatory policy, there is a simpler and more effective solution. The SEC, likely with the support of other federal regulatory agencies, should request that Congress amend the Sunshine

3. 64 Stat. 1265 (1950).
4. Reorg Plan 10 and the 1962 authority to delegate responsibility to the staff implemented recommendations to Presidents Truman and Kennedy, respectively, made by the same individual, James Landis, the second Chairman of the SEC and one of the coauthors of the federal securities laws.
5. 5 U.S.C. § 552b (2008).
6. An advice memo is submitted by the staff to the Commission to solicit the Commission's views on a decision that the staff intends to take by delegated authority, prior to taking action. Typically an advice memo contains a time deadline: "Unless the Commission instructs otherwise, in XX days, the staff intend to do the following." An information memo is issued to inform the Commission of a significant action or event after it has occurred.

Act to provide each agency with sufficient flexibility to meet regularly with its own staff in nonpublic meetings to discuss the interpretation of agency regulations and the application of these regulations to decisions that have been delegated to the staff.

In making this recommendation, it is critical to emphasize that the goal is not to require the Commission to engage in the daily responsibilities of the staff. This would be a disastrous outcome. The staff must retain the ability to act quickly and decisively in its daily activities. Much of this work is highly technical and it is unrealistic to expect that the five Commissioners collectively would have the expertise and the time to act on questions concerning, for example, the Commission's net capital rule or executive compensation disclosure rules. At the same time, the Commission should be the final authority on questions of regulatory policy, both in the interpretation of rules and in periodically overseeing and engaging in discussions of the priorities of each division. The following chapters make recommendations on how the Commission could assume a discrete and appropriate role when routine staff functions raise questions of policy. A limited amendment of the Sunshine Act would make this possible.

RECOMMENDATION 4—The SEC should create a chief operating officer position with sufficient authority to oversee daily operations.

This recommendation may be the most radical proposal in this report. It would fundamentally change the responsibilities of every division director and senior officer at the SEC. It would also enable the chairman to perform the CEO responsibilities under Reorg Plan 10 and provide a degree of consistency and uniformity to SEC operations that has been absent for much of its history.

As discussed, the four primary operating divisions of the SEC, and the comparably sized OCIE, operate semiautonomously. Each has virtually complete control over its operations (with the exception of Enforcement, which has only limited delegated authority) and may adopt policies and procedures that differ from those of the other operating units. While the chairman is informed of significant activities and has the opportunity to control any decision, this is often a reactive—not proactive—process. The division largely controls what is presented to the chairman or the Commission.

The responsibilities of the SEC are substantial, and the issues that require its attention are often dictated by the conditions of the capital markets. These are matters of national policy and require careful attention. For this reason, the daily operations of the SEC are rarely given much attention. This usually holds true for the division directors. Many division directors are selected from the Commission's staff, but frequently they are hired from outside the SEC. While some division directors serve for a decade or more, most serve for the term of the chairman who appointed them. They arrive with an agenda of policy matters that they hope to address and view daily operations as a lower priority. While efficiency is always a goal, it is seldom a priority.

In providing this critical assessment of the problem, one must acknowledge that it is a generalization based upon the practices of a variety of division directors over the past 25 years. Ironically, in the past three years, the incumbent division directors of Corporation Finance, Trading

and Markets, and Investment Management have each made operational efficiency a priority. Moreover, each has achieved meaningful improvements worthy of note. These include the creation on the SEC Website of the compliance and disclosure interpretations by Corporation Finance, the July 2008 release on SRO filing procedures by Trading and Markets, and the implementation by Investment Management of internal procedures to reduce the processing time for exemptive applications. The success of these efforts demonstrates that change is possible—if efficiency is a top-down priority.

A chief operating officer (COO) would institutionalize this current commitment to agency efficiency and reduce the pressure on each division director to be the driving force. If a chairman appointed a COO whose mandate is to improve agency operations, it would relieve the division directors of this responsibility and give them greater freedom to focus on agency policy. A single COO could also address the existing inconsistencies in process.

This is not a new concept. Over the years, some SEC chairmen have assigned COO duties to either the chairman's chief of staff (also referred to as executive assistant to the chairman or managing director) or the executive director. In fact, when the position of executive director was established at the SEC, this was to be a core responsibility.[7] Historically this has not occurred, largely because an executive director must focus on the annual congressional appropriation cycle, budgeting process, and administrative duties. Because of the critical importance of these responsibilities, executive directors have been selected who possess expertise in these areas, rather than knowledge of agency operations. The chief of staff has similar higher priority duties, including managing the office of the chairman, working with the division directors on policy issues, and acting as the chairman's surrogate or representative.

A COO, on the other hand, must understand the federal securities laws and the complex and varied functions that the staff performs. To be effective, a COO would have to have the authority to assign responsibilities, impose deadlines, allocate staff resources, and have a role in personnel selection, evaluation, and bonuses.

The creation of a COO may appear to represent a diminution in the authority of the division directors, the general counsel, and the chairman's chief of staff. In fact, it likely would have the opposite effect. It would reduce the burden on these senior officials to devote their limited time to mundane or arcane, but still important, problems. Furthermore, directors appointed from outside the agency would not have to devote time to learning internal operating procedures and would not be in the awkward position of providing direction to career subordinates who have more experience in their area of expertise.

Prior to making this recommendation, serious consideration was given to a less dramatic alternative, creation of a COO position in each operating division. Admittedly this alternative would be less controversial and less unsettling. It would not alter the primacy of the division director. The downside to this approach is that the ability of the COO to improve efficiency or effect change would be completely dependent upon the support provided by each division

7. The description of responsibilities for the executive director includes the following: "The Executive Director is responsible for developing and executing the overall management policies of the Commission for all its operating divisions and staff offices." 17 C.F.R. § 200.13.

director. As noted previously, the current system is flawed because short-term division directors typically have limited time horizons and higher priority policy agendas. If a division director is not personally committed to improving efficiency, a subordinate COO will be unlikely to succeed in doing so.

RECOMMENDATION 5—A Coordinating Council should be established to resolve issues or disagreements involving more than one division or office.

Increasingly, innovative investment products and services are not confined to a single regulatory scheme or a single division of the SEC. For example, while the Division of Investment Management has the authority to consider applications for exemptions under the Investment Company Act, it must coordinate its review with other offices and divisions of the SEC when applications raise issues under other statutes. For example, an exchange-traded fund (ETF) is a product listed on a securities exchange, and that exchange must submit proposed listing standards to the Division of Trading and Markets for review and approval. Similarly, issues often arise under the Securities Act that must be coordinated with the Division of Corporation Finance. For example, before Corporation Finance could develop a regulatory regime for asset-backed securities (ABSs) (through a series of no-action letters), it was necessary to address the application of the Investment Company Act to the issuer of the ABS.[8]

At the SEC, any issue that crosses divisional lines of responsibility also requires the involvement of the Office of General Counsel. When more than one office or division must examine a new product, the process often becomes long and complex. One experienced practitioner described the process firsthand:

> The most interesting ETF project, in the Chinese sense of the word "interesting," was the ProShares order, which took seven years from start to finish.The relief requested involved not only regular ETFs, but also included leveraged, inverse, and inverse-leveraged funds.A great deal of that time was taken up in the interface between IM [Investment Management] and Market Reg, because Market Reg had a whole host of issues about listing products whose portfolios would include derivatives, leveraged, and short positions.Their concerns were originally raised in connection with the ProShares listing rules proposed by the AMEX [American Stock Exchange], but these concerns frequently intersected with issues raised in the application for '40 Act relief.So for a long time there were joint conferences with staff members from Market Reg and IM, during which each group analyzed each issue from vantage points driven by different statutes and public policy considerations.We were trying to please both sides of the table, which finally, finally came to fruition.[9]

8. The Commission eventually converted its original exemptive orders for ABS issuers into a general exemptive rule. 17 C.F.R. § 270.3a-7.
9. SEC Historical Society Annual Meeting, *Exemptive Authority: The Mandate of the Division of Investment Management*, remarks by Kathleen Moriarty (June 5, 2008), *available at* http://www.sechistorical.org/collection/programs/transcripts/Transcript_2008_0605_AM.pdf [hereinafter 2008 SEC Historical Society Meeting].

It is increasingly common for an exemptive application, a request for a no-action letter, or an SRO filing to raise issues that are significant to another division or involve legal questions for which another division is responsible. This is another manifestation of the semiautonomous status of each division, compounded by the enormous changes in the financial services industry that have largely eliminated the clearly defined separations of function that formed the basis for the current organization.

The Commission must create an ongoing process to resolve policy disputes among the operating divisions and/or the advisory offices such as the OGC, Chief Accountant, and Chief Economist. Disagreement between offices and divisions or the inability to obtain a final answer from an office is frequently cited as the principal reason why action is delayed. Current SEC staff, former SEC staff, and members of the industry consistently made this comment.

Traditionally, the OGC has performed the role of intermediary in these disputes. This approach may be effective when OGC has the expertise to identify a rational solution. However, if the OGC staff is unwilling to assume this role, or if the OGC staff raised the difficult issue, they may not be in a position to resolve the problem. Moreover, as the OGC performs a wide range of functions with a limited staff, it is not always in a position to respond quickly. Applicants often say that when delays occur, the staff of a division will explain that they cannot act until they "hear from OGC."

While the general counsel may be the person best suited to exercise this authority, competing obligations make it difficult for the general counsel to engage in a matter unless it is a major policy question. The general counsel of the SEC must perform many roles. These include acting as the chief legal official of the agency, acting as the personal legal advisor to the chairman, acting as the final authority on ethics, and managing an office of several hundred lawyers performing an extraordinarily wide range of legal duties. It is unrealistic to propose a solution that creates one more burden for this person.

The approach recommended is the creation of a coordinating council composed of the division directors, the general counsel, the chief of staff, and the heads of the key policy offices. The COO would chair the council and coordinate its operation. This council would meet regularly, possibly weekly or bimonthly, and would consider any questions on which there is disagreement among offices or divisions. The function would be purely reactive, providing a forum to resolve disagreements or to obtain sign-off on proposed decisions. If this body is unable to resolve an issue or disagreement, the item would be submitted with alternative recommendations to the Commission for action.[10]

10. Minutes of these meetings could be circulated to the Commissioners to ensure that they are aware of these questions and the decisions that are made.

This recommendation mirrors similar processes successfully used by the SEC to recruit, interview, and promote senior officials (the Executive Resources Board) and to allocate funding for information technology (IT) projects. The objective is to create an internal discipline that emphasizes prompt decisions rather than stalemate or inaction.

RECOMMENDATION 6—The SEC should expand the breadth of its staff expertise. Legal and accounting expertise should be complemented with staff who possess expertise in capital markets operations and the business operations of regulated entities as well as financial economics.

If the SEC is to continue as an effective capital markets regulator, it must increase the number of staff experts in capital market operations, business conduct, and financial economics. Historically, the SEC has been a lawyer-dominated agency that resolves complex questions from a lawyer's perspective. This legal perspective will continue to be critical to effective regulatory policy. But it must be augmented with greater knowledge and insight of persons with operational expertise and an understanding of the economic principles that drive the legal issues presented.

The SEC has recognized this need in the past and has made an effort to increase the pool of staff with critical expertise. One successful approach has been the creation of the accounting fellows program in the Office of the Chief Accountant, and the occasional appointment of attorney-fellows in the Office of the General Counsel and in the operating divisions. Persons with exceptional credentials receive one- or two-year appointments and serve as resident experts advising Commission staff.

The SEC should augment its staff expertise by creating an industry fellows program. Knowledgeable members of the industry would be recruited for limited appointments to provide career staff with in-house expertise in the complex workings of the securities markets. In this way, when an SRO files a highly technical proposal affecting, for example, order routing, the staff would not have the burden of developing the technical expertise to analyze the proposal.

Historically, when the SEC has tried to recruit staff from the private sector, it has been hampered by uncompetitive salaries, the obligation to relocate from New York or other locations, and the conflict-of-interest questions presented. Fortunately, these problems should not be as significant in the future. Pay parity has made salary differences less significant. The creation of remote work site programs, based upon electronic contact, makes it feasible for employees to work from New York or other cities. The Chief Accountant's Office has succeeded in resolving the conflict questions for accountants temporarily loaned by the major accounting firms.

Most important, the job market has changed. The dramatic restructuring of the financial services industry has caused many large firms to downsize, often by providing early retirement to a substantial number of highly trained professionals. Many of these individuals would enjoy the opportunity to work at the SEC for a limited period, providing expertise and knowledge gained from a career in the industry.

In the chapters discussing each core function, the potential adverse consequence of making the "wrong decision" has been identified as a contributor to excessive delay. When persons responsible for a decision have access to reliable expertise, it increases the likelihood that the decision made will be defensible. This confidence will reduce the tendency of some to "continue to analyze" issues rather than make a decision.

Furthermore, when issues are considered from more than one perspective, it improves the quality of the decision. While a Commission decision to provide an exemption or approve an SRO filing must always satisfy applicable legal requirements, these requirements are often phrased in terms of reducing barriers to competition or protecting investors. The analysis required to determine whether the legal standard has been met often requires consideration of business objectives, costs, and the benefits to be provided, as well as an understanding of the mechanics of implementing the proposal. A multidisciplinary analysis may be superior to an exclusively legal analysis.

RECOMMENDATION 7—The SEC should develop a knowledge management program.

Knowledge management has become a buzzword in both the private sector and the public sector. Knowledge management is a broad concept, encompassing the need to preserve and memorialize information and expertise and make it available to other staff, now and in the future, both in substantive knowledge of the securities markets and in the best methods for doing a job. As anyone familiar with the SEC knows, its greatest resource is the individual and collective knowledge and expertise of its staff. Because the SEC historically has had a high turnover rate, it has routinely been faced with the challenge of preserving the expertise of key staff, transferring it to new staff, and exchanging it among staff in different offices or performing different functions.

Anyone who has worked at the SEC knows how extensively the agency relies upon written memos to document and memorialize staff actions or decisions not to act; whether it is a case-closing memo in Enforcement, a decision to declare a registration statement effective in Corporation Finance or a decision not to recommend an OCIE inspection to Enforcement. Similarly, anyone who has drafted a memo to the Commission for action can attest to the effort required, including the levels of review and analysis. It is ironic that this enormous body of information explaining decisions taken is not a readily available resource for new staff trying to understand past actions. At a minimum, the staff of the Commission should have electronic access to a searchable database of all internal memos submitted to the Commission or circulated within a division or office. The Commission should also routinely record all internal division training programs or visiting lectures and provide "electronic on demand" access to staff throughout the agency.

Development of a comprehensive plan for knowledge management at the SEC is beyond the scope of this report. However, it is a concept that is vital to the long-term effectiveness of the Commission, and the SEC should make it a priority.

Exemptive Orders Under the Investment Company Act of 1940

I. INTRODUCTION

The Investment Company Act of 1940 imposes an extensive set of legal and procedural requirements on investment companies. The Act is fundamentally different in structure and philosophy from the Securities Act of 1933. The Securities Act is a disclosure-based law. It regulates by requiring companies that offer securities to the public to fully disclose all material information that a reasonable investor would need to determine whether to invest, rather than have the regulatory agency assess the investment merits of a particular security. The Investment Company Act is a prescriptive and proscriptive law. It contains detailed legal requirements for investment companies offering shares to the public. These requirements concern the legal structure of an investment company, the process of offering shares to the public and redeeming those shares, restrictions on the investment decisions that may be taken, limitations on dealing with related entities, and requirements for disclosure of information to investors.

Because of the structure of the Investment Company Act, an important activity of the Division of Investment Management of the SEC is reviewing and granting companies exemptions from specific requirements of the Act when the division, acting pursuant to delegated authority, concludes that it is appropriate and in the public interest. This authority to grant exemptions from specific statutory requirements is provided in numerous sections of the Investment Company Act. An SEC study of the Act identified 33 separate provisions of the act that permits the SEC to grant an exemption.[11]

In addition to the specific grants of authority, § 6(c) of the Investment Company Act provides the SEC with omnibus authority to grant exemptions from any requirement of the Act to one or more registrants, either by application and order or by the adoption of a rule or regulation. This broad authority is limited by only one requirement, a finding by the Commission that the relief is "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the title." Throughout its history, the Commission has used this authority to grant relief and adopt regulations concerning those statutory provisions that do not contain congressional authority for exemptions.

11. U.S. Sec. & Exch. Comm'n, Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation, 503 (May 1992), http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf [hereinafter 1992 IM Report].

David Shenker, one of the authors of the Investment Company Act and at the time the chief counsel of the Commission's Investment Trust Study, explained to Congress during a hearing on the proposed law that "the difficulty of making provisions for regulating an industry which has so many variants and so many different types of activities…is precisely [the reason that section 6(c) is inserted]."[12]

For much of the history of the SEC, the Investment Company Act was the only one of the federal securities laws that provided the Commission with the ability, for good cause, to exempt a registrant from a statutory or regulatory requirement. The effectiveness of this exemptive process was validated by subsequent congressional action amending the other securities laws to provide the SEC with identical, or at least analogous, authority. In 1970, Congress added §206A to the Investment Advisors Act,[13] which duplicated §6(c) of the Investment Company Act. In 1996, the National Securities Markets Improvements Act (NSMIA) added §36 to the Exchange Act,[14] which provided the Commission with comparable exemptive authority under that statute. NSMIA also added §28 to the Securities Act,[15] providing the SEC with limited authority to grant exemptions by rule or regulation, but not by order.

An exemptive order is significantly different from and more powerful than a staff no-action letter. Only an exemptive order permits actions that otherwise would violate the law. Because an exemptive order is a "final agency action," §38 of the Investment Company Act[16] provides the recipient with legal protection for any acts taken in good faith pursuant to a Commission order. A staff no-action letter does not provide similar protection in litigation and is not accorded interpretive deference by the judiciary.

The ability of the SEC's staff to review and responsibly act on the hundreds of applications that it receives each year is critical to the effectiveness and vitality of its regulatory system. The time and resources it takes to review and act on these requests is also an important measurement of regulatory effectiveness. In this section we will describe the current process for applying for and obtaining an exemptive order and make recommendations to improve this process, while maintaining the regulatory effectiveness of the program.

II. BACKGROUND ON THE EXEMPTIVE ORDER PROCESS

A. EXEMPTIVE ORDERS ARE A VEHICLE FOR RESPONSIBLE INNOVATION

Martin Lybecker, a former senior official in the Division of Investment Management now in private practice, explained the significance of exemptive authority to regulation: "I think it is fair to say that, [without that exemptive authority, the Investment Company Act would have become irrelevant] or at least the investment company industry would have become irrelevant by 1960 or 1970. Instead, we have a vibrant investment management

12. *Id.* at n.5.
13. 15 U.S.C. § 80b-6a (2008).
14. 15 U.S.C. § 78mm (2008).
15. 15 U.S.C. § 77z-3 (2008).
16. 15 U.S.C. § 80a-37 (2008).

industry, investors enjoy access to variable annuities, money market funds, multiple classes, funds of funds, ETFs, all of which wouldn't have happened without the existence and use of this exemptive authority, and they have the opportunity to select among classes, which allows them to pay fees for services in a variety of ways."[17]

As Mr. Lybecker noted, exemptive authority has been the vehicle for profound changes in the mutual fund industry. It has also enabled the Commission to address a wide variety of issues, from complex trading vehicles that do not necessarily fit within the regulatory

WHILE EXEMPTIVE ORDERS HAVE SUCCESSFULLY FACILITATED REMARKABLE INNOVATIONS, THE PROCESS HAS OFTEN TAKEN YEARS.

Actually, the history of the ETF structure is very interesting. It all started because the AMEX wanted to develop new trading products that they could list. Nate Most, the head of the AMEX new products committee at the time, thought it might be a good idea to list mutual funds that could be traded on the exchange. So he went to John Bogle at Vanguard and discussed listing some of their mutual funds. John Bogle had a bunch of issues with the concept, including the fact that he felt that people frequently buying and selling on the AMEX would disrupt their whole fund portfolio management. So, Nate went back to the drawing board. He began to think about a structure, more like a custodial receipt or a basket trade, where stocks would be deposited into a fund and the fund's individual shares would be traded on an exchange at market prices. Meanwhile, institutional owners of the fund could redeem or purchase fund shares in huge lots at NAV using the underlying securities rather than by paying in cash. So this really turned out to be a hybrid structure. I was not involved in the very first presentation to IM, but I think it was made in 1989. The idea and the structure progressed and worked its way through IM, Corp Fin, Market Reg, and ultimately to the commissioners, during which time lots and lots of meetings and discussions took place. The IM staff in particular was very encouraging. Finally, the SPDR Trust was granted its relief in January 1993. Note that the SPDR Trust order contained no future relief; given that the SPDR Trust was a novel product, the Commission wanted to see how it operated and was traded and received by the marketplace. The subsequent orders granted to MidCap SPDRS, DIAMONDS, WEBS, and CountryBaskets again were specific to each particular product; none provided for future relief. It wasn't until the iShares Trust received its exemptions in 2001 that the Commission first granted future relief. Since that time, there are now in excess of 600 ETFs trading in the United States. They hold a wide array of portfolio investments, including domestic and foreign equity and debt securities, track broad or narrow market indexes, concentrate in particular market segments or sectors of geographic regions, follow "value" or "growth" styles, financial indexes, or follow other specialized strategies.

— Kathleen Moriarty, SEC Historical Society Roundtable, 2008

17. 2008 SEC Historical Society Roundtable, *supra* note 9, remarks by Martin Lybecker.

parameters of the Investment Company Act, to new sales and distribution practices in the mutual fund industry, as well as relatively minor operational matters affecting investment companies.

Exchange-traded funds (ETFs) are one of the most successful innovations in collective investment schemes in the past generation. ETFs provide investors with trading flexibility, low expenses, and diversification. The regulatory history of this innovation demonstrates the importance of the exemptive application process and the impediments faced by an innovator.[18] With an exemptive order, a financial services company may develop a new investment product that was never envisioned when the Act was passed. However, obtaining that order may require years of effort and very substantial legal costs to the applicant. The process also places a very heavy burden on the SEC staff, who must analyze an inchoate idea, consider the explicit legal questions raised in the application, identify any other issues that have not been raised but that may exist, and resolve these difficult legal questions based upon projections of how the product will be offered to the public and trade in the secondary market. Because new products and services often create regulatory questions under the other federal securities laws, these applications must be reviewed by SEC staff in other offices and divisions with different, and sometimes conflicting, regulatory responsibilities.

B. THE COMMISSION FREQUENTLY IMPOSES CONDITIONS IN ITS EXEMPTIVE ORDERS

Because the Investment Company Act requires a finding that granting an exemption is necessary and appropriate and consistent with the protection of investors and the purposes of the act, the Commission typically imposes one or more conditions on the recipient of the exemption. These conditions are often limits on the scope of the exemptive relief. Frequently, the Commission has used this authority to impose conditions on registrants that are not covered by the Investment Company Act or that conflict with or expand upon the requirements of the Act.

Not infrequently, the conditions in the exemptive order are so detailed and extensive that they effectively

CONDITIONS TO AN EXEMPTIVE ORDER CAN BE AS IMPORTANT AS THE EXEMPTION ITSELF.

Applications are generally built around those conditions and provide the factual basis under which the Commission or the staff, under delegated authority, can make the requisite findings. Applications generally contain conditions that are designed to demonstrate that the investors in the fund will be protected. Often those conditions will appear to be procedural in nature—for example, in the affiliated transaction area, the orders and the rules generally will provide for review of the transaction by the fund's board.

—Kenneth Berman, former Associate Director of the Division of Investment Management, SEC Historical Society Roundtable, 2008

18. 2008 SEC Historical Society Roundtable, *supra* note 9, remarks by Kathleen Moriarty.

create a comprehensive regulatory structure. A recent example of this is an exemptive order that the Commission issued to a closed-end fund seeking permission to distribute capital gains to investors more than once a year, which is prohibited by section 19(b) of the Investment Company Act.[19] This is an area that was the basis for SEC enforcement actions in recent years. To obtain this relief, the applicant in its application offered to accept wide-ranging conditions. Among other requirements, the fund agreed to extensive board oversight of the process and clear disclosure to the investor of the source of the distribution, both narrative and graphic, distributed to investors and posted on its Website. Furthermore, the fund's chief compliance officer was required to report quarterly and annually to the board on the fund's compliance with the conditions.

Typically, after the Commission has issued a series of exemptive orders providing the same relief to many registrants, it codifies the relief into a rule of general applicability, eliminating the need for other entities to apply for the same exemptive order. If the exemptive orders have contained restrictive conditions, these conditions are incorporated into the rule. Because the adoption of an exemptive rule is an exercise of regulatory discretion, there is virtually no limitation on the types of requirements that can be included in the exemptive rule. On some occasions, the Commission has imposed new regulatory requirements by making them additional conditions to general exemptive rules previously adopted.[20]

C. EXEMPTIVE ORDERS ARE TYPICALLY APPROVED BY THE STAFF PURSUANT TO ITS DELEGATED AUTHORITY

Due to the significant number of exemptive applications submitted annually and the highly technical nature of the issues raised, the five-member Commission rarely is involved in the decision to approve an exemptive order. Instead it has delegated authority to the staff of the Division of Investment Management to review, publish notice, and approve the majority of applications. Pursuant to this delegation of authority,[21] the division may approve any application requesting relief that has been granted previously and that does not raise issues of fact or policy concerning the public interest or the interest of investors warranting Commission consideration. However, the division may not approve an application if an interested person submits a request for a hearing.

By definition, a novel product or service may be approved only by a vote of the five-member Commission. Commission action invariably requires additional time, as the Commission has many competing responsibilities, most of which are time sensitive. When an application raises highly technical issues, there is a significant learning curve for commissioners who do not routinely review and act upon exemptive applications.

19. ING Clarion Income Fund, Investment Company Act Release No. IC-28352 (Aug. 5, 2008), *available at* http://sec.gov/rules/ic/2008/ic-28352.pdf.
20. While section 10 of the Investment Company Act prohibits mutual funds from having boards composed of more than 60% nonindependent directors, the Commission has effectively amended the act by including a condition in a series of widely used exemptive rules a requirement that a majority of directors must be independent.
21. 17 C.F.R. § 200.30-5 (2008).

Furthermore, when five individuals with competing backgrounds and perspectives confront a difficult and novel question, unanimity is unlikely. The Commission's decision in 1985 to expand the investment freedom of "funds of funds" is a classic example of this problem. The Commission approved, by a three-to-two vote, an application from the Vanguard Tax-Advantaged Retirement Fund to make investments in other Vanguard funds that exceed the statutory limits contained in §12(d)(1) of the Investment Company Act.[22] Although this exception was narrowly approved and included a sharply worded public dissent from two commissioners, it led to a long series of similar exemptions. In 2007, the Commission codified this relief into a general exemptive rule.[23]

D. HOW THE DIVISION PROCESSES EXEMPTIVE APPLICATIONS

The process for reviewing and issuing exemptive orders is time-consuming and labor-intensive, both for the SEC staff and for the applicant.[24] The Commission estimates that it receives approximately 125 applications per year.[25] Additionally, a small number of draft applications (13 in FY 2005) are submitted each year. These drafts typically involve a novel or complex issue or requested relief and are submitted with a request for confidential treatment.

In a recent release, the SEC estimated the cost of preparing an exemptive application. "Based on conversations with applicants and attorneys, the cost ranges from approximately $7,000 for preparing a well-precedented, routine application to approximately $80,000 to prepare a complex and/or novel application. We estimate that the Commission receives 20 of the most time-consuming applications annually, 80 applications of medium difficulty, and 25 of the least difficult applications."[26]

SEC Rule 0.2 under the Investment Company Act[27] specifies the requirements for submitting an application. An applicant must file an application that sets forth "a brief statement of the reasons why the applicant is deemed to be entitled to the action requested with a reference to the provisions of the act and of the rules and regulations under which application is made."[28] The application must identify the applicant seeking the relief. This might be more than one fund within a fund complex or it might be all funds managed by the same adviser or under common control.

In a 1985 release that is still applicable, the Commission identified other requirements for an application for exemptive relief. In addition to the statement of the relief requested, the

22. In the Matter of the Vanguard Special Tax-Advantaged Retirement Fund, Inc., Investment Company Act Release No. IC-14361 (Feb. 7, 1985).
23. 17 C.F.R. §§ 270.12d-1 to 12d-3 (2008). See also, Funds of Funds release, Securities Act Release No. 33-8713, Investment Company Act Release No. IC-27399, (June 20, 2006) [hereinafter Funds of Funds Release].
24. The Commission's process for receiving and considering exemptive applications is contained in Policy and Guidelines for Filing of Applications for Exemption, Investment Company Act Release No. IC-14492 (Apr. 30, 1985). Certain requirements in this release have been superseded by a Commission rule requiring electronic filing of applications via EDGAR. *See* Mandatory Electronic Submission of Applications for Orders under the Investment Company Act and Filings Made Pursuant to Regulation E, Securities Act Release No. 33-8981, Exchange Act Release No. 34-58874, Investment Company Release No. IC-28476 (Oct. 29, 2008), http://www.sec.gov/rules/final/2008/33-8981.pdf [hereinafter EDGAR Filing Release].
25. EDGAR Filing Release, *supra* note 24.
26. *Id.* at 34.
27. 17 C.F.R. § 270.0-2 (2008).
28. *Id.*

application must contain an explanation of the need for the relief and a legal analysis supporting the application and justifying that it satisfies the statutory requirement for relief. If the relief sought has been previously provided to another applicant, the prior application and order must be identified, and any factual or legal differences must be identified. Any conditions that will be attached to the relief must be identified as well. In October 2008, the Commission adopted a rule requiring all applications to be filed electronically on EDGAR.

Within the Division of Investment Management, the Office of Investment Company Regulation is responsible for reviewing most, but not all, applications. An associate director who supervises two assistant directors and a staff of trained attorneys heads the office. In most cases, a supervisor in Investment Management reviews and assigns the application to one of four branches, and the branch chief, in turn, assigns the application to a staff attorney. The assignment is typically based on the workload in each branch as opposed to the substance of the request or the expertise of the staff attorney. The staff attorney reviews the request and prepares a comment letter to the applicant seeking clarifications or modifications to the application, if necessary.

Once the staff has completed its review of an application, the Investment Company Act requires the Commission to publish a notice in the *Federal Register* outlining the requested relief and giving interested persons an opportunity to object to the application and request a hearing. The notice provides extensive information about the relief requested and the conditions for the exemptive relief. After a notice period of approximately 25 days, an order is issued granting the requested relief, unless a hearing is requested by an interested party or is ordered by the Commission on its own motion.

Federal Register notices are not short, general statements. In the notice, the staff provides a detailed summary of the request, as well as a summary of the applicant's legal reasoning in support of the application. It is not uncommon for a notice to exceed 20 pages. Nonetheless, notices very rarely result in any public comments or hearing requests. If no requests for hearing are received, the staff may approve a routine request pursuant to its delegated authority.

If an interested person requests a hearing on an application or the staff recommends that a hearing be held, the Commission must make that determination. If the Commission orders a hearing on the application, the process may vary. On particularly complex issues, the Commission may assign the matter to an administrative law judge to conduct a full evidentiary hearing and prepare a written opinion. This is an exceedingly rare event.[29] More frequently the

29. Application of TIAA-CREF, Investment Company Act Release No. IC-16235, proceeding instituted Jan. 12, 1988. Settled proceeding concluded Jan.11, 1990, Investment Company Act Release No. IC-17303.

Commission will order a written hearing that consists of a public order identifying the issues to be addressed and invites interested persons to submit written statements. The Commission then issues its order based upon this written record.

E. THE USE OF RULEMAKING TO ADDRESS MULTIPLE ROUTINE EXEMPTIVE APPLICATIONS

A Commission exemptive order is expressly limited and applies only to the applicant. If other entities desire the same relief, each must file its own exemptive application. Even though these applications are routinely granted, preparing and processing "copycat" applications is time-consuming and costly for both the applicant and the staff. As such, while the process is well suited for experimentation, it is an ineffective method of regulation. Accordingly, the division prefers to develop a general exemptive rule to provide the requested relief when it determines that individual applications are not necessary.

For example, in 1999 the Commission adopted amendments to Investment Company Act Rule 15a-4, which deals with changes in control and acquisitions of investment advisers. This change eliminated the need for one of the most common exemptive orders granted at that time. In July 2002, the Commission adopted Investment Company Act Rule 17a-8, which governs mergers of affiliated investment companies. In 2006, the Commission adopted three rules to provide greater investment flexibility to so-called "funds of funds."[30]

One other proposed exemptive rule is pending.[31] In 2003, the Commission proposed a general exemptive rule that would permit mutual funds to retain sub-advisors for the fund without the burden of obtaining a shareholder vote. In the proposing release, the Commission stated that it had issued more than 100 exemptive orders granting this relief. To date, the Commission has not adopted the rule.

For several years, the adoption of exemptive rules to reduce the number of routine applications has been an explicit Commission goal and is identified in the SEC Strategic Plan as a priority initiative. Historically, the process has not been smooth or efficient. In 2006, the SEC inspector general found that as of the end of FY 2005, approximately 24 fund of funds, cash sweep, and multimanager applications were pending (15% of the total exemptive applications pending) that likely would have been unnecessary if the proposed rules had been adopted sooner.[32]

The inspector general identified a structural reason that contributes to this problem. The staff responsible for drafting rulemakings reports to a different associate director than the exemptive application staff. As a result, there may be conflicting priorities, and there is a limited number of attorneys (five attorneys and one branch chief) assigned to rulemaking.

30. *See* Fund of Funds Release, *supra* note 23.
31. *See* Exemption from Shareholder Approval for Certain Subadvisory Contracts, Securities Act Release No. 33-8312, Exchange Act Release 34-48683, Investment Company Act Release No. IC-26230 (Oct. 23, 2003), http://www.sec.gov/rules/proposed/33-8312.htm.
32. U.S. Sec. & Exch. Comm'n, Inspector General Report, IM Exemptive Application Processing (2006), http://www.sec-oig.gov/Reports/AuditsInspections/2006/408final.pdf [hereinafter 2006 SEC Inspector General Report].

This is not a new phenomenon. As Ms. Moriarty pointed out in the Historical Society roundtable, "The first ETF order was granted in 1993, and the rule proposal to codify the ETF applications and orders was proposed in March of this year [2008]."

THE COMMISSION HAS USED THE EXEMPTIVE APPLICATION PROCESS AS THE EXPERIMENT TO PROVIDE EMPIRICAL EVIDENCE FOR A NEW EXEMPTIVE RULE.

There has been a long practice within the division, which I personally think has been healthy and good, to try something. I don't want to call it an experiment, but the division would use the exemptive authority to issue the first ETF order or issue the first amortized cost order, and then sit back, see what happens, and use the order resources in the Commission to pay attention. That is what the division did with the first amortized cost orders; the division used the inspection authority of the Commission to see what the money market funds were doing, and to see if the amortized cost orders were going to work. That way, the division gets its feet wet, the applicant can actually have an experience, and then the division and the applicant can learn from it, among other things, in managing the division's workload. If it turns out that everybody wants an exemptive order to start up a money market fund, the division can end up with hundreds of applications to do what is now codified in Rule 2a-7, and that's just an unreasonable workload for the division. So over time, during different administrations, under different division directors, and under different chairmen, there has always been a focus on trying to find a pattern of applications and then turn them into a rule, which basically outsources the compliance process back to the industry and law firms. Rules 3a-5, 3a-6, 3a-7, and 3a-8 are all examples of finding a way to adopt a rule to get that line of exemptive application off the Commission's workload and allow the industry to police itself.

—Martin Lybecker, SEC Historical Society Roundtable, 2008

F. PROCESSING TIME

Reducing the time to act on exemptive applications has been a goal of Investment Management for more than 20 years. The 1985 Commission release attempted to improve efficiency by setting a forty-five-day goal for staff comments and a sixty-day deadline for applicant responses. In 2006 the SEC inspector general found that only 13 of the 83 non-draft exemptive applications received in FY 2005 received initial comments within Investment Management's guidelines of 45 days.[33] Furthermore, there was a backlog of 160 pending applications at the end of FY 2005, a slight decline from the 177 pending at the end of FY 2004.

During the past two years, the division has again made improved efficiency a priority. The director of Investment Management announced in a speech in December 2007 that the division issued 81 substantive notices in FY 2007, an 84% increase over the prior fiscal year. He also stated, "The median time that applications have been pending dropped from 16 months to eight months over the course of the fiscal year. The staff has also reduced the number of pending applications by more than 25%." In that speech he stated that the new internal goal for

33. *Id.* at 1.

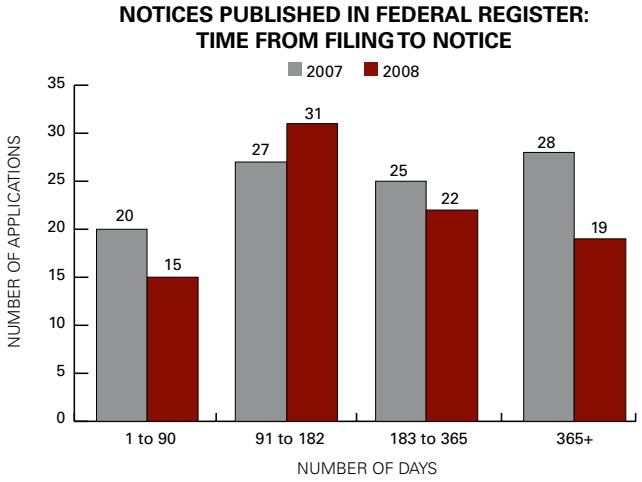
providing comments on an application would be 120 days.

Since 2007, the SEC has posted all exemptive application notices and orders on its Website. This provides the public a simple method of determining what relief may be requested and under what circumstances and conditions. It also provides an opportunity to measure the speed of staff action.

Because each notice lists the date of filing of the application and the filing date of any amendments, it is possible to calculate the lapsed time between date of filing and date of notice publication, as well as the lapsed time from filing and notice to the date when an exemptive order is issued. Based upon our analysis of these filings, it appears that there has been some improvement in processing efficiency. The median lapsed time between filing of an application and publication of the *Federal Register* notice for the application has dropped from 192 days in 2007 to 162 days in 2008. The median lapsed time between filing of an application and the order grant date dropped from 232 days in 2007 to 190 days in 2008.

The time required to review and act on an exemptive application is not exclusively within the control of the SEC staff. And for this reason, responsibility for delays in the process also is a shared burden of the staff and the applicant. Omissions or deficiencies in the application and the quality of the legal analysis submitted by the applicant are major factors in determining whether the application receives prompt action. Investment Management staff rarely rejects an application as clearly deficient. Instead the staff frequently provides extensive comments on applications and requests amendments addressing relevant issues. Occasionally an applicant will be asked to withdraw the application.

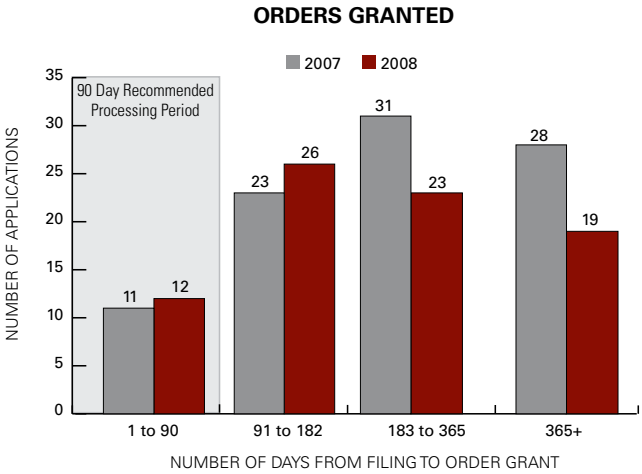
FIGURE A



Data source: www.sec.gov

It should be possible to complete the entire process for reviewing routine exemptive applications in less than 90 days, a dramatic improvement from current practice (see Figure B).

FIGURE B



Data source: www.sec.gov

Data current as of November 2008

The 1985 release states that exemptive applications should be adequately detailed and justified. It describes "clearly deficient" applications as those that do not comply with the Commission's procedural rules or that misstate or lack adequate facts and analysis. The SEC inspector general report in 2006 found some evidence of "clearly deficient" applications:

> We reviewed a judgment sample of 15 comment letters relating to 15 of 154 exemptive applications (excluding de-registrations) filed in FYs 2004 and 2005. Five comment letters requested substantial rewording of the investor protection conditions in the applications. Another comment letter requested substantial rewording of almost the entire application. These types of applications, while not the majority, occupy [Office of Investment Company Regulation] OICR resources that could have been applied to better prepared applications.[34]

Because an exemptive order provides relief only for that specific applicant, many subsequent applications follow the format of the original request and seek similar relief. While these exemptive applications are viewed as routine, the office does not use a triage process to identify routine applications and expedite their processing. Because staff attorneys may be assigned both routine and novel exemptive applications at the same time, some routine applications may take longer than other comparable requests.

In 2002, an internal SEC study calculated the total response time from application date through final Commission order. While 100 of the 238 closed applications (including inactive applications) were closed within 100 days, 57 applications required more than six months. More important, 111 of 214 open pending applications had been open for more than six months. These numbers demonstrate that routine applications, while requiring a significant amount of staff effort, are processed fairly quickly, but the novel and complex applications move through the process at a slower pace.

In some cases, the pace can be exceedingly slow. In the SEC Historical Society roundtable, Ms. Moriarty described the time required for one such order: "The most interesting ETF project, in the Chinese sense of the word 'interesting,' was the ProShares order, which took seven years from start to finish."

III. IMPROVING THE EXEMPTIVE ORDER PROCESS

A. EXPEDITING ACTION ON ROUTINE APPLICATIONS

The exemptive application process is vital to an effective regulatory program. It provides the financial services industry with a vehicle to experiment and innovate in ways unforeseen when the Investment Company Act was passed in 1940. It enables the SEC, as the regulator, to permit such experimentation in a limited and controlled way. The staff is able to fulfill statutory responsibilities in similarly creative ways. It can create and impose unique conditions on the

34. *Id.*

innovator to protect investors and limit adverse consequences to the market. These conditions can be developed through negotiation with the applicant to ensure that the conditions are not so burdensome that the relief is no longer attractive. The statutory notice and comment requirement provides transparency to this negotiated process and enables third parties, including investors and potential investors, to participate in the decision. This is pragmatic and collaborative regulation that has stood the tests of time.

No process is perfect, and improvements are always possible. In an extensive series of interviews with practitioners, including former and current SEC staff, the fundamental effectiveness of the process was confirmed. At the same time, there was a widespread view that the process for reviewing routine applications could be made simpler, with fewer burdens placed upon the staff. The process for reviewing novel or complex applications also could be improved so that an application could be acted upon without many years of review.

It is rare for the staff not to approve a routine application. In fact, it would be a problem if this occurred frequently. As two scholars explained in their treatise, "When another party applies for an exemptive order under similar circumstances, the Commission might be hard pressed to deny the order unless there are good reasons for doing so. Otherwise, the Commission's denial could be deemed to be arbitrary. …The exemptive process is costly and takes time even if the request is routine."[35]

While reducing time, expense, and staff workload are common goals, the recommendations that follow differentiate between changes in the process for routine applications and for novel or complex applications. Simply put, a routine application should never be reviewed and acted upon in the same manner as something new or complex. The recommendations concerning routine applications are fundamentally different from the recommendations for reviewing novel or complex applications.

Alternatives to processing deadlines have been proposed in the past. For example, the thorough and farsighted 1992 staff study identified two possible changes. One alternative would be based upon the way that the Division of Corporation Finance acts on routine securities registration statements from large and established companies. These documents are effective upon filing, with limited or no staff review. While the 1992 study discussed this option, it did not recommend its adoption. There was little support for it in interviews. The second alternative proposed the use of a legal counsel certification that staff could rely upon to make the necessary legal findings required for issuing an exemptive order. As proposed, an expedited procedure would be available for applications containing a certification that it is consistent with the two most recent applications relied on as precedent, the most recent of which was issued within the last two years, and that the application contains all of the same conditions and material representations as the most recent precedential application. Eligible applications would be noticed within 90 days, and an approval order would be issued 120 days after filing. The process would be subject to staff concurrence on eligibility.

35. Tamar Frankel and Clifford E. Kirsch, *Investment Management Regulation*, Carolina Academic Press, at 41 (1998).

While there was support for this recommendation in 1992, it was never implemented. Informally, several persons interviewed indicated that the division on more than one occasion worked on implementation, but other priorities required action and prevented completion of any changes.

In conversations with persons in the private sector, several minor but significant problems were identified with the 1992 recommendation. These included the requirement that counsel certify as to the accuracy of factual representations, rather than legal analysis. Another concern was that its scope was too narrow and would limit the process to only the truly "cookie-cutter" applications. Interviewees suggested that nonmaterial differences among fund groups might prevent many applications, even when the legal analysis required to support the application was the same. The ability of staff to have unfettered discretion to divert an application to the regular process was another problem.

Based in part on these concerns, a modification of this proposal is recommended. The application, filed on EDGAR as a public filing, would contain a full statement of the relief sought, identify past Commission orders that provided comparable relief, discuss any factual differences from prior orders relevant to the application, and provide a legal analysis supporting the application. The application would also discuss the applicability of any conditions imposed in the comparable orders and indicate acceptance of these conditions or explain why the conditions should not be imposed.

Two certifications would be included with the application. The applicant would certify as to the accuracy of the factual representations. Legal counsel would certify that the facts as presented are substantially the same as the previous orders identified, or that any differences identified do not alter the legal analysis supporting the relief requested. Legal counsel would also certify that the facts, taken as a whole, provide a legal basis for the Commission to find that the relief requested is "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Investment Company Act."

The use of a certification of fact from the applicant responds to the concern that legal counsel may not be in a position to independently certify as to facts that form the basis for exemptive relief. The legal certification would not be limited to a representation that the facts are identical to previous relief granted. In practice, this is often difficult and limiting. Instead, legal counsel would provide an analysis of the facts presented compared with the facts supporting previous orders, and explain why any differences in the facts do not affect the ability of the staff to find that the application meets the statutory basis for granting the relief sought.

A critical component of this recommendation is a requirement that applicants file complete and informative applications. To ensure this, the Division of Investment Management should adopt a long-standing practice of the Division of Corporation Finance, the "bedbug letter." The exemptive application process is discretionary and for the benefit of applicants. The division should require applicants to submit a proper application rather than rewrite it for the

applicant through the comment process. Detailed public guidance would be given as to what is required in form and substance for an exemptive application to be acted upon by the staff, with an understanding that applications that do not meet the minimum standards will be rejected.

To ensure that staff discretion to reject an application is not abused, the "bedbug letter" would be required to identify the areas in which the application was deficient, and the letter would be publicly available on EDGAR, as is the practice for comment letters on registration statements and disclosure documents.

Properly filed applications would be included in a weekly summary notice published in the *Federal Register*. This summary notice would be modeled after the notices that the Division of Investment Management issued under the Public Utility Holding Company Act of 1935. Each application would be identified in a one-sentence statement that would identify the relief sought. A hyperlink to the formal application on EDGAR would be included for each item. Access to the full application would permit interested persons to examine the application and determine whether to file a comment or request a hearing on the application.

Under this approach, the staff would not have the burden of drafting a detailed notice. Instead, the staff could focus on preparation of its comment letter to the applicant. The combination of EDGAR filing (or the successor to EDGAR) and a short, weekly summary notice will provide the public the information needed to submit comments or request a hearing and, at the same time, reduce the workload burden on the staff to draft long, detailed public notices.

No later than 30 days after expiration of the public comment period on the application, the staff would be required to take action on the request. Staff would have two options:

Option 1 – If the staff concludes that the application may be granted under its delegated authority and no requests for hearing have been filed, an order granting the request would be issued.

Option 2 – If the staff believes that the request is not "routine," a memo would be sent to the Commission. Several reasons may warrant this action. For example, the staff may decide that the application is materially different from the prior orders cited and not appropriate for routine action. Or the staff may conclude that the application is routine, but that it does not have delegated authority to grant the relief. Or the staff may believe that the application raises

issues that have not been adequately addressed and it is not possible to conclude that the relief is routine. Before the staff submits a recommendation to the Commission, the applicant would be notified and provided an opportunity to withdraw its application.

The Commission would review the memo and either grant the application as routine or determine that the application should be considered under the procedure for non-routine applications, discussed in Recommendation 2.

A requirement that the staff take action on the request within 30 days after expiration of the notice period is necessary to maintain managerial discipline. While some may believe that 30 days is insufficient time, it is important to highlight that it is 30 days following a twenty-to-thirty-day publication and notice period. In fact, the staff will have more than two months from the date of filing to examine the request. If the staff sends the applicant a comment letter that requires an amendment to the application, this will further extend the time for staff review.

It should be possible to complete the entire process in less than 90 days, a dramatic improvement from current practice. Importantly, staff review would be focused not on the period prior to publication of the notice but rather on the period after publication, when it has the benefit of any public comments. As it is rare for these requests to generate public comments, the staff will benefit by being able to focus on those orders that generate legitimate concerns.

If after two or more months, the staff is not persuaded that the request is routine, then it should be able to draft a short memo to the Commission identifying and justifying this concern[36] and recommending that the Commission decline to approve the application or order an administrative hearing on the request.[37]

RECOMMENDATION 1—An expedited process should be created for routine exemptive applications that mirror prior exemptive orders. Applications that contain a factual certification from the applicant and a legal counsel certification that the application is consistent in all material ways with applications previously approved would be eligible for expedited action. A single weekly summary *Federal Register* notice would be published for all eligible filings. The weekly notice would contain a hyperlink to each application included. If no requests for hearing are submitted and the staff has concluded that the certifications in the application are sufficient, approval orders would be issued immediately following the expiration of the notice period.

RECOMMENDATION 2—Incomplete applications would be rejected with "bedbug letters," consistent with published standards explaining the grounds for rejecting deficient filings.

36. At first glance, this might appear to be a substantial new workload for the staff and for the Commission. This does not need to be the case. Currently the Commission considers literally hundreds of memos every year from the Division of Enforcement requesting authority for a formal order of investigation. These memos typically are less than ten pages in length, and the Commission invariably votes in short order. While a memo concerning an exemptive application would inevitably be longer and more complex than a request for a formal order, it would also likely be an uncommon even, with only a small number prepared and submitted annually.

37. While the Commission could order a full administrative hearing before an administrative law judge (ALJ), who would prepare an initial decision, this would not be required. Instead, the Commission could order an administrative hearing in which the applicant, the public, and the staff would submit written statements responding to the specific issues or factual matters in question. These would be reviewed by the Office of General Counsel, which would advise the Commission on final agency action. This process is discussed more fully in the chapter on SEC management and operations.

RECOMMENDATION 3—Internal compliance deadlines should be adopted for staff review and action, and apply to applicant responses or revisions based upon staff comments.

B. EXPEDITED PROCEDURES FOR NON-ROUTINE APPLICATIONS

This procedure would be utilized for exemptive applications that may not be novel or complex but are nonetheless sufficiently different from previous exemptive orders to prevent legal counsel from providing the certification required for the first category. Staff review and processing would be governed by a schedule similar to the 1985 release standards, with modifications.

To encourage applicants to submit high-quality applications, the "bedbug" process would apply. Staff would review applications not rejected for deficiencies and comments issued no later than 30 days after filing. Applicants would be required to adhere to the same deadline. The applicant would be required to respond in 30 days with a draft amended application. While a thirty-day initial review period is substantially more demanding than the current one hundred twenty-day period, it is not unreasonable. In the Division of Corporation Finance, the staff is expected to complete the initial review of registration statements and prepare written comments within 30 days. Also, under this proposal, the staff would be relieved of the burden of preparing lengthy *Federal Register* notices.

This amended filing would be noticed in the weekly summary notice for the standard twenty-five-day period. If no requests for hearing were submitted, the staff would have 30 days to act on the application. Staff options for action would be the same as those for routine applications: approval or submission of an action memo to the Commission recommending an expedited administrative hearing.

C. APPLICATIONS INVOLVING NEW RETAIL PRODUCTS OR SERVICES

In the chapter on SEC management, reorganization of the Division of Investment Management and Division of Trading and Markets is recommended. Under this proposal, a single office would be responsible for action on all new retail products or services offered to the investing public, regardless of whether it is a mutual fund product under the Investment Company Act or a new product or service offered by a stock exchange or broker-dealer regulated under the Exchange Act. A new procedure for expedited conditional review of new products or services is recommended.

D. EXPANDED USE OF EXEMPTIVE RULES

There was substantial agreement among practitioners and SEC staff that the prompt drafting of exemptive rules is preferable to the processing of numerous individual applications for the same exemptive relief. As discussed previously, the SEC inspector general report found that in 2005, 15% of all pending exemptive applications requested relief that would be provided automatically if three pending rule proposals had been finalized.

The impediment to greater emphasis on adopting exemptive rulemaking is the fact that the responsibility for rulemaking is under the authority of a different associate director, who has a limited number of staff and other, higher priority rulemaking assignments. This problem could be solved if the staff responsible for exemptive applications had the authority and the resources to engage in rulemaking that codified routine exemptive relief.

> There was substantial agreement among practicioners and SEC staff that the prompt drafting of exemptive rules is preferable to the processing of numerous individual applications for the same exemptive relief.

It is not unusual for more than one unit within a division to have rulemaking responsibilities. In fact, two offices within the Division of Investment Management have the authority to draft rules. Every office in the Division of Trading and Markets has rulemaking responsibilities for its areas of responsibility. Providing OICR with this authority would eliminate the delays due to higher rulemaking priorities. It would also likely be a more efficient process, as the rule-writing responsibility could be assigned to a person who has processed exemptive applications granting the relief covered and is therefore expert in the relief to be provided and the conditions that must be incorporated into the rule.

RECOMMENDATION 4—Expanding the use of exemptive rules could substantially reduce the number of routine applications. Reassigning rule-writing authority for exemptive rules to the same staff that acts on exemptive applications would eliminate the organizational impediment that historically has hampered the rule development process.

Review and Action on SRO Rule Filings by the Division of Trading and Markets

I. INTRODUCTION

Section 19(b) of the Exchange Act requires each SRO to file proposed rule changes with the SEC, accompanied by a concise general statement of the basis for, and purpose of, the proposed change. The SEC must approve a proposed rule change if it finds that the proposal is consistent with the requirements of the Act and the applicable rules and regulations. SEC approval of an SRO rule change confers implied antitrust immunity.

> SEC OVERSIGHT OF SRO RULES IS THE LEGAL CORNERSTONE THAT LEGITIMIZES THE ASSIGNMENT OF CLASSIC GOVERNMENTAL POWERS TO PRIVATE NONGOVERNMENTAL ENTITIES.
>
> Certain fundamental concepts concerning the relationship between the self-regulatory institutions and the Government stem from the fact that, in important respects, the self-regulatory body is an official arm or delegate of the governmental power. The crucial function of public oversight, vested by Congress in the Commission, involves assuring that the delegated powers are exercised effectively and not in a manner inimical to the public interest…Although governmental oversight of self-regulation is essential, the workability of self-regulation depends also on restraint in the Commission's exercise of its reserve power. The relationship between the Commission and the self-regulatory organizations has at times been referred to as a "partnership" or "cooperative relationship." Under either expression, the roles of the Commission and the self-regulatory agencies are essentially complementary, and the self-regulatory agencies must enjoy such autonomy as will enable them to act as responsible, dynamic partners in a cooperative enterprise.
>
> —*1963 SEC Special Study of Securities Markets*

The rule-filing process under the Exchange Act requires the SEC to examine whether SRO rules and practices are consistent with the Exchange Act and the goals of the national market system, including promotion of fair competition among markets, transparency of prices, best execution of customer orders, fair and orderly markets, and most important, investor protection. SRO rules also must be designed to prevent fraudulent and manipulative acts and practices and promote just and equitable principles of trade. Finally, the public notice

and comment procedure ensures that interested persons have an opportunity to provide input into SRO actions that may have a significant impact on market participants and individual investors.

During the past 10 years, two fundamental changes in the structure of SROs highlight the importance of this process and provoke questions as to its continuing efficacy and impact on the U.S. capital markets. One change is the transformation of stock exchanges from not-for-profit, member-owned entities into demutualized for-profit public companies, competing with each other and competing globally with other capital markets. The second change is the consolidation of most, but not all, traditional regulatory functions into a single regulatory organization, the Financial Industry Regulatory Authority (FINRA). Because of the significance of these changes, some of the persons interviewed for this report questioned whether the SEC should continue to play a regulatory oversight role on SRO decisions that pertain to competitive business decisions, such as the development and pricing of new products or services, given the influence of competition from other SROs and unregulated competitors. Others stressed that the consolidation of regulatory functions into a single entity, FINRA, and the pressure on exchanges to compete profitably and maximize revenue for services, has increased the need for SEC oversight.

This report does not take a position on the competing views. Instead it focuses on how the regulatory process may be performed more efficiently, without diminishing the substantive benefits of government oversight.

II. THE SELF-REGULATORY ORGANIZATION RULE FILING PROCESS

A. COMMISSION AUTHORITY OVER SELF-REGULATORY ORGANIZATIONS

In its original form, the Exchange Act provided the SEC with relatively narrow authority to review and approve SRO rules.[38] Before a stock exchange could be registered, section 6(c) required the SEC to find that the stock exchange's rules were just and adequate to ensure fair dealing and the protection of investors. Once registered, however, under the original section 19, a registered stock exchange was not required to submit its rules to the SEC for review and approval. Instead section 6(a)(4) of the Exchange Act required a stock exchange to file rule changes with the SEC "forthwith on their adoption." SEC authority was limited to amending a stock exchange's rules only if the exchange failed to comply with a written request by the Commission to amend its rules.

The SEC's authority over the National Association of Securities Dealers (NASD), as a national securities association, was substantially greater. Section 15A of the Exchange Act was added in 1938, with the passage of the Maloney Act. Under section 15A, the NASD was required to file its rules and amendments with the SEC 30 days prior to the rule's effective date. The SEC had the authority to disapprove the rule during this thirty-day period. However, contrary to its authority to amend stock exchange rules, the agency's authority to amend NASD

38. *See Federal Securities Exchange Act of 1934*, LexisNexis, 2007. § 2.02[1], for a detailed discussion of the SEC's oversight authority.

rules was limited to "procedural matters."[39]The landmark *1963 Special Study of Securities Markets* recommended eliminating the disparity in oversight between stock exchanges and the NASD by requiring prior SEC review and approval of all SRO rules and rule changes.[40]

While the Commission lacked the authority to require prior review and approval of a stock exchange's rules or rule amendments, it did make an effort to oversee the rules of stock exchanges. For many years this was done informally, with stock exchanges discussing significant planned rule changes with SEC staff. In 1964, the SEC used its general record-keeping authority to require all stock exchanges to file a report of any proposed rule change three weeks prior to final action.[41]

IN 1975, CONGRESS AMENDED THE EXCHANGE ACT TO PROVIDE THE SEC WITH COMPREHENSIVE OVERSIGHT AUTHORITY OVER ALL SRO RULES.

The Committee believes that self-regulation should be preserved in the securities industry, but it also believes that the self-regulatory organizations must display a greater responsiveness to their regulatory obligations and to the need to coordinate their functions and activities. In the new regulatory environment created by this bill, self-regulation would be continued, but the SEC would expect to play a much larger role than it has in the past to ensure that there is no gap between self-regulatory performance and regulatory need and, when appropriate, to provide leadership for the development of a more coherent and rational regulatory structure to correspond to and to police effectively the new national market system … [This Act] is designed to accomplish this, not only by clarifying regulatory responsibility at all levels but also by assuring that the self-regulatory organizations follow effective and fair procedures, that their activities are not anticompetitive, and that the Commission's oversight powers are ample and its responsibility to correct self-regulatory lapses is unmistakable. The intent of the bill is not to diminish the role of self-regulation but to strengthen the total regulatory fabric.

—Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 27 (1975).

1. The Section 19(b)(2) Review Process

As amended, section 19(b) established the requirements for SEC review of all SRO rule filings. Under section 19(b)(2), SROs are required to file with the SEC all proposed rules or rule changes" accompanied by a concise general statement of the basis and purpose of such proposed rule change." The SEC is then required to "publish notice thereof together with the

39. S. COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, SECURITIES INDUSTRY STUDY REPORT OF THE SUBCOMMITTEE ON SECURITIES, S. Doc. No. 93-13, at 172. (1973).
40. U.S. SEC. & EXCH. COMM'N, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, Part 5, U.S. Government Printing Office, at 198 (1963) [hereinafter 1963 SPECIAL STUDY OF SECURITIES MARKETS].
41. The director of Trading and Markets was given delegated authority to waive the three-week requirement.

terms of substance of the proposed rule change or a description of the subjects and issues involved."

Section 19(b)(2) establishes strict time limits for subsequent action by the SEC. The Commission must either approve the filing or institute a proceeding to determine whether to disapprove the rule within 35 days of publication of the proposal. The Commission may extend this deadline up to 90 days from publication if it finds the extension to be appropriate and publishes its reasons for so finding. This deadline may also be extended indefinitely if the SRO consents to the extension. The SEC may not approve a filing sooner than 30 days after publication of the notice, unless it finds good cause for accelerating approval and publishes its reasons for so finding.[42]

If the SEC institutes a disapproval proceeding, the proceeding must be concluded within 180 days of publication of the notice of the filing. The Commission may extend this deadline for an additional sixty days, or for a longer period with the SRO's consent.

2. The Section 19(b)(3) Review Process

Section 19(b)(3)(A) provides an alternative review process for four categories of rule filings:

1. A stated policy, practice, or procedure of an existing rule
2. A rule establishing or changing a due, fee, or other charge imposed by the SRO
3. A rule concerned solely with the administration of the SRO
4. Other matters that the SEC by rule may specify, consistent with the public interest and the purposes of this subsection

Filings under this paragraph are effective upon filing with the SEC. Nonetheless, the Commission must publish these filings for public comment and, within 60 days of filing, the SEC may summarily abrogate the filing and require the SRO to re-file it under section 19(b)(2). Filings are rarely abrogated, as SROs typically withdraw the filing rather than have it abrogated by the division.[43]

While the Exchange Act imposes strict time limits on action by the SEC, these time limits are triggered by SEC publication of a notice of the filing in the *Federal Register*. Significantly, the Exchange Act does not impose a deadline on when the SEC must publish this notice. Also, the Exchange Act provides that an SRO may waive or agree to extend these deadlines. Form 19b-4 contains a block in which the SRO may provide such a waiver as part of its filing.

42. The legislative history of the 1975 amendments anticipated that accelerated approval, eliminating the opportunity for public comment, would be rarely used. *See* H.R. Comm. on Interstate and Foreign Commerce, Report on the Securities Reform Act of 1975, Government Printing Office, at 63 (1975).

43. In 2008, the Division of Trading and Markets, by delegated authority, issued an Order of Summary Abrogation of the NYSE Arca, Inc. filing, File No. SR-NYSEArca-2008-19. *See* Order of Summary Abrogation, *In the Matter of NYSE Arca, Inc.*, Release No. 34-57648 (Apr. 11, 2008), *available at* http://www.sec.gov/rules/sro/nysearca/2008/34-57648.pdf.

3. The Section 19(c) Review Process

Finally, section 19(c) of the Exchange Act provides the SEC with the authority to adopt rules that impose, rescind, or amend SRO rules. In exercising this authority, the SEC must undertake a modified administrative hearing and provide the SRO affected as well as other interested persons the opportunity to submit written statements or oral testimony and respond to submissions. An SEC rulemaking proceeding under section 19(c) must be conducted as a federal rulemaking in accordance with the Administrative Procedure Act (APA).[44] SEC review and action on SRO rules under section 19(b) is considered an administrative action, and the agency process is not subject to the APA rulemaking requirements.

B. SEC RULES GOVERNING THE SRO RULE REVIEW PROCESS

SEC rule 19b-4 contains definitions of the critical terms that establish whether a filing may be filed under sections 19(b)(2) or 19(b)(3)(A). In 1994 the Commission amended this rule to expand the categories of rules that could be filed as effective on filing under section 19(b)(3)(A).[45] The rule expanded the categories of rule filings that would be immediately effective, including rules that do not significantly affect the protection of investors or the public interest or do not impose any significant burden on competition.

While these SRO rules are effective on filing, the SRO must provide the staff with a draft filing five days in advance and must provide that the rule is not operative until 30 days after the date of the filing. The pre-filing requirement was designed to serve as an opportunity for Commission staff to "discuss with the SRO whether there exists an adequate basis upon which the proposed rule change may properly qualify" for immediate effectiveness under rule 19b-4(f)(6), and allows the SRO to "elicit guidance from Commission staff to help the SRO identify those aspects of a proposed rule change that the Commission deems important."[46]

SEC rule 0.3[47] provides that any filing under the Act will be considered to be filed as of the date of filing, provided that all requirements with respect to the filing have been complied with. The staff has interpreted this rule liberally to reject filings that it believes do not

44. 5 U.S.C. §§ 1001–1011 (2008).
45. *See* Proposed Rule Changes of Self Regulatory Organizations; Annual Filing of Amendments to Registration Statements of National Securities Exchanges, Securities Associations, and Reports of the Municipal Securities Rulemaking Board, Exchange Act Release No. 34-35123 (Dec. 20, 1994), *available at* http://www.sec.gov/rules/final/19b4.txt. These changes implemented a staff recommendation contained in the Market 2000 report. U.S. Sec. and Exch. Comm'n, Division of Market Regulation, Market 2000: An Examination of Current Equity Market Developments (Jan. 1994) [hereinafter Market 2000 Report].
46. Commission Guidance and Amendment to the Rules Relating to Organization and Program Management Concerning Proposed Rule Changes Filed by Self Regulatory Organizations, Exchange Act Release No. 34-58092 (Jul. 3, 2008) [hereinafter *2008 SEC release on SRO filings*].
47. 17 C.F.R. § 240.0-3 (2008).

satisfactorily respond to these requirements. In 2004 the Commission amended rule 19b-4 to require electronic filing of SRO rule changes.[48]

In 2001, the Commission proposed Exchange Act rule 19b-6 and amendments to Exchange Act rule 19b-4. Proposed rule 19b-6 would have expanded the categories of proposed rule changes that SROs may designate for immediate effectiveness to include most trading rules (other than fundamental market structure changes). In addition, the rule 19b-6 proposal would (1) require that the SEC publish notice of a proposed SRO rule change within 10 business days of filing or a longer period if the SRO consents in writing; (2) clarify that when SRO rules are effective upon filing, no inference can be made regarding the proposed rule's consistency with the public interest, including whether it has an impact on competition (i.e., effectiveness does not confer antitrust immunity); (3) permit SROs to file proposed rule changes electronically; and (4) eliminate the current five-day pre-filing notice requirement and the thirty-day delayed operational period before a noncontroversial rule change can be filed or become operative.

In 2008, the SEC issued a release announcing major changes to its internal operating procedures for reviewing SRO rule filings.

When the proposal was issued, it received widespread criticism, both from the SROs and from other entities subject to or affected by SRO rules. Certain SROs believed that the proposal provided only minor benefits that were far outweighed by burdensome new requirements, such as concerns about personal liability for a CEO, general counsel, or chief financial officer certifying the accuracy and completeness of each rule filing. Several SROs also expressed concern that the SEC would reject filings as a result of minor deficiencies. Finally, the SROs argued strenuously that rule filings that are effective immediately should receive implied antitrust immunity and objected to the statement in the proposing release that when an SRO rule filing (including a trading rule) becomes effective on filing, the SEC would not make a public interest finding or a finding about the rule's impact on competition. In contrast, market participants generally objected to proposed rule 19b-6 because of concerns that it would not allow for a meaningful opportunity to comment on proposed rule changes, that the Commission would be hesitant to abrogate rules that were effective immediately, that the categories set forth in the proposal were too broad or unclear, or that SROs would have too much discretion or lack sufficient safeguards in filing immediately effective proposed rules.

In 2008, the SEC issued a release announcing major changes to its internal operating procedures for reviewing SRO rule filings.[49] The most significant change requires the staff to publish the *Federal Register* notice for all filings within 15 business days, unless an extension of this deadline is authorized by the Director of Trading and Markets. If an extension is provided, the Commission must be notified and may direct publication. In the release, the Commission provided guidance to encourage SROs to file more rules under the section 19(b)(3)(A) process. Specifically, the SEC identified trading rules (such as rules concerning the protection of limit orders, the obligations of market makers, and rules on order preferencing), "copycat" rules

48. *Proposed Rule Changes of Self-Regulatory Organizations*, Exchange Act Release No. 34-50486, (Oct. 4, 2004), http://www.sec.gov/rules/final/34-50486.htm.
49. *2008 SEC Release on SRO Filings, supra* note 46.

(mirroring other previously approved SRO rule filings), and rules concerning minor rule violations as types of rules that could be filed as an immediately effective rule. The release also rescinded the Commission's delegation of authority to the staff to abrogate rule filings.

C. AUTHORITY OF STAFF PURSUANT TO DELEGATED AUTHORITY

The Commission has delegated to the staff of the Division of Trading and Markets substantial authority to take necessary actions to review and approve SRO filings. This authority includes the decision on whether to accept or reject as improperly filed the initial SRO filing, to determine when to publish the *Federal Register* notice, to decide whether to grant accelerated approval when requested, and the decision to approve the filing. The only significant decision that the Commission has reserved for itself is the decision to order a hearing to determine whether a filing should be disapproved and, if a hearing is so ordered, the final decision on disapproval.

Section 4A, which permits the Commission to delegate its authority, provides that any action taken pursuant to delegated authority may be reviewed by the Commission, either at the request of a single commissioner or upon a petition for review by a person or entity. While the Commission rarely accepts such petitions, in 2007 it accepted a petition for review of a New York Stock Exchange filing concerning fees for "noncore" market data.[50] Commission action on the petition for review is pending as of November 2008.

The statutory procedures for processing SRO filings contain rigid time frames that are rarely adhered to.

D. CURRENT REVIEW AND APPROVAL PROCESS

The statutory procedures for processing SRO filings contain rigid time frames that are rarely adhered to. Instead, the process has evolved into one that is both highly flexible and time-consuming. Because the statutory time limits are triggered by *Federal Register* publication and the division controls that decision, SEC staff can minimize the impact of the time limits by delaying publication. Similarly, an SRO can extend the process by initially providing the filing as an informal draft and engaging the staff in informal negotiations to resolve any issues. An SRO may also extend the process after the official filing by voluntarily agreeing to extend the statutory deadlines. Any amendments to an application will also restart the statutory time frame.

The staff review of an SRO filing is fundamentally different from the disclosure-based review of securities registrations by the Division of Corporation Finance. In its 1994 report, *Market 2000*, the staff described the review process:

> The Division regards with the utmost seriousness its statutory obligations to review proposed rule changes to ensure that they

50. Order Granting Petition for Review and Scheduling of Statements, *In the Matter of NetCoalition*, Exchange Act Release No. 34-55011 (Dec. 27, 2006), *available at* http://www.sec.gov/rules/other/2006/34-55011.pdf.

> comply with the provisions of the Federal securities laws. The Congressional intent expressed in the 1975 amendments was that the Commission would conduct a comprehensive review of a proposed rule change, including the justification for the change, any burden on competition that the change may impose, the impact on the public, and public comments received concerning the rule change. The division attempts to fulfill this obligation by conducting a careful study of every rule filing it receives. This often requires that the Division consider complex and significant issues raised in the rulemaking process.[51]

The review of SRO rule filings is a major responsibility of the Division of Trading and Markets. In 2006 the division reviewed 1,014 filings, and in 2007 it reviewed 1,143.[52] Of the 1,014 rules processed in 2006, 479 were 19(b)(2) rules and 535 were 19(b)(3)(A) rules. Of the 1,143 rules processed in 2007, 511 were 19(b)(2) rules and 632 were 19(b)(3)(A) rules. This workload has increased substantially during the past decade. In 1994, the SEC received approximately 450 filings.[53]

In 2008, an SEC Inspector General report on the SRO rule filing process found that "the Commission did not consistently finalize proposed rule changes within the statutory time frame set forth in the Exchange Act".[54] In a sample of 58 filings, 28 were submitted under section 19(b)(2). The inspector general determined that it took forty-four days on average to publish the *Federal Register* notice for the 13 (of 28) filings that were granted accelerated approval under the rule. The *Federal Register* notice for the remaining fifteen (of 28) filings was published in an average of 67 days. The final approval order for eight of these 15 filings was issued after the thirty-five-days-after-publication statutory deadline for SEC action.[55]

The true measure of delay is often reflected in the time lapses for filings under review without final agency action.

While these statistics suggest considerable delay in the process, they are in fact an improvement over processing times in 2002. An internal study of SRO filings reviewed by the Office of Market Supervision (OMS) during the first six months of FY 2002 found that 58% (70 of 120) of the section 19(b)(2) filings closed during this period were published for notice more than 30 days after the initial filing. Of these, more than half were published more than 90 days after the initial filing. Thirty-two of the filings (24%) were closed more than one year after the initial filing. Processing time of SRO filings by the Office of Securities Processing Regulation (OSPR) was even slower in 2002. Of the 25 filings under section 19(b)(2) examined in the 2002 study, *Federal Register* notices were published for 15 filings between 30 and 90 days after filing, with the remaining 10 filings noticed more than 90 days after filing. Processing time in 2002 for section 19(b)(3)(A) filings was similarly slow. Of 25 filings examined, only seven were completed within 30 days.

51. Market 2000 Report, *supra* note 45, at VI-10.
52. U.S. Sec. & Exch. Comm'n, Office of the Inspector General, SRO Rule Filing Process, at 4 (Mar. 31, 2008), http://www.sec-oig.gov/Reports/AuditsInspections/2008/438final.pdf [hereinafter 2008 SEC Inspector General Report].
53. Market 2000 Report, *supra* note 45, at VI-9.
54. 2008 SEC Inspector General Report, *supra* note 52, at 7.
55. *Id.* at 10.

The true measure of delay is often reflected in the time lapses for filings under review without final agency action. As of December 31, 2007, there were 226 SRO filings in review by the Division of Trading and Markets. Two hundred and two were filed under section 19(b)(2), and 24 were filed under section 19(b)(3)(A). On average the filings had been in review for 229 days, with 115 days the median. The oldest was filed more than four years previously. 64 of the 226 filings were pending more than 180 days from the later of the date of filing or the date of filing the most recent amendment.[56] The inspector general report explained that these delays were not solely the responsibility of the Trading and Markets staff. The report noted that Trading and Markets records indicated that 41 of the 64 were awaiting a response or amendment from the filing SRO.

Again, these statistics represent an improvement from the 2002 study. Of the 178 filings in that survey that were still open at the end of the six-month sample period, 93 (52%) had been pending for more than 180 days after initial filing. Of the 117 filings not yet noticed, 65 (56%) had been pending without notice published for more than 180 days.

The statistics also omit all filings that the SEC staff rejects as not properly filed. This is an informal and ambiguous action. An objective standard for proper filing has never been articulated. Staff merely returns the filing after a phone call. The number of SRO filings rejected as improperly filed is substantial. The Inspector General report found that 127 filings were rejected in 2006 and 138 filings were rejected in 2007 as incomplete or incorrectly filed.[57]

1. Limited Use of Disapproval Hearings

The 1975 amendments to the Exchange Act authorize the Commission to approve SRO rule filings following *Federal Register* notice and opportunity for comment. However, a decision to disapprove an SRO filing may occur only after the Commission has conducted a hearing on the filing.

> The plain language of section 19(b)(2) appears to presume that disapproval hearings would be frequent events, whenever the SEC could not approve quickly, an SRO filing. In fact, the opposite has been the case.

If the Commission determines that it is unable to approve the rule as filed, it must issue an order instituting a proceeding to determine whether to disapprove the filing within 35 days of the *Federal Register* publication date. The disapproval proceeding must be concluded within 180 days of the publication date of the original *Federal Register* notice of the filing. The Commission may extend this deadline for an additional sixty days, or longer with the SRO's consent.

While the Act sets a deadline for completion of the proceeding, absent a waiver by the SRO, the Act provides limited guidance on the specific requirements for such a proceeding. The Senate committee report on the 1975 amendments provides guidance on the lack of specifics: "Section 19(b)(2) would give the SEC sufficient flexibility to fashion a proceeding appropriate to

56. The 2008 SEC Inspector General Report noted that the Division of Trading and Markets records indicated that 41 of the 64 were awaiting a response or amendment from the filing SRO.
57. 2008 SEC Inspector General report, *supra* note 52, at 7.

the particular self-regulatory proposal being considered. In many, perhaps most, situations, notice and an opportunity for public comment would be sufficient, and there would undoubtedly be few, if any, comments. In cases in which fundamental policy issues are involved, however, oral hearings or publicly announced conferences might be most appropriate."[58]

The plain language of section 19(b)(2) appears to presume that disapproval hearings would be frequent events, whenever the SEC could not approve quickly, an SRO filing. In fact, the opposite has been the case. In the 33 years since enactment of the law, the process has been virtually ignored, and there have been very few disapproval hearings. In fact, it was not possible to even determine how many have occurred. One of the few reported cases occurred in 1980, when the SEC disapproved a proposed change in the disciplinary process of the Chicago Board Options Exchange (CBOE).[59] Demonstrating the mutual disinterest in this process, the rule disapproved by the SEC had been enacted by the CBOE membership over the opposition of CBOE management. This peculiar procedural history may explain why a disapproval hearing occurred.

The process for SEC review and approval or disapproval of SRO rule filings is a paradox. The Exchange Act creates an explicit timetable for completion of the process, yet it is rarely followed.

2. Analysis of the Current Process

The process for SEC review and approval or disapproval of SRO rule filings is a paradox. The Exchange Act creates an explicit timetable for completion of the process, yet it is rarely followed. Furthermore, both parties to the process, the SRO and the staff of the SEC, routinely express frustration over delays in the process, without making unilateral changes within their control.

In 1994, the staff of the Division of Market Regulation (now Trading and Markets) published *Market 2000*, a comprehensive analysis of the U.S. equity markets and the regulatory issues that must be addressed. In its discussion of the process for SEC review of SRO rule changes, the report stated, "The SROs have complained that the rule filing process is too lengthy and places them at a competitive disadvantage to PTSs [proprietary trading systems]… which are not subject to section 19(b). The SROs claim that the process hampers their efforts to provide prompt, flexible, and innovative order-entry and trading services to their members and the investing public. …The NYSE [New York Stock Exchange] further recommends that only rule filings that present genuine investor protection concerns should be subject to the pre-effective review process."[60]

These comments from 15 years ago could have been made today. In fact, they closely reflect the opinions expressed in interviews for this report. The only significant difference is that today the competitors include foreign markets, as well as U.S. alternative trading systems.

58. S. Comm. on Banking, Housing, and Urban Affairs, Report of the Securities Act Amendments of 1975, at 30 (Apr. 14, 1975) [hereinafter 1975 Senate Committee Report].
59. *In the Matter of Chicago Board Options Exchange*, Exchange Act Release No. 34-17198, (Oct. 7, 1980).
60. Market 2000 Report, *supra* note 45, at VI-9.

Market 2000 also describes the views of the SEC staff on additional causes of delay. The staff views in that report closely mirror comments received from current staff interviewed for this report: "Generally, the Division finds that the review process is lengthened by three factors: (1) submission of an incomplete Form 19b-4 by the SRO; (2) adverse comment on a proposed rule change; or (3) significant impact on the trading process that could potentially result from a proposed system change."[61]

The continuing pattern of the same concerns raises the obvious question of why nothing is done to change the process. For example, if the SROs believe that the process is too lengthy and places them at a competitive disadvantage, an affected SRO could refuse to waive the statutory deadlines when SEC staff requests a waiver. Similarly, if the SEC staff is concerned about issues raised in comment letters or the potential impact of a change on the trading process, it could recommend that the Commission institute a disapproval proceeding, which would provide a vehicle for obtaining more information.

These questions were routinely raised in interviews with SEC and SRO staff. Specifically, interviewees were asked why waivers are invariably provided when requested, and why hearings are not routinely instituted when difficult issues cannot be quickly resolved. Invariably, both sides provided the same answer—a strong preference for informal, confidential negotiation of the issues, rather than the uncertainty and transparency of a public proceeding that would enable third parties to participate to a limited extent. Interviewees also opined that a hearing involved too much unnecessary work and became a resource problem, both for the SEC staff and the SRO staff. SRO staff also suggested that a hearing would require the use of outside legal counsel and expert witnesses, at considerable expense.

This mutual preference for a negotiated process is interesting, given the recurring comments that the "other side" is largely responsible for the problem. Consider the following anecdotal comments made in interviews:

- SEC staff repeatedly said that some SRO filings are poorly prepared and lack basic information or well-reasoned justifications. SRO staff typically responded that SEC staff often rejects a filing because they don't understand it. They also commented they had no incentive to submit a carefully prepared filing because the SEC staff always rejected the first filing.
- SRO staff occasionally suggested that SEC staff raise issues on filings that are based on lack of familiarity with market operations or concerns about business agendas. A common complaint is that the SEC staff member is a lawyer who lacks expertise in market

61. *Id.*

operations, information technology, or financial economics that is required to understand the proposal. SEC staff responds that filings do not clearly explain the likely impact of a change on market operations and require the staff to do their own research.

- SRO staff believes that the SEC prefers rule changes that mirror other SRO filings, even if the proposal offers a different and superior approach. SEC staff believes that SROs submit alternative solutions to common problems as a form of "regulatory arbitrage," to gain a competitive advantage.

The above comments are anecdotal and it is impossible to assess the accuracy or significance of the complaints, except to say that they are widely shared. The data in the Inspector General report demonstrate that the SEC staff rejects a large numbers of filings as improperly filed and that a significant number of delayed filings are awaiting a response from the SRO. However, both sides could argue that this data supports their views. Without knowing the specific reasons why SEC staff rejected a filing as not properly filed, it is impossible to know whether the SRO submitted an incomplete filing or whether the staff rejected it for other reasons. The same problem exists with assessing delays caused by staff requests for changes in the filing. In both cases, the problem is attempting to analyze a process that—notwithstanding public filing, public notice, and comment requirements—is typically informal and opaque.

Because disapproval hearings are so infrequently ordered, it is also not possible to determine whether the process would be lengthier than the current informal process, would require more work by SEC and SRO staff, or would require an SRO to hire outside counsel or outside experts for a hearing. One must remember, however, that when Congress created the process in 1975, it intentionally did not impose specific procedural requirements for the process. The legislative history explains that this was intentional to enable the SEC to tailor the process to the issues raised in the filing.

Another aspect of the process contributes to the preference for informal negotiations. That is the complex, and occasionally conflicting, roles that the SEC staff and SRO staff play. On the one hand, when the SRO submits a rule filing to the SEC, the staff must perform a quasi-adjudicatory function, balancing the interests of the SRO with the interests of investors, member firms, and other competitors, including regulated and unregulated entities. At the same time, the staffs of the SEC and the SRO are joint regulators, working together on mutual interests. It can be difficult to separate these functions. Further complicating the relationship is the potential for SEC enforcement action against an SRO for violations of the Exchange Act or the SRO's own rules.

Another factor complicating the review and approval process is the broad regulatory principles that must be considered under the statutory standard for making a decision. The application of these broad, complex, and occasionally conflicting principles often involves difficult judgments. Some of these principles are clear. For example, SRO rules must promote "just and equitable principles of trade" and "protect investors and the public interest." Other principles are sometimes difficult to apply. For example, SRO rules must "remove impediments to and perfect the mechanism of a free and open market and a national market system," and these rules may not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title."

The problem confronting SEC staff applying these ambiguous standards to new products, trading mechanisms, or rules of conduct is the same problem confronted by SEC staff reviewing exemptive applications or considering requests for no-action letters. The consequences of making a difficult judgment that results in an unforeseen and undesirable outcome always outweigh the rewards of prompt, correct action. In fact, it could be argued that the SRO filing decision is more difficult. The legal standard is more complex. It may involve balancing tests such as deciding if a burden on competition is necessary or unnecessary. It may affect many groups with overlapping or competing interests.

The Supermontage proposal filed by NASDAQ in 1999 is an example of the delays that occur when an SRO proposes something innovative, the conflicting interests of different segments of the industry that must be considered and balanced, the difficulty in applying statutory principles that may be in conflict, and the competitive consequences to the SRO of a long regulatory review process. The original 1999 filing was amended nine times, reflecting an extensive series of informal negotiations between NASDAQ and the SEC. It was finally approved more than 15 months later.[62]

The difficulty in balancing significant competing interests and the delays that result is apparent in the ongoing Commission review of an NYSE Arca filing proposing a schedule of market data fees for so-called noncore market data. The filing was initially made as a 19b-4 routine filing on May 23, 2006, and the notice for comment was published on June 9, 2006. Following receipt of six comment letters, the application was approved by the staff by delegated authority on October 12, 2006. A petition requesting Commission review was filed on November 6, 2006, and on December 27, 2006, the Commission issued an order granting the petition for review and permitting additional comments by other parties. In June 2008, the Commission took the unusual step of publishing for comment a proposed order granting final approval of the 2006 application.[63] In that order, the Commission noted that 32 comments were filed on the matter. The Commission continues to review this application, more than two years after it was originally filed.

The unavoidable conclusion is that several factors contribute to the delays in this process. These include the complex relationship between an SRO and the SEC, which is simultaneously arms length and collaborative; the broad and ambiguous legal standards that govern the decision; the complexity of the U.S. capital markets and the enormous structural changes that are ongoing; and the broad and diverse groups that are affected by a single proposal. Finally, one must recognize that while the review and approval process is a legal procedure, a correct decision may often be based upon economic or technical questions, requiring a different expertise.

H. L. Mencken once wrote that for every difficult and complex problem there will be a simple and obvious solution. And that solution will be wrong. This comment clearly applies to

62. Order Granting Accelerated Approval of Amendment No. 9 Relating to the Establishment of the Nasdaq Order Display Facility and Order Collector Facility and Modifications of the Nasdaq Trading Platform, Exchange Act Release No. 34-43863 (Jan. 19, 2001), http://www.sec.gov/rules/sro/nd9953o.htm.
63. Notice of Proposed Order Approving Proposal by NYSE Arca, Inc., Exchange Act Release No. 34-57917 (June 4, 2008), http://www.sec.gov/rules/other/2008/34-57917.pdf.

the problem of improving the efficiency of the SEC process for reviewing SRO filings. The simple and obvious solution of strict processing deadlines has not worked. Congress tried this in 1975 when it amended the Exchange Act and specified deadlines. Since 1975, virtually every Chairman of the SEC has instructed the Division of Market Regulation/Trading and Markets to "clean up the backlog," with limited long-term impact.

Similarly, the obvious solution of applying an "effective on filing" process for routine filings has not been entirely successful. Eliminating SEC oversight of all SRO rule changes that do not involve issues of investor protection or restraints on competition or restraints on access to services may be facially appealing, but it has limitations as well. The Commission attempted to do just that when it amended rule 19b-4 in 1994 and attempted to expand the exclusion when it proposed rule 19b-6 in 2001.

The theme of these recommendations is that delays are not caused by a lack of resources, too much bureaucracy, or the lack of deadlines. Instead, delays reflect the complex relationship that will always exist between the SEC and the SRO, the ambiguity and subjective nature of the standards that affect a decision, and most important, the informality and opacity that define the current process.

The comments opposing adoption of rule 19b-6 clearly identify the limits of this approach. It is often difficult to determine if a rule raises investor protection or competition issues. An effective-upon-filing process may not provide an SRO with a defense under antitrust laws or may expose SRO officials to personal liability. There are too many competing groups of market participants that may be directly or indirectly affected by the change, and balancing these issues is a core responsibility of the SEC that should not be eliminated through an automatic process, even one that provides for an after-the-fact abrogation process.

For these reasons, the recommendations that follow are nuanced proposals designed to fine-tune the existing procedures. The theme of these recommendations is that delays are not caused by a lack of resources, too much bureaucracy, or the lack of deadlines. Instead, delays reflect the complex relationship that will always exist between the SEC and the SRO, the ambiguity and subjective nature of the standards that affect a decision, and most important, the informality and opacity that define the current process. The recommendations that follow are based upon two of the traditional themes of SEC regulation: disclosure and transparency. In addition, one recommendation is a resource proposal that reflects the reality that a correct decision by the SEC must reflect conformance with the law and must also be based upon an analysis of the technological and economic issues raised in the filing. It is based upon an approach used in the Division of Corporation Finance.

III. IMPROVING THE SRO RULE FILING PROCESS

A. FINE-TUNING THE JULY 2008 INITIATIVE

In July 2008, the Commission issued its release announcing voluntary changes to the internal processes of the Division of Trading and Markets. The most significant change was the creation of a fifteen-business-day deadline for publication of *Federal Register* notices, triggered by the filing date. While it is too soon to assess the lasting significance of the change, it appears to have had a positive impact. Based upon the filings posted on the SEC Website, it appears that the staff is making a conscientious, and generally successful, effort to meet this deadline.

This same approach should be applied to another step in the process, when the SRO submits a filing and the staff rejects it as not properly filed. This is a continuing source of disagreement between the SEC staff and SRO staff. During the interviews for this report, there were suggestions that following adoption of the fifteen-day publication deadline, the staff is rejecting a greater number of filings, sometimes because the staff is reluctant to quickly publish a proposal that it views as complex and requiring informal discussion. It was not possible to assess whether these comments are valid or whether this is a frequent or infrequent event. However, it is revealing that around 12% of SRO filings are rejected annually as improperly filed, even though the SROs preparing and submitting the filings are knowledgeable and experienced.

The division could address this concern by publishing a standard articulating the appropriate grounds for rejecting a filing as improperly filed. The division should also require its staff to send a rejection letter to the SRO identifying which items on Form 19b-4 are deficient. This recommendation would not require the staff to prepare a detailed analysis of the deficiencies, which would defeat the purpose of a rejection. However, documenting the items that are deficient would assist the SRO in resubmitting a complete form. If these rejection letters are also published on the SEC Website or on the SRO Website, they would provide useful information to other SROs, which might improve the general quality of filings.

Another aspect of the process in which informality contributes to delay is the requirement that an SRO must submit a draft five days before it files a proposal that will be effective upon filing. While this process may have been useful initially to ensure that the SRO staff and the SEC staff were in agreement on the application of the rule, after 14 years of experience, there should not be continuing uncertainty. The disadvantage of the pre-filing process is that it is opaque. It is also unnecessary. Staff has the ability to reject a filing as improperly filed, and, as these filings do not become operational for 30 days after filing, there is ample time for the staff to abrogate a filing and require refiling under the 19(b)(2) process. Rule 19b-6 proposed in 2001 would have

eliminated the pre-filing requirement. Under this approach, there might be more frequent use of the abrogation process. Thus, it would be beneficial for the Commission to re-delegate abrogation authority to the staff.

Another practice that appears to contribute to delay is the excessive reliance upon SRO waivers of the statutory deadlines. Form 19b-4 contains a box for the SRO to consent to waive application of deadlines in the initial filing. While this does not routinely occur, SRO staff interviewed confirmed that they routinely consent to a waiver whenever the SEC staff requests one. SRO staff described this as a general policy to avoid conflict or as a professional courtesy. Once again, the informality of this process and the implicit desire of SRO and SEC staffs to work collegially contribute to delay. While there will be occasions when consideration of a filing will require more time than the statutory deadlines provide, necessitating an extension of time, this should be the exception rather than the norm.

The July 2008 Commission release concerning a solution to the related problem of delays in publication of the notice could apply here. SEC staff should be required to request permission from a senior official prior to requesting an extension from the SRO. This request should be written and clearly articulate why additional time is needed.

There is, of course, a danger in escalating so many interim processing decisions to the division director. A division director has too many other responsibilities to devote significant time to considering the merits of requests for extensions of time. For this reason, it may be preferable to designate one senior official in the division as responsible for approving these requests. For this to be effective, the designated official should not be the supervisor of the staff reviewing SRO filings and should be evaluated on successfully managing the process.

RECOMMENDATION 1—In 2006, 127 filings (12.5%) were rejected, and in 2007, 138 filings (12%) were rejected by the SEC staff as incomplete or incorrectly filed. These high rejection levels demonstrate that a problem exists. The division should formulate a standard articulating the grounds for rejecting a filing as improperly filed. The division should also require its staff to send a rejection letter to the SRO identifying which items on Form 19b-4 are deficient.

RECOMMENDATION 2—Waivers of statutory time limits should be the exception, not the norm. All requests for waivers of statutory deadlines should require senior-level approval and should be time limited.

RECOMMENDATION 3—The five-day pre-filing requirement should be eliminated.

RECOMMENDATION 4—The Commission should re-delegate to the staff the authority to abrogate SRO filings.

B. THE SEC SHOULD UTILIZE THE STATUTORY HEARING PROCESS CREATED BY CONGRESS

In 1975, Congress gave the SEC the responsibility to review and approve SRO rules and rule changes. The 1975 amendments identified a complex series of standards to govern SEC approval decisions. The legislative history of the 1975 amendments repeatedly refers to the responsibility of the SEC to balance these competing interests.[64] Possibly because of the difficulty in balancing multiple goals and the interests of many different groups, the amendments created a simple hearing process to be used whenever the Commission found itself unable to approve an SRO filing.

An administrative hearing process is well suited to resolving complex questions that require balancing competing interests and competing parties. In this regard, it is significant that Congress provided the Commission with flexibility in structuring this process. While it would be possible to order an evidentiary hearing before an independent administrative law judge, this is not required. If appropriate, the process could be simply an order for a disapproval proceeding that specified the issues to be considered and the time period for responding. Any interested entity could submit its views and respond to the positions advanced by others.

Because section 19(b)(2)(B) of the Exchange Act refers to a "hearing" rather than a hearing "on the record," the procedural requirements of the APA likely do not apply. This provides the SEC with even greater flexibility, as there is no need to create a "Chinese wall" within the Division of Trading and Markets to satisfy the APA separation-of-functions requirement. Of course, if the Commission believed that the quality of the decision-making process would be improved by a separation of functions, this could be achieved easily by assigning the adjudication role to the Office of the General Counsel.

A disapproval proceeding should never become the norm whenever the review process exceeds the thirty-five-day period in the act. Simply put, the number of filings where disapproval is a possibility is probably quite small. However, the existence of a meaningful deadline would undoubtedly motivate all parties to resolve disagreements. Under the Act, the thirty-five-day deadline to institute a proceeding may be extended to 90 days. This might be an appropriate motivational deadline.

RECOMMENDATION 5—The SEC should order hearings on SRO filings that raise complex issues that cannot be resolved following the notice and comment period. Division staff should have responsibility for review of all papers submitted in response to the order for hearing and for submitting a recommendation to the Commission. An administrative law judge should be assigned only for exceptionally complex matters.

64. *See, e.g.*, 1975 Senate Committee Report, *supra* note 58, for a discussion of the "Elimination of Unnecessary Regulatory Restrictions."

C. THE SEC SHOULD CREATE AN OPTIONAL CONDITIONAL APPROVAL PROCESS TO ENCOURAGE SRO INNOVATION

There is a great deal of similarity between an SRO filing to create a new product or service and an exemptive application seeking regulatory relief needed to offer a new product or service. In both cases, the staff must confront the difficult problem of analyzing the legal issues posed by something that does not yet exist. Given the difficult balancing of competing factors required for approval of SRO filings, it is not surprising that new ideas may be subjected to a review process lasting more than a year.

In the management section, a new procedure is recommended that could be used for action on SRO filings concerning a new product or service as well as applications to Investment Management for exemptive orders pertaining to a new product or service.

D. THE DIVISION SHOULD IMPLEMENT A DUAL REVIEW PROCESS

The Division of Corporation Finance uses a dual reviewer system for securities registration statements. An attorney reviews the legally required disclosures, and an accountant reviews the financial statements. The Division of Trading and Markets should adopt the same approach. An attorney would review the filing to ensure that it addresses all legal requirements, and a technical examiner would consider the adequacy of the description of the impact of the rule change. As noted previously, the statutory factors that the Commission must consider under the Exchange Act are broad and can be in conflict, requiring a careful balancing of interests. An effective review cannot be based solely upon legal analysis. One must understand how the change will affect the overall operation of the market or how it will likely be implemented by member firms or entities. This requires industry expertise that a lawyer may not possess.

The chapter on management in this report recommends a program to augment the current staff with industry professionals who could provide this critical expertise. This is an example of how these trained professionals could be best used.

SEC Staff No-Action Letters

I. INTRODUCTION

Since its inception in 1934, the SEC, through its divisions and offices, has routinely provided informal guidance and administrative interpretations of the securities laws and the regulations to members of the public, prospective registrants, and others. This informal assistance has been used to provide clarity on the applicability of the securities laws and SEC regulations to particular situations and to assist the public in complying with the law.[65] While the SEC has been criticized occasionally for its frequent use of informal guidance to create a body of "informal regulations," informal guidance has become an important vehicle for advising the public and regulated industries of SEC staff positions and interpretations. The challenge is creating and implementing informal processes that provide prompt and useful guidance without overstepping boundaries and creating or altering regulatory policy.

For an agency that is often criticized for "regulating through enforcement," regulatory procedures that promote prophylactic compliance are an essential complementary function to effective enforcement. This chapter focuses on the use of no-action letters, the current processes for requesting and receiving a no-action letter, variations among the SEC's office and divisions, and concerns about the continued vitality of the process. The recommendations are designed to reinvigorate the no-action letter process by making it faster and less costly to the SEC and the requestors, while retaining its informality. The recommendations also propose changes to ensure that policy remains the responsibility of the five-member Commission. One recommendation is made to address concerns expressed about the number of staff informal guidance processes.

For an agency that is often criticized for "regulating through enforcement," regulatory procedures that promote prophylactic compliance are an essential complementary function to effective enforcement.

II. THE NO-ACTION LETTER PROCESS

A. NO-ACTION LETTERS ARE ONE OF MANY TYPES OF SEC INFORMAL GUIDANCE

Staff no-action letters are the best known of the SEC's informal guidance procedures. The term "no-action letter" is derived from the standard sentence that is typically either the

65. 17 C.F.R. § 202.2 (2008).

first or last sentence in any staff response to a request for guidance: "Based on the facts presented, the Division will not recommend enforcement action to the Commission." The staff's letter is a response to a specific inquiry seeking advice, interpretations, opinions, and, most important, assurances that no enforcement action will be recommended to the Commission in regard to a particular transaction, disclosure requirement, or method of achieving compliance with an SEC rule.

SEC staff uses many other methods to provide informal guidance to persons and entities on the correct interpretation of and compliance with the federal securities laws and the regulations adopted by the SEC.

FORMS OF SEC STAFF INFORMAL GUIDANCE

1. Staff interpretive letters—In an interpretive letter, a Division interprets a specific statutory provision, rule or regulation in the context of a factual situation described in the request.[1] While the Commission has periodically attempted to articulate a distinction between a no-action letter and an interpretive letter, in practice this distinction has often tended to blur. As one former SEC staffer, who personally authored many no-action letters, wrote "it is often difficult to characterize a response definitively as either no-action or interpretive, especially because many, if not most, 'no-action' letters invariably involve interpretations of the law."[2]

2. Staff Accounting Bulletins (SAB) and Staff Legal Bulletins (SLB)—The Office of the Chief Accountant, in conjunction with the relevant operating division, issues Staff Accounting Bulletins expressing the staff's views regarding accounting-related disclosure practices.[3] Since the first SAB was issued in 1975, OCA has issued 110 SAB's. A list of SAB's issued since 1980 is published in the *Code of Federal Regulations*.[4] Beginning in 1997, the Commission's staff has also sporadically issued Staff Legal Bulletins. They represent interpretations and policies followed by the issuing office or division. SAB's and SLB's explicitly state that they contain the views of the Commission's staff and are not approved or disapproved by the Commission itself. In fact, the standard practice at the SEC is for the five members of the Commission to review informally each bulletin prior to release.

3. Frequently Asked Questions (FAQ)—Following the adoption of a new regulation, the staff of the responsible division receive a wide array of questions concerning the proper interpretation of the rule. Since the late 1990's, the staff has typically compiled the most frequently asked questions and the staff's responses into a single document and made it available on the SEC Website.[5]

4. Compliance and Disclosure Interpretations—For many years the Division of Corporation Finance periodically issued compilations of its standard answers to telephone calls seeking explanatory

1. Securities Act Release No. 33-7407, at 10 (Mar. 27, 1997).
2. Thomas P. Lemke, *The SEC No-Action Letter Process*, 42 Bus. Law.1019, 1020 (August, 1987).
3. *See,* Notice of Institution of a Series of Staff Accounting Bulletins, Securities Act Release no. 33-5640 (Nov. 4, 1975).
4. 17 C.F.R. § 211, Subpart B.
5. *See, e.g.,* the staff's FAQ on the Sarbanes-Oxley Act, *available at* http://www.sec.gov/news/press/2003-94.htm.

information, "telephone interps." Originally, these were non-public references available only to the staff of the Division.[6] Since 1984, these compilations have been public and are available on the SEC Website. Recently the Division has begun a systematic updating of these interpretations and has compiled them as "Compliance Disclosure Interpretations." They are available on the SEC Website, with a disclaimer that "these responses are intended as general guidance and should not be relied on as definitive. There can be no assurance that the information presented in these interpretations is current, as the positions expressed may change without notice."

5. Staff speeches—The public views of senior staff of the SEC are closely examined for insight into the priorities of the agency, the issues of concern and upcoming initiatives. Not infrequently these speeches are also used as opportunities to provide guidance to the industry on regulatory compliance and new interpretations of existing regulations. For example, in a recent speech the Director of Corporation Finance expressed views on the applicability of the Treasury Department's Troubled Asset Relief Program (TARP) requirements on executive compensation for participating financial institutions to nonparticipating companies under the Commission's executive compensation rules.[7] At one time, this practice suffered from inadequate or selective disclosure of the remarks. This problem has been eliminated with the posting of staff speeches on the SEC Website.

6. Staff comment letters on filed documents and staff summaries of comments—Reviewing filed securities registration statements and periodic filings represents the greatest regulatory responsibility of the Division of Corporation Finance. Typically, when the staff review a registration statement (or a periodic filing), they prepare a comment letter requesting additional information, clarification or even amendment of the document. Historically, these letters were considered non-public documents and were available only pursuant to a FOIA request. Beginning in 2004, the Commission changed its policy and now makes these comment letters publicly available on EDGAR, approximately 45 days. Additionally the Commission has begun a practice of periodically compiling its comments on a particular subject and publishing a staff summary to inform others.[8]

7. Staff Reports—The staff of the Commission occasionally undertakes detailed examinations of a particular regulatory issue that has become nationally significant. Frequently a staff report is issued that contains the staff's findings and analysis. In some cases these report conclude with recommendations for future Commission action or recommendations on best practice compliance by regulated entities. In virtually every case, these reports are carefully reviewed by the sitting Commissioners. However the report is issued as a staff report, with a disclaimer that it does not represent the official views of the Commission.[9]

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6. The decision to make these interpretations public followed a Freedom of Information Act request submitted by a former director of the Division of Corporation Finance.
7. Speech by Division of Corporation Finance Director John White, October 21, 2008, *available at* http://www.sec.gov/news/speech/2008/spch102108jww.htm.
8. *See, e.g.,* Staff Observations in the Review of IFRS Financial Statements (July 2, 2007), *available at* http://www.sec.gov/divisions/corpfin/ifrs_staffobservations.htm.
9. *See e.g.,* Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies (July 8, 2008), available at http://www.sec.gov/news/studies/2008/craexamination070808.pdf.8, 2008 and *available at* http://www.sec.gov/news/studies/2008/craexamination070808.pdf.

8. Small Entity Compliance Guides—In 1996, Congress enacted the Small Business Regulatory Enforcement Fairness Act (SBREFA), which directed federal agencies to improve the regulatory climate for small entities by, among other things, to expand efforts to provide formal and informal guidance to small entities.[10] These guides "summarize and explain rules adopted by the Commission, but is not a substitute for any rule itself. Only the rule itself can provide complete and definitive information regarding its requirements."[11]

9. Telephone calls to the staff—Oftentimes the simplest method of requesting and receiving informal guidance is by making a telephone call. Each SEC division has an established procedure for providing information over the phone and answers literally thousands of calls annually. In Corporation Finance there is a voice mailbox for the Chief Counsel's Office, and other key support offices.[12] The public may leave a voice mail question and it will be assigned to a knowledgeable staff member who is expected to respond within 24 hours. In Investment Management, responding to telephone inquiries is a duty that is rotated among a group of experienced staff. Each is assigned one day of "telephone duty" to answer that day's questions, either directly or by requesting assistance from another member of the staff. Trading and Markets has an Office of Interpretations and Guidance (OIG) that is responsible for responding to phone and e-mail questions from market participants. Each division has an internal policy on the types of questions that may be answered orally.

10. The SEC program is first described in a Commission policy statement entitled *Informal Guidance Program for Small Entities*. Securities Act Release No. 33-7407 (Mar. 27, 1997).
11. *See, e.g.*, Amendment to Eliminate the Options Market Maker Exception in Exchange Act Rule 203(b)(3) of Regulation SHO — A Small Entity Compliance Guide, available at http://www.sec.gov/divisions/marketreg/tmcompliance/rule203b3-secg.htm.
12. In November 2008, Corporation Finance created a procedure for submitting email questions through the SEC Website.

B. THE ROLE OF NO-ACTION LETTERS IN SECURITIES REGULATION

A law review article discussing the role of SEC no-action letters began with this quoted dialogue between noted administrative law scholar Kenneth Culp Davis and legendary former SEC Chairman Manuel Cohen: "Davis contended that 'some of the most important law of the SEC is embodied in a big batch of no-action letters. This is law. The interpretations are law.' Manuel Cohen, then Chairman of the Securities and Exchange Commission, objected vehemently to this characterization and retorted that the SEC's bevy of no-action letters 'may be lore, l-o-r-e, but it is not law.'"[66]

Professor Davis's opinion is shared by most securities law practitioners. Chairman Cohen's response is not. In fact, one could argue that it did not even reflect his personal opinion. Cohen served in the Division of Corporation Finance for most of his career prior to becoming a Commissioner and then Chairman. In Corporation Finance he was personally responsible for many significant no-action letters.[67]

66. Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 Cornell L. Rev., 921, 923 (1998).
67. In fact, one former Corporation Finance staffer suggested that the decision to make no-action letters public was driven in part by the disappearance of numerous letters from the Corporation Finance files when Cohen left the division to become a Commissioner. Since the decision to make these letters public occurred almost ten years after Cohen became a Commissioner, this is probably hyperbole.

As a purely legal matter, Chairman Cohen was correct. Under the APA, a rule is defined as "an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[68] Because a no-action letter represents the views of the staff, it is not an agency statement. Except on rare occasions, such as when the Commission expressly adopts a no-action position in a Commission release, it does not have the imprimatur of the Commission.

Throughout the history of the SEC, the ability of the financial services industry and public companies to solicit informal guidance from the staff on the correct interpretation of the securities laws and regulations and on its applicability to new financing transactions, disclosure of emerging developments and satisfactory regulatory compliance methods has been cited as a strength of the SEC.[69]

While specific no-action letters do not represent the views or endorsement of the Commission, historically the process has received Commission endorsement. There is, in fact, an SEC rule on "informal procedures." Paragraph (c) of rule 202.1 states the following:

> The informal procedures of the Commission are largely concerned with the rendering of advice and assistance by the Commission's staff to members of the public dealing with the Commission. While opinions expressed by members of the staff do not constitute an official expression of the Commission's views, they represent the views of persons who are continuously working with the provisions of the statute involved. And any statement by the Director, associate director, assistant director, chief accountant, chief counsel or chief financial analyst of a division can be relied upon as representing the views of that division.[70]

However, the process has been subject to criticism as well. Some have argued that the guidance in no-action letters occasionally is not restricted to specific nonbinding staff views. Instead, the staff sometimes extends a no-action letter to include statements of policy or general applicability that should be addressed by rule under the APA, after notice and comment. These critics suggest that the use of no-action letters represents usurpation by the staff of the responsibilities of the Commission.[71]

SEC staff no-action letters evolved from "opinion of counsel" letters that the SEC staff began issuing in 1936, but that actually predate the creation of the SEC.[72] In its earliest form, an SEC staff opinion of counsel letter was an explicit statement of legal interpretation by the staff. Gradually these letters evolved into a more neutral statement—the staff's view that it would

68. 5 U.S.C. § 551(4) (2008).
69. Nagy, *supra* note 66, at n.45. The Commission's willingness to allow its staff to render informal advice has been commended as an "excellent practice in administrative procedure." (citing Task Force on Legal Serv. & Proc., Commission on Org. of the Executive Branch of The Gov't, Report on Legal Services and Procedures, 189 (1955)).
70. 17 C.F.R. § 202.1 (2008).
71. While the Commission may delegate to its staff a wide range of responsibilities, Section 4A of the Exchange Act prohibits the Commission from delegating the rulemaking function. 15 U.S.C. § 78d-1 (2008).
72. *See, e.g,* the opinion letter interpreting section 11 of the Securities Act, issued on September 5, 1933, and signed by Baldwin Bane in his position as chief of the Securities Division of the Federal Trade Commission. SEC Release No. 33-45.

not recommend that the Commission take enforcement action based on the facts and circumstances described in the incoming letter. Not only does the staff's response rarely provide an explicit legal analysis or even concurrence with the legal analysis submitted by the requesting party, at various times the staff's response has been little more than a single sentence that refers to the analysis contained in the incoming letter. As one commentator explained, a no-action letter was viewed as a more flexible process.[73]

In keeping with the informal nature of the request, no-action letters began as nonpublic documents. In 1970 this changed. Following public notice and a request for comment, the SEC adopted rule 81, making these letters public.[74] Initially there was a thirty-day delay in public issuance. However, the Commission abandoned this delay in 1988.

The process, form, and content of no-action letters has evolved, or oscillated, over the years from highly informal and succinct to formal and detailed. For example, in 1980 the Division of Corporation Finance issued a release announcing that instead of a detailed response to incoming letters, it was adopting the "short form" yes-or-no approach that the Division of Investment Management used. In later years, the various divisions shifted back to more fulsome responses, including detailed analyses of the issues raised, particularly when the letter is intended to provide general relief to a category of entities instead of a single entity.[75]

Even the willingness of a division or office of the SEC to provide a no-action letter has varied. For example, in 2007 the Division of Corporation Finance posted 69 no-action or interpretive letters on the SEC Website. Contrast this volume with the statement in the 1980 release on no-action letters that "the Division annually issues more than 1000 such letters, and the letters commonly are four or more pages in length."[76]

These changes in practice frequently are influenced by changes in division director or senior staff or by changes in SEC Chairman. Under one former Chairman, the staff was informally advised to greatly restrict the use of no-action letters. Another Chairman supported the use of more generic forms of staff guidance, such as staff legal bulletins (SLBs) or answers to frequently asked questions (FAQs).

While most, but not all, letters explicitly limit the guidance to the facts and circumstances described in the incoming request, the reality is that participants in the financial markets and their advisors, such as lawyers and accountants, typically regard staff no-action letters as definitive guidance that can be relied upon as Commission "common law."

Historically, courts have not accorded staff guidance the same deference or respect. It is well established that a court is not required to afford a published staff interpretation the same deference that is given to an interpretive position issued by the Commission itself, particularly if the Commission statement followed a notice and comment process. Not infrequently, courts

73. Thomas P. Lemke, *The SEC No-Action Letter Process*, 42 *Bus.* Law., 1019, 1020 (1987).
74. Securities Act Release No. 33-5098 (Oct. 29, 1970). Rule 81 is codified as 17 C.F.R. § 200.81 (2008).
75. *See, e.g.,* FINRA, SEC No-Action Letter (Feb. 19, 2008) (Response letter from the Division of Trading and Markets granting request for no-action relief from Rule 17a-4 for certain form filings made on Web CRD), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/2008/finra021908.pdf.
76. Securities Act Release No. 33-6253, at n. 5 (Oct. 28, 1980), *available at* http://www.sec.gov/rules/interp/33-6253.pdf.

have considered the staff's analysis contained in the no-action letter, and to the extent that the analysis is sound and well reasoned, have adopted it. However, when courts interpret a statutory or regulatory position differently, they do not view a contrary staff interpretation as limiting or directing the analysis. This is true even on occasions when the Commission subsequently acknowledged or embraced the staff's view, but did not explicitly transform it into a Commission statement.

C. SUBSTANTIAL VARIATION EXISTS IN THE PRACTICES OF THE DIFFERENT DIVISIONS OF THE COMMISSION

There are certain general principles that all offices and divisions of the SEC uniformly apply to requests for no-action letters. These include requirements that the request be in writing,[77] that the requesting parties must be identified, that the factual predicate must not be a hypothetical question, that the request not be a routine or obvious issue, that the letter concern prospective actions rather than ratification of an action already taken, and that the request not pertain to or entail parties or questions that are the subject of an open Enforcement inquiry or investigation.

Generally each division attempts to review no-action requests on a first-in, first-out basis, but this is rarely the result. Some letters are inherently time sensitive and require prompt attention, such as letters concerning a tender offer or responding to a major financial crisis. The complexity of the issues presented typically causes some letters to require more time, as do the competing work priorities of the staff person assigned to the letter. Frequently the staff will make multiple requests to a requestor for additional information, clarification, or revisions to the submitted letter. In fact, the incoming letter itself will often be the subject of careful negotiation between the requestor and the staff before a response is issued.[78]

Because the no-action-letter process represents a discretionary request and a discretionary response, the division or office may decline to answer the request, and the requesting party may withdraw the request. In fact, requestors who are informally advised that a staff response will be negative usually withdraw the request rather than receive a public answer.[79]

77. There are occasional exceptions to this requirement. The Division of Trading and Markets has been known to provide oral no-action relief in response to an oral request. The most commonly cited example of this is in an emergency situation, such as a close-of-business problem with the calculation of a brokerage firm's net capital.

78. The practice of negotiating edits and revisions to the incoming letter is the reason why so many published no-action letters appear to be issued on the same day or a few days after the date of the incoming letter. The date on the published incoming letter is the date of the final, edited request, not the date of the original request.

79. On occasion a request will not be withdrawn and the staff will issue a negative response. *See, e.g.,* Response letter from the Division of Corporation Finance, Office of Chief Counsel, to the Missouri Bankers Association (Aug. 18, 2008), *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/2008/missouribankers081808-2a1.htm.

SEC divisions differ frequently in the use of no-action letters or exemptive orders to address a request.

SEC divisions differ frequently in the use of no-action letters or exemptive orders to address a request. While the two vehicles are vastly different, both can be used to provide relief or comfort to a regulated entity. An exemptive order is a final agency action taken by the staff pursuant to a delegation of authority from the Commission. In effect, the staff stands in the shoes of the Commission and speaks for the Commission. Conversely, a no-action letter expressly states that it does not reflect the official views of the Commission. It is not a final agency action, is not subject to judicial review or afforded legal deference by a court. Under the securities laws, an entity acting pursuant to an exemptive order is entitled to certain protections from liability.[80] Recipients of a no-action letter are not similarly protected.[81] Exemptive orders under the Investment Company Act require a statutory notice and comment process, while no-action letters do not. Under the Exchange Act, there is no notice and comment requirement for an exemptive order. Occasionally a single letter will contain both a staff no-action position and an exemptive order.[82] On other occasions, a no-action letter appears to be providing an exemption from an explicit regulatory requirement.[83] As a result, it is often difficult to distinguish between the letters, notwithstanding the very different legal status for the two.

A difference of even greater significance has been the use of no-action letters that provide relief to more than one requestor, provided the factual circumstances are the same. In its release on the informal guidance program for small entities, the Commission expressly acknowledged this practice and stated, "In certain cases, however, the staff of a division may approve reliance by third parties." General-applicability letters are frequently used by the Division of Investment Management and occasionally by the Division of Trading and Markets.[84]

D. DE FACTO RULES: NO-ACTION LETTERS THAT ESTABLISH POLICY

Each division, at various times, has issued a no-action letter that had the effect of creating or altering SEC policy, an exercise in *de facto* rulemaking. Sometimes no-action letters have been used to create substantive regulatory obligations in circumstances where the Commission lacked explicit regulatory authority or when it sought to promote innovation or experimentation. Ironically, because staff no-action letters are not considered to be binding and final agency action, they are not subject to judicial review, as a new SEC rule would be. Thus, this informal process is conducive to regulatory experimentation.

80. *See, e.g.*, Securities Exchange Act § 23, 15 U.S.C. § 78w (2008).
81. *See, e.g.*, IBM, SEC No-Action Letter (Oct. 9, 2008) (Response letter from the Division of Corporation Finance to IBM permitting Cash Tender Offer by IBM for Ordinary Shares and ADSs of ILOG S.A.), *available at* http://www.sec.gov/divisions/corpfin/cf-noaction/2008/ibmilog100908-sec14.htm [hereinafter IBM No-Action Letter].
82. *See id.*
83. *See, e.g.*, SS&C Technologies, Inc., SEC No-Action Letter (Aug. 13, 2008) (Response letter from the Division of Trading and Markets permitting electronic notifications to satisfy the rule 10b-10 requirement of a written confirmation), *available at* http://www.sec.gov/divisions/marketreg/mrnoaction/2008/ssctech081308-10b10.pdf [hereinafter SS&C Technologies, Inc. No-Action Letter].
84. *See, e.g.*, Investment Company Institute, SEC No-Action Letter (Oct. 8, 2008), Response letter from the Division of Investment Management to the Investment Company Institute concerning participation in the U.S. Treasury Temporary Guarantee Program for Money Market Funds), *available at* http://www.sec.gov/divisions/investment/noaction/2008/ici100808.pdf [hereinafter ICI No-Action Letter].

The history of SEC regulation is replete with examples of this experimental or nonbinding regulatory process. Prior to congressional enactment of the Credit Rating Agency Reform Act of 2006, the SEC had no clear authority to license or regulate credit agencies. For more than twenty years, the staff addressed this void through a series of no-action letters to members of the securities industry permitting their use of and reliance upon credit ratings issued by "nationally recognized statistical rating organizations." In the late 1980s, the Commission provided regulatory relief to fledging electronic communications networks or alternative trading systems via no-action letters, until it had sufficient comfort to develop a comprehensive formal regulatory structure. The use of no-action letters was necessary because, at the time, the SEC lacked general authority under the Exchange Act to issue exemptive orders.

At times, the staff of a division has used no-action letters to modify explicit statutory requirements.

At times, the staff of a division has used no-action letters to modify explicit statutory requirements. For example, the Division of Corporation Finance used no-action letters to dramatically relax long-standing interpretations of section 5 of the Securities Act concerning the use of offering materials outside of the prospectus and on the conduct of private offerings prior to a public offering.[85]

In one notable situation, the Commission affirmatively incorporated a prospective staff no-action position into a proposed rulemaking in order to provide affected entities with the exemptive benefits of the proposed rule before the Commission formally adopted the rule. In the notice of proposed rulemaking, the Commission stated, "Until the Commission takes final action on the proposed rule, the Division of Investment Management will not recommend, based on the form of compensation received, that the Commission take any action against a broker-dealer for failure to treat any account over which the broker-dealer does not exercise investment discretion as subject to the Act."[86]

E. NO-ACTION LETTERS AND THE SEC PROXY RULES, 14A-8

Staff no-action letters pursuant to SEC rule 14a-8 are fundamentally different than no-action letters in virtually any other context. In other contexts, the staff's letter is a discretionary response to an uncontested incoming request. Under the Commission's proxy rules, the staff response is a form of nonbinding advisory adjudication of a dispute between a public company and one or more of its shareholders. While not legally required to respond, the staff routinely provides a response when either a company or a shareholder makes a timely request for the staff's views. However, the staff's opinion is advisory and not dispositive. A company can ignore the views of the staff and risk shareholder legal action. Or the shareholder can sue the company notwithstanding the staff's opinion.

85. *See, e.g.,* Exxon Capital Holdings Corp., SEC No-Action Letter, (May 13, 1988) *see also*, Black Box Inc., No-Action Letter (June 26, 1990).
86. Certain Broker-Dealers Deemed Not To Be Investment Advisers, Exchange Act Release No. 34-42099 (Nov. 4, 1999).

These no-action letters are also distinct because of the external time deadline for action, the annual shareholder meeting date. Annually, the SEC considers more than 400 such requests during a truncated "annual meeting season" each year.

The staff proxy process is also distinctive because the Commissioners occasionally play a role. Under the Commission's rules on informal and other procedures,[87] an issuer or shareholder may request that the staff submit the proxy issue to the Commission for review. This is generally processed as a written seriatim memorandum[88] to avoid the open meeting requirements of the Government in the Sunshine Act. In submitting the question to the Commission, the staff will invariably recommend that the Commission decline to review the staff's decision. In this way, while the matter will have been submitted to the Commission as requested, the vote to decline to review will not transform the staff's nonreviewable informal guidance into a final agency action that could be appealed to the federal courts.

F. CHANGING THE STATUS QUO

As described above, the SEC staff no-action letter process has a long and generally positive history. So why should anything be changed? This is a fair question, and the answer depends in large measure on one's perspective.

In the case of the SEC, critics suggest that there is no clear boundary on the subject or scope of a no-action letter. In its narrowest form, a no-action letter is merely a staff examination of an isolated set of facts and circumstances resulting in a limited staff conclusion that, based upon that set of facts and circumstances, enforcement action for violation of the federal securities laws would not be recommended. Contrast this narrow result with a no-action letter that confers upon a credit agency the designation of a "nationally recognized statistical rating agency," a valuable regulatory franchise that is essential to doing business in the United States. Can one reasonably generalize about the merits of a process that can cause results so different in scope?

In her law review article, Professor Nagy identifies four problems with SEC use of no-action letters:

1. No-actions letters cannot be relied upon by the public or the courts as authoritative statements.
2. They are an inefficient form of rulemaking. Ad hoc and fact-specific letters generate a barrage of follow-up requests to ascertain general applicability as interpretations are slightly modified to fit slightly different facts.
3. The conclusion contained in the no-action letter often reflects a carefully negotiated result between the staff and one interested party, with the quality of analysis suffering from a lack of independent third-party scrutiny and input.

87. 17 C.F.R. § 202.1(d) (2008).
88. The SEC seriatim process for obtaining Commission action is described at 17 C.F.R. § 200.42 (2008).

4. The private, negotiated nature of the process contravenes the APA, as it lacks a requirement for public notice and comment on proposed interpretations or policies.

An additional problem not included in Professor Nagy's list is the lack of a clear role and responsibility for the five-member Commission. Under the federal securities laws, Congress made the Commissioners, acting as a collegial decisional body, the decision makers for application and interpretation of the federal securities laws. Under the current process, the role of the Commission is cabined. The Commissioners participate only when the responsible staff apprises them of a request and proposed response and solicits their concurrence in a one-on-one way.

A consistent theme in interviews for this report is widespread dissatisfaction with the current process for requesting a no-action letter, particularly in the context of the many other methods that the SEC staff uses to provide interpretive guidance. These criticisms focus on the following problems:

- The staff uses too many different and overlapping methods to provide guidance.
- There is little consistency between SEC divisions in the process and use of no-action letters.

THE NO-ACTION PROCESS SERVES A NUMBER OF USEFUL PURPOSES, PRIMARILY FOR THE PUBLIC AND PRACTITIONERS BUT ALSO FOR THE COMMISSION.

Individuals benefit by obtaining expert advice and assistance from the staff in ascertaining appropriate conduct under the law, and they can obtain this assistance without substantial public controversy or cost. In addition, individual no-action responses constitute an "ounce of prevention" that eliminates any reasonable possibility of Commission enforcement action and provides at least some degree of comfort in the face of any private litigation. Because responses are publicly available, the process educates practitioners as to the current thinking of other members of the bar and more importantly, of the staff on important issues. The process also aids the Commission by providing the staff with information, and the views of practitioners, on current issues. This information is essential for effective implementation of the Commission's various statutory mandates. The process provides the staff with a means to modify regulatory policy informally in light of new developments and permits the Commission to issue formal rulings based on a more complete understanding of practical, legal, and business considerations. Addressing certain regulatory concerns through informal means, rather than formal ones, promotes efficient use of the Commission's limited resources. Finally, by assisting the public in complying with the law, the process promotes voluntary compliance and lessens the demand on the SEC's limited regulatory and enforcement resources.

- Thomas P. Lemke, *The SEC No-Action Letter Process*, 42 Bus. Law.1019, 1022-1023 (1987).

- The time and cost of obtaining a letter is so great that it has become a last-resort option.
- The staff creates de facto regulatory policy through no-action letters, without the involvement of the Commissioners. This practice violates the APA and results in policy that cannot be challenged in the courts.

While many of the comments received could be considered overstatements, the frequency and consistency of these views suggest some degree of truth in each. The challenge is creating and implementing informal processes that provide prompt and useful guidance without overstepping boundaries and creating or altering regulatory policy. The recommendations provided are designed to reduce and rationalize the multiplicity of staff vehicles for regulatory guidance and to reinvigorate the no-action letter process by making it faster and less costly to the SEC and to requestors, while retaining its informality. The recommendations also propose changes to ensure that policy remains the responsibility of the five-member Commission.

An effective regulatory agency must not only enforce compliance with the law, it must also promote and assist compliance. While a free market will always be plagued with some level of crime and noncompliance, most of the participants will conduct business in compliance with the law. The key is understanding what is required and what is acceptable practice. In a dynamic financial market, new products and new transactions invariably will raise new questions about what is permitted under the law. The SEC regulatory regime should be designed to *promote a culture of compliance.* Providing reliable, informal guidance to the financial services industry is a long tradition at the SEC. This tradition should be respected and invigorated.

A robust system for providing informal guidance, however, requires balancing two competing and, frequently, conflicting policies. On the one hand, informal guidance should be readily obtainable without undue time or expense. On the other hand, the guidance provided must be publicly available to all interested parties and represent a uniform and consistent interpretation of the applicable law.

III. IMPROVING THE NO-ACTION LETTER PROCESS

A. REDUCING THE VARIETY OF FORMS OF STAFF GUIDANCE

As previously mentioned, the SEC staff uses at least nine different methods to provide the public with regulatory guidance. This number increases if one includes in the list negotiated SEC administrative proceeding orders and exemptive orders, both of which are technically not informal but rather final agency actions. The staff's use of different formats for providing guidance changes periodically, with changes in the SEC chairman and division directors. Although the Commission has on occasion publicly identified the various formats that the staff may use, the explanations of the differences between the types of advice and the legal significance of guidance have been limited, ambiguous, and overlapping.

This variety in interpretive documents is analogous to a common criticism of U.S. Generally Accepted Accounting Principles (GAAP)—that there is no single authoritative source of GAAP.[89] The Commission should reduce the number of informal guidance documents by clearly announcing the purpose of each type and combining redundant formats into a single comprehensive system.

The Division of Corporation Finance has begun this process through its development of Compliance and Disclosure Interpretations (CDIs). The material is organized by statute and subject matter. This format could easily incorporate and replace the information currently contained in SLBs, FAQs, summaries of staff comment letters, small entity compliance guides, and interpretive letters.

RECOMMENDATION 1—The Commission should rationalize the current system of informal guidance by reducing the number of vehicles it uses to provide guidance. The purposes of each method should be publicly stated and distinguished. The legal status of each should also be identified. Each operating division should develop a system of Compliance and Disclosure Interpretations, which should replace Staff Legal Bulletins, FAQs, summaries of staff comment letters, small entity compliance guides, and interpretive letters.

B. GREATER CONSISTENCY AT THE SEC

The distinction between no-action letters and exemptive orders may appear obvious. A no-action letter concerns the applicability of an existing regulation to a new or unusual practice or transaction, while an exemptive order provides relief from a rule that applies to the described facts and circumstances. In practice it is difficult to observe a clear line. Occasionally a single letter will contain both a staff no-action position and an exemptive order.[90] On other occasions, a no-action letter appears to be providing an exemption from an explicit regulatory requirement.[91]As a result, it is often difficult to distinguish between the letters, notwithstanding the very different legal status for the two. Part of the confusion between exemptive orders and no-action letters reflects the fact that for most of its history, the Commission could issue exemptive orders only under the Investment Company Act, and that act limits the scope of the order to the applicant.

Another area of inconsistency concerns the ability of third parties to rely upon a no-action letter. In its release on the informal guidance program for small entities, the Commission expressly acknowledged this practice and stated, "In certain cases, however, the staff of a division may approve reliance by third parties." General applicability letters are frequently used by the Division of Investment Management and occasionally by the Division of Trading and Markets.[92] When the staff issues a no-action letter that explicitly provides relief or guidance

89. The Commission's Advisory Committee on Improvements to Financial Reporting (CIFR) discussed this criticism of U.S. GAAP at length in their final report. U.S. Sec. & Exch. Comm'n, Final Report of the Advisory Committee on Improvements to Financial Reporting (Aug. 1, 2008), http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf. The Committee's final report recommended that the number of methods of interpreting GAAP that are considered authoritative should be reduced to only documents issued by the Financial Accounting Standards Board. Id. at 5-6.
90. *See, e.g.,* IBM No-Action Letter, *supra* note 81.
91. *See, e.g.,* SS&C Technologies, Inc. No-Action Letter, *supra* note 83.
92. *See, e.g.,* ICI No-Action Letter, *supra* note 84.

to a broad class of individuals or entities, it is difficult to argue that this is an informal expression of staff views and not a rule of general applicability that should be adopted by the Commission in compliance with the APA.

At times, it has been argued that market conditions require the staff to act quickly and decisively in a general fashion and that a no-action letter is the only viable option available. At one time this may have been true. For example, following the 1987 market break, SEC staff issued no-action letters that effectively waived regulatory limitations on public company repurchases of shares. At that time, the SEC lacked the authority to issue exemptive orders under the Exchange Act. Since 1990, the Commission has had general exemptive authority under each statute (by rule only for the Securities Act). As such, it has the authority to issue final agency exemptive orders, rather than general no-action letters, when circumstances dictate. Under section 12(k)(2) of the Exchange Act, the Commission has the authority to issue temporary orders to adopt, amend, or revise general rules, without a notice and comment period, under its emergency powers.[93] Following the expiration of a temporary order or in place of a temporary order, the APA provides a method for the Commission to issue rules without a notice and comment process.[94]

Given the Commission's general exemptive authority and broad emergency authority, it is difficult to identify a circumstance that would require the issuance of a general applicability no-action letter because an agency exemptive order or emergency order could not be crafted.

RECOMMENDATION 2—The Commission should publish guidelines distinguishing the use of no-action letters and exemptive orders.

RECOMMENDATION 3—The practice of issuing no-action letters of general applicability should be discontinued in favor of exemptive orders or emergency orders, as appropriate.

C. REDUCING THE TIME AND COST OF OBTAINING STAFF GUIDANCE ON ROUTINE QUESTIONS

One of the most frequently voiced complaints about no-action letters concerns the length of time required to obtain one. Numerous people interviewed gave estimates of a minimum of six months to obtain an uncontroversial no-action letter, with examples of specific requests that were not finalized for more than one year. Invariably the process entailed multiple phone calls or meetings and several draft requests, each carefully negotiated with the staff. Some estimated that legal fees alone greatly exceeded $50,000.

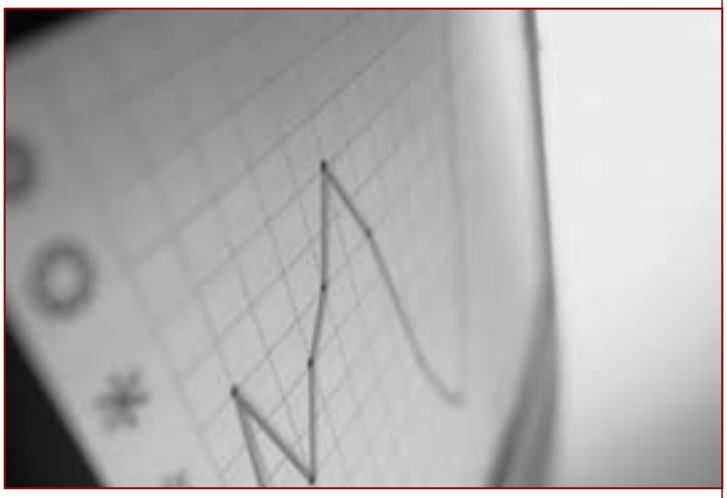
Experienced practitioners who were interviewed consistently commented that, because of the delay and expense involved in obtaining a no-action letter, it is increasingly the last option in resolving an uncertainty. A process that requires a year of effort to obtain an answer

93. The SEC used these emergency powers in recent months when it ordered a ban on short selling in certain stocks. *See,* Exchange Act Release No. 34-58592, (Sept. 18, 2008).
94. 5 U.S.C. § 553 (2008).

is of little use in today's capital markets or regulatory environment. Decisions must be made in less time.

Typically the problem is viewed as a combination of insufficient resources at the SEC, unnecessary layers of review, and/or a general reluctance to provide an answer until every issue has been identified, every question has been asked and answered, and every material fact has been provided. When a request involves an issue that affects more than one division or office, the coordination problems within the SEC are frequently cited as the greatest contributor to delay.

Resource limitations and competing work priorities will always affect the timeliness of response. However, virtually everyone interviewed stressed that the problem of delay did not reflect a poor work ethic among the staff of the SEC. In fact, most persons familiar with the process suggested that some portion of the delay typically was due to private counsel who do not always respond promptly to questions or comments from the staff. Because the process takes so long, there is little incentive for either side to act promptly. For this reason, some form of informal deadlines that apply to both sides likely would be beneficial.



But the allocation of more staff and the creation of deadlines are not by themselves a solution. These factors should not be allowed to obscure the two other factors contributing to delay, which must be addressed.

The first is the natural tendency of any person (and especially a lawyer) to avoid making a decision until all issues have been raised and all information has been obtained. This tendency is a by-product of the institutional bias at any government agency to avoid a mistake. Simply put, the consequences to an individual at the SEC of making the wrong decision always greatly outweigh the rewards of a rapid and correct decision. When the questions posed are novel or deal with future actions whose consequences may be unknowable, it is unrealistic to believe that a rational person will be comfortable making a difficult decision quickly and on the basis of incomplete information.

This problem is not unsolvable. The key is to provide the decision maker with a safety net. Ideally, this would be a system that recognizes that mistakes in judgment are inevitable and can be subsequently corrected in a way that does not punish or embarrass the person making the decision, that does not cause the good-faith beneficiary of the decision to suffer, and that places a premium on "getting it right," even after the fact.

The following set of recommendations proposes a solution to these problems. It is premised upon using more staff to provide informal interpretive guidance by telephone or e-mail, with all responses memorialized for ongoing review by senior staff and publication in the CDI format.

The basic structure of this process would build and expand upon facets of the existing processes in Corporation Finance, Investment Management, and Trading and Markets. Each division has a program for making telephone inquiries and for providing answers to FAQs on the SEC Website. During the past year, the Division of Corporation Finance has been noteworthy in its commitment to updating and codifying more than a decade's worth of "telephone interps" into its new CDI. This recommendation is an incremental step to expand the effectiveness of these programs.

Biweekly review meetings of designated staff and supervisors are a key component of this process. It requires senior staff to regularly meet with staff to review, discuss, and commit to a common interpretation. These meetings will provide the continuing oversight to ensure that information provided is accurate and consistent with established policies. They will provide the quality control necessary to ensure that the information and staff guidance added to each division's Website are accurate. They will also provide a timely opportunity for supervisors to correct staff if an answer was incorrect. This will reduce the adverse consequences of a mistake and reduce the pressure to "always be right."

Finally, uploading short questions and answers to the SEC Website twice a month will eliminate the concern about "nonpublic" guidance provided to some but not all. Over time, as the body of information available online increases, it will reduce the volume of telephone inquiries.

RECOMMENDATION 4—Each division should post on the SEC Website a list of the staff members, with e-mail addresses and phone numbers, who are authorized to provide assistance on specified topics. Authorized SEC staff should complete a short summary of each telephone inquiry received and each answer provided on an internal template, retained on an internal shared file, accessible by all designated staff and the senior staff in each division. If the staff person is uncertain or uncomfortable responding to a question, the question should be added to the internal system with a notation that no answer was provided. Each division should have a biweekly meeting of the designated staff (typically the staff of the Office of Chief Counsel) to review and discuss all questions answered during the previous two weeks. The responses should be reviewed for accuracy and to identify topics of interest. Topics of interest should be posted on the SEC Website, eliminating the concern about "nonpublic" guidance provided to some but not all. Over time, as the body of information available online increases, it would reduce the volume of telephone inquiries.

D. FASTER RESPONSES ON COMPLEX REQUESTS

Historically, the function of staff no-action and interpretive letters has been far broader than merely answering the routine or straightforward request. No-action letters have often been used to facilitate or enable novel or innovative transactions or compliance methods.

Fundamental changes in the securities offering process have resulted from staff no-action letters.[95] On important occasions, the staff has issued no-action letters that provide guidance or relief to broad segments of the regulated community.[96]

These letters typically concern regulatory issues that cannot be answered in a phone call and that should not reflect the informal views of a single staff member. Some complex transactions cannot close without a staff no-action letter to confirm that the SEC staff will not recommend enforcement action.

Complex requests are not appropriate for the process previously described. Some requests require a detailed written request and careful analysis. However, even the most difficult request should not require six months or a year for a response, the length of time that people interviewed typically described. Given that this is a discretionary process, shouldn't the staff be expected to provide a response or to conclude that they are unable to provide the relief in less than a year's time?

The simplest approach would be to impose a firm deadline on the staff's response. In fact, this has been tried unsuccessfully in the past. The problem is that the interaction between the staff and the requestor, usually entailing revisions in the request sought and the relief obtained, makes a firm deadline impossible to apply.

An alternative approach would be to establish interim deadlines for both the staff and the requestor. For example, each division could adopt processing standards requiring the staff to respond in writing within 30 days of receipt of the request and the requestor to submit a revised request within 30 days of the staff's response. The problem with this approach is that it creates a potential for an infinite number of responses back and forth between the staff and the requestor. Another problem is that no-action letters are discretionary. The staff can always decline to consider the request. Imposition of a hard deadline for action might result in an increase in the number of letters that the staff declines to consider.

For these reasons, it may be preferable to establish a guideline or target deadline of ninety days for response, combined with a formal procedure for monitoring. Each quarter, each division would be required to send an advice memorandum to the Commission identifying all requests pending for ninety days or longer. The memo would identify the issues presented that must be resolved and provide a target date for resolution. The division should also indicate if it is unlikely that a no-action letter will be issued.

In a separate recommendation, the creation of a chief operating officer (COO) structure is proposed. One responsibility of a COO would be active oversight of core functions. A COO might be a viable alternative to Commission oversight.

95. *See, e.g.,* the Exxon Capital Holdings Corp., SEC No-Action Letter (May 13,1988). *See also,* Black Box Inc., SEC No-Action Letter (June 26, 1990).

96. *See,* Investment Company Institute, SEC No-Action Letter, Response letter from the Division of Investment Management concerning the Treasury Department temporary insurance program for money market funds (Oct. 8, 2008), *available at* http://www.sec.gov/divisions/investment/noaction/2008/ici100808.pdf.

RECOMMENDATION 5— Each division should attempt to provide a final response to a no-action request within ninety days of receipt. To promote compliance, each division should be required to send quarterly an advice memorandum to the Commission identifying all requests pending for ninety days or longer. The memo would identify the issues presented that must be resolved and provide a target date for resolution. The division should also indicate if it is unlikely that a no-action letter will be issued.

Each division, at various points in time, has issued no-action letters that have such broad and substantial impact that they become *de facto* rules.

E. A GREATER ROLE FOR THE COMMISSION THROUGH PERIODIC ISSUANCE OF INTERPRETIVE RELEASES THAT REVIEW, ADOPT, AND CODIFY SIGNIFICANT STAFF NO-ACTION POSITIONS

Each division, at various points in time, has issued no-action letters that have such broad and substantial impact that they become *de facto* rules. Sometimes no-action letters have been used to create substantive regulatory obligations in circumstances where the Commission either lacked explicit regulatory authority or sought to promote innovations. Ironically, because staff no-action letters are not considered to be binding and final agency action, they are not subject to judicial review, as a new SEC rule would be. Thus, this informal process is conducive to regulatory experimentation.

When the staff issues a no-action letter that results in a significant change in understanding or in business activities, it raises several concerns. First, it means that a regulatory action has been taken outside the procedural requirements of the APA. The APA defines a rule broadly as "the whole or part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy."[97] Under the APA, agencies must publish all rules (with limited exceptions) in draft and provide the public with notice and an opportunity to submit comments.

Only the five-member Commission may propose and adopt rules. When Congress amended the Securities Exchange Act in 1962 to permit the Commission to delegate authority to the staff, delegation of rulemaking responsibilities was expressly prohibited.

To the extent that a no-action letter has the effect of setting regulatory policy, the lack of Commission involvement is a significant problem. In fact, many argue that a major reason for delay is the staff's legitimate concern that any guidance or interpretation must be carefully written to prevent its views from inadvertently setting a new standard.

Another often-heard remark is that the staff must carefully consider not only the question contained in the letter, but also the unstated questions that a too-broad interpretation may be construed to address. The concern about usurping the Commission's authority requires the staff to proceed with caution in responding to novel questions.

97. 5 U.S.C. § 551(4) (2008).

One of the important lessons that all SEC staff members learn is that a regulatory agency will never act as quickly as the capital market it regulates. Not only do markets move quickly, they move in unpredictable directions. When the SEC adopts a regulation, it is anticipating an appropriate response from the parties subject to the regulation. However, the reality is that the response is often not easily predictable. It may be better or worse than anticipated, but it will be different. The reason is the dynamism of the market. By the time compliance is required, unforeseen changes may have occurred, and the compliance strategy will often reflect those changed circumstances.

Formal APA rulemaking can never keep pace. An effective regulator must have the capacity to be nimble—to fine-tune its analysis and to work with regulated entities collaboratively. When entities subject to regulation propose new ideas that do not conflict with regulatory policies, even if they do not comply strictly with the regulatory language, it may be beneficial to find common ground to facilitate innovation but not require formal amendments to the existing regulation.

At the same time, the APA requirements for public notice of a proposed rule and opportunity to submit comments are not antiquated and cumbersome requirements. Because of the dynamism of the capital markets, there is rarely a single obvious and appropriate regulatory response to an identified problem. Instead there are often several competing choices, each with advantages and disadvantages. The public notice and comment process is an effective method for identifying the strengths and weaknesses of a proposed approach and for learning from others of alternative approaches that may have a better mix of strengths and weaknesses.

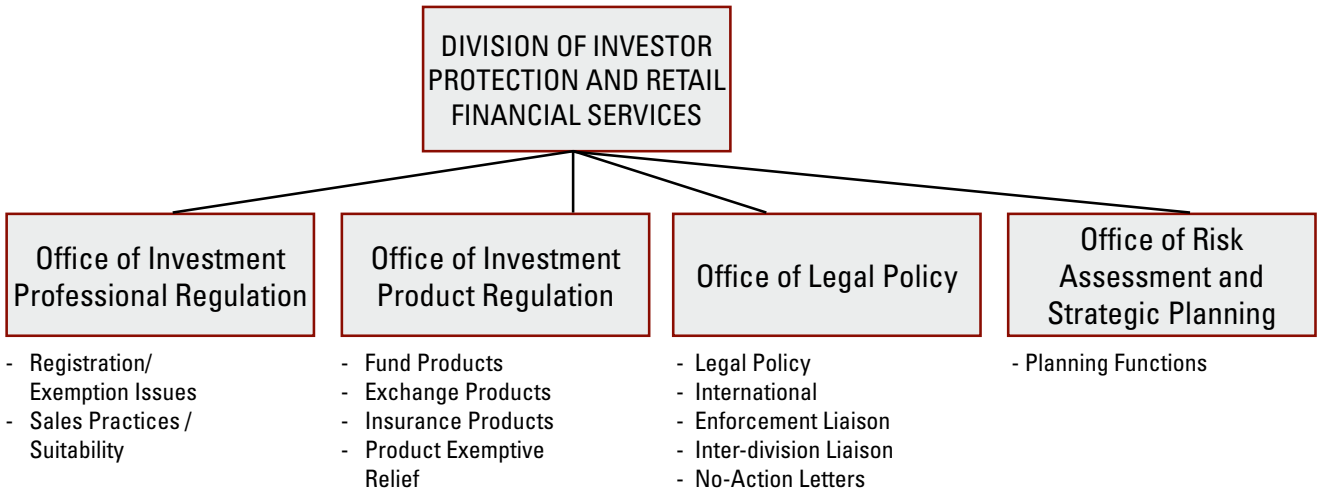
In addition to the APA, there is the related question of identifying the appropriate role for the Commissioners. To the extent that a no-action letter or other form of informal guidance creates a principle of general applicability that is binding, it is improper for the staff of the SEC to set policy. Congress has authorized the Commission to delegate to its staff virtually all decisional responsibility, with one exception. The Commission may not delegate the function of rulemaking to the staff. Only the sitting Commissioners may propose, adopt, or rescind a rule. At the same time, if speed is an essential attribute of a no-action letter process, it is infeasible to require the staff to take all significant actions to the Commission for a decision.

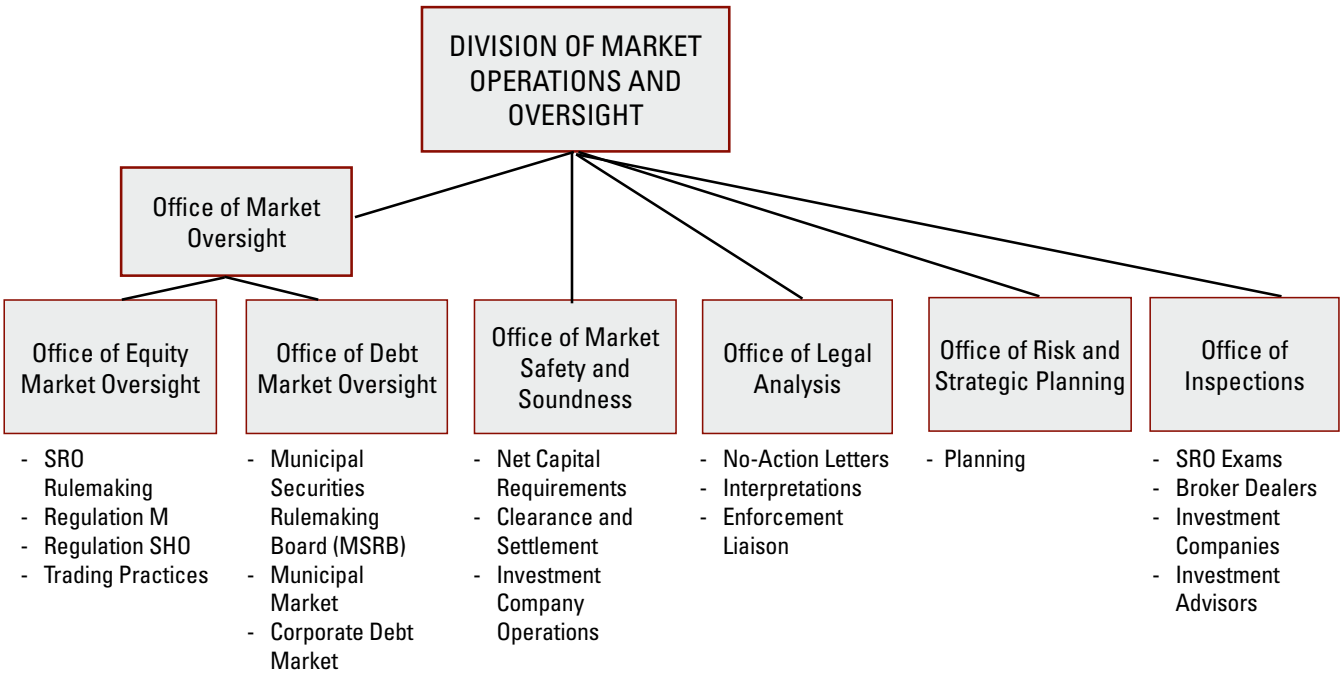
Realistically, it is impossible to develop a procedure that ensures that the staff has sufficient discretion to quickly advise private parties on novel questions without ever going too far. However, it does appear reasonable for the Commission to adopt a set of principles that would guide and discipline the process.

RECOMMENDATION 6—A no-action letter should be viewed as informal guidance rather than a method of setting regulatory policy. Because it is often difficult to distinguish interpretation from policy on a prospective basis, the Commission should annually issue interpretive statements that review, adopt, and codify significant staff positions contained in no-action letters. These releases could also be used to withdraw or revise a no-action position previously taken, based upon new facts or an analysis of how it has been interpreted. The Commission should issue these interpretive statements following an opportunity for public notice and comment. The original recipient of a no-action letter could continue to rely upon the assurances provided in the letter. Any revisions or changes reflected in the Commission interpretative release would be applicable prospectively to third parties.

Appendix A

Sample organization charts for the proposed divisions.





Appendix B

Investment Company Act Notices and Orders for 2008

INVESTMENT COMPANY	DATE				DATA			
	Filing	Last Amendment	Notice	Order	Days from Filing to Notice	Days from Notice to Order	Days from Filing to Order	Days from Last Amendment to Order
Wortham Finance, L.P. et al. (Notice)	9-Jan-00	30-Oct-08	10-Nov-08		3228			
Calamos Convertible Opportunities and Income Fund, et al. (Order)	27-Jan-04	24-Jul-08	7-Oct-08	4-Nov-08	1715	28	1743	103
Wells Fargo Funds Trust, et al. (Notice)	21-Jul-08	29-Oct-08	31-Oct-08		102			
Allianz Life Insurance Company of North America, et al. (Notice)	11-Jan-08	30-Oct-08	30-Oct-08		293			
Aberdeen Asset Management Inc. and Aberdeen Funds (Order)	8-May-08	17-Oct-08	30-Sep-08	28-Oct-08	145	28	173	11
MCG Capital Corporation, et al. (Order)	25-Sep-07	10-Oct-08	30-Sep-08	28-Oct-08	371	28	399	18
HLHZ Investments II, L.L.C. and Houlihan, Lokey, Howard & Zukin, Inc. (Order)	26-Aug-04	23-Oct-08	30-Sep-08	28-Oct-08	1496	28	1524	5
H&Q Healthcare Investors, et al. (Order)	30-May-07	30-Sep-08	30-Sep-08	28-Oct-08	489	28	517	28
WisdomTree Asset Management, Inc. and WisdomTree Trust (Order)	5-Dec-07	26-Sep-08	29-Sep-08	27-Oct-08	299	28	327	31
Dodge & Cox Funds and Dodge & Cox Incorporated (Order)	18-Jan-08	1-Oct-08	29-Sep-08	27-Oct-08	255	28	283	26
Forward Funds and Forward Management, LLC (Order)	19-May-08	25-Sep-08	29-Sep-08	27-Oct-08	133	28	161	32
First Trust Advisors L.P., et al. (Order)	14-Jan-08	16-Oct-08	29-Sep-08	27-Oct-08	259	28	287	11
Invesco PowerShares Capital Management LLC, et al. (Order)	12-Feb-08	8-Oct-08	29-Sep-08	27-Oct-08	230	28	258	19
Reserve Municipal Money-Market Trust, et al. (Notice of Application and Temporary Order)	14-Oct-08	24-Oct-08	24-Oct-08		10			
The Reserve Fund (Notice)	22-Sep-08		24-Oct-08		32			
Eaton Vance Floating-Rate Income Trust, et al. (Order)	10-Jun-08	2-Sep-08	2-Oct-08	23-Oct-08	114	21	135	51
Delaware Management Business Trust, et al. (Order)	15-Apr-08	19-Sep-08	24-Sep-08	21-Oct-08	162	27	189	32
Morgan Stanley Series Funds, et al. (Order)	18-May-08	19-Sep-08	23-Sep-08	21-Oct-08	128	28	156	32
Aberdeen Asset Management Inc., et al. (Order)	8-May-08	14-Oct-08	25-Sep-08	21-Oct-08	140	26	166	7
Boulder Total Return Fund, Inc., et al. (Notice)	9-Apr-04	22-Aug-08	20-Oct-08		1655			
The Zweig Total Return Fund, Inc., et al. (Notice)	14-Feb-08	30-Jul-08	20-Oct-08		249			
Van Kampen Retirement Strategy Trust, et al. (Order)	7-Mar-08	19-Sep-08	25-Sep-08	17-Oct-08	202	22	224	28
Trust for Professional Managers, et al. (Order)	31-Mar-08	7-Oct-08	19-Sep-08	15-Oct-08	172	26	198	8
Triangle Capital Corporation, et al. (Order)	3-Jan-07	16-Sep-08	19-Sep-08	14-Oct-08	625	25	650	28

INVESTMENT COMPANY	DATE				DATA			
Rafferty Asset Management, LLC, et al. (Order)	23-Jan-08	12-Sep-08	12-Sep-08	6-Oct-08	233	24	257	24
Global X Funds and Global X Management Company LLC (Order)	14-Apr-08	20-Aug-08	10-Sep-08	3-Oct-08	149	23	172	44
Prudential Financial, Inc., et al. (Order)	5-Sep-08		5-Sep-08	1-Oct-08	0	26	26	
Fidelity Aberdeen Street Trust, et al. (Order)	29-Feb-08	2-Sep-08	5-Sep-08	30-Sep-08	189	25	214	28
PIMCO Municipal Income Fund, et al. (Order)	2-May-07	29-Aug-08	29-Aug-08	29-Sep-08	485	31	516	31
Phoenix Equity Trust, et al. (Order)	23-Apr-08	22-Sep-08	3-Sep-08	29-Sep-08	133	26	159	7
Van Kampen Retirement Strategy Trust, et al. (Order)	7-Mar-08	19-Sep-08	25-Sep-08	17-Oct-08	202	22	224	28
John Hancock Income Securities Trust, John Hancock Investors Trust, John Hancock Patriot Premium Dividend Fund II, John Hancock Preferred Income Fund, John Hancock Preferred Income Fund II, John Hancock Preferred Income Fund III, John Hancock Tax-Advantaged Dividend Income Fund, John Hancock Tax-Advantaged Global Shareholder Yield Fund, and John Hancock Advisers, LLC (Order)	18-Jan-07	18-Jul-08	29-Aug-08	24-Sep-08	589	26	615	68
Aberdeen Asset Management Inc., et al. (Order)	8-May-08	11-Sep-08	25-Aug-08	22-Sep-08	109	28	137	11
Allianz Life Insurance Company of North America, et al. (Order)	19-Nov-07	27-Aug-08	28-Aug-08	19-Sep-08	283	22	305	23
Prudential Financial, Inc., et al. (Notice and Temporary Order)	5-Sep-08		5-Sep-08		0			
Advanced Series Trust, et al. (Order)	2-Jun-08	26-Aug-08	8-Aug-08	3-Sep-08	67	26	93	8
Prudential Annuities Life Assurance Corp., et. al. (Order)	7-May-08	15-Jul-08	8-Aug-08	3-Sep-08	93	26	119	50
DNP Select Income Fund Inc. and Duff & Phelps Investment Management Co. (Order)	11-Apr-07	24-Jul-08	31-Jul-08	26-Aug-08	477	26	503	33
Javelin Exchange-Traded Trust, et al. (Order)	21-Sep-07	31-Jul-08	31-Jul-08	26-Aug-08	314	26	340	26
Goldman Sachs Trust, et al. (Order)	27-Nov-07	4-Aug-08	31-Jul-08	26-Aug-08	247	26	273	22
Van Eck Associates Corporation, et al. (Order)	10-Mar-08	21-Aug-08	31-Jul-08	25-Aug-08	143	25	168	4
Cohen & Steers Advantage Income Realty Fund, Inc., et al. (Order)	3-Jan-05	21-Jul-08	24-Jul-08	19-Aug-08	1298	26	1324	29
The Mexico Fund, et al. (Order)	21-Nov-07	11-Aug-08	17-Jul-08	12-Aug-08	239	26	265	1
PIMCO Funds, et al. (Order)	25-Mar-08	6-Aug-08	17-Jul-08	12-Aug-08	114	26	140	6
ING Clarion Real Estate Income Fund, et al. (Order)	26-Mar-04	8-Jul-08	8-Jul-08	5-Aug-08	1565	28	1593	28
Van Eck Associates Corporation, et al. (Notice)	10-Mar-08	29-Jul-08	31-Jul-08		143			
The Penn Mutual Life Insurance Company, et al. (Order)	29-Jun-07	2-Jul-08	2-Jul-08	25-Jul-08	369	23	392	23
Minnesota Life Insurance Company, et al. (Order)	21-Nov-07	24-Jun-08	26-Jun-08	22-Jul-08	218	26	244	28
American International Group, Inc., et al. (Order)	25-Sep-07	8-May-08	23-May-08	18-Jun-08	241	26	267	41
Matrix Capital Group, Inc., et al. (Order)	15-Jan-08	21-May-08	22-May-08	17-Jun-08	128	26	154	27
Prudential Retirement Insurance and Annuity Company, et al. (Order)	29-Nov-07	2-May-08	7-May-08	6-Jun-08	160	30	190	35
Main Street Capital Corporation, et al. (Order)	12-Oct-07	28-Apr-08	8-May-08	3-Jun-08	209	26	235	36
Harris & Harris Group, Inc. (Order)	9-Apr-08			30-May-08			51	
The Bessemer Group, Inc., et al. (Order)	30-Mar-06	2-May-08	29-Apr-08	28-May-08	761	29	790	26
The RBB Fund, Inc. and Abundance Technologies, Inc. (Order)	7-Feb-08	12-May-08	30-Apr-08	28-May-08	83	28	111	16
Fidelity Rutland Square Trust, et al. (Order)	16-Jan-08	29-Apr-08	30-Apr-08	28-May-08	105	28	133	29

INVESTMENT COMPANY	DATE				DATA			
ING USA Annuity and Life Insurance Company, et al. (Order)	27-Dec-07	18-Apr-08	28-Apr-08	23-May-08	123	25	148	35
Thrivent Mutual Funds, et al. (Order)	20-Feb-08	22-Apr-08	24-Apr-08	20-May-08	64	26	90	28
U.S. Bank National Association FAF Advisors, Inc. (Order)	14-Nov-05	13-Mar-08	16-Apr-08	7-May-08	884	21	905	55
ALPS Advisers Inc., et al. (Order)	2-Oct-07	15-Apr-08	9-Apr-08	1-May-08	190	22	212	16
Franklin California Tax-Free Income Trust, et al. (Order)	22-Feb-08		31-Mar-08	28-Apr-08	38	28	66	
Kohlberg Capital Corporation (Order)	27-Feb-07	17-Apr-08	28-Mar-08	23-Apr-08	395	26	421	6
American Family Life Insurance Company, et al. (Order)	2-Nov-07	14-Mar-08	19-Mar-08	16-Apr-08	138	28	166	33
MetLife Insurance Company of Connecticut, et al. (Order)	10-Oct-07	7-Mar-08	10-Mar-08	16-Apr-08	152	37	189	40
Jefferson National Life Insurance Company, et al. (Order)	21-Nov-07	7-Mar-08	10-Mar-08	3-Apr-08	110	24	134	27
Prudential Annuities Life Assurance Corporation, et al. (Order)	29-Oct-07	7-Jan-08	4-Mar-08	1-Apr-08	127	28	155	85
CUNA Mutual Insurance Society, et al. (Order)	7-Sep-07	5-Feb-08	4-Mar-08	1-Apr-08	179	28	207	56
Pruco Life Insurance Company, et al. (Order)	9-Oct-07	7-Jan-08	4-Mar-08	1-Apr-08	147	28	175	85
JPMorgan Trust I, et al. (Order)	9-Aug-07	30-Jan-08	4-Mar-08	1-Apr-08	208	28	236	62
RSI Retirement Trust (Order)	4-Mar-08	5-Mar-08		26-Mar-08			22	21
Eaton Vance Mutual Funds Trust, et al. (Order)	18-Jan-08	30-Jan-08	26-Feb-08	25-Mar-08	39	28	67	55
Advisors Series Trust, et al. (Order)	31-Dec-07	28-Jan-08	27-Feb-08	25-Mar-08	58	27	85	57
Patriot Capital Funding, Inc. (Order)	29-Nov-06	17-Mar-08	28-Feb-08	25-Mar-08	456	26	482	8
Kohlberg Capital Corporation (Order)	27-Feb-07	10-Mar-08	25-Feb-08	24-Mar-08	363	28	391	14
Triangle Capital Corporation (Order)	31-Oct-07	20-Feb-08	20-Feb-08	18-Mar-08	112	27	139	27
NETS Trust (Order)	1-Nov-07	29-Feb-08	25-Feb-08	17-Mar-08	116	21	137	17
Pioneer Bond Fund, et al. (Order)	24-Sep-07	16-Jan-08	5-Feb-08	4-Mar-08	134	28	162	48
WisdomTree Trust, et al. (Order)	8-Jan-08	22-Feb-08	6-Feb-08	27-Feb-08	29	21	50	5
Barclays Global Fund Advisors, et al. (Order)	25-Jan-08	14-Feb-08	6-Feb-08	27-Feb-08	12	21	33	13
Bear Stearns Asset Management, Inc., et al. (Order)	21-Dec-06	14-Jan-08	5-Feb-08	27-Feb-08	411	22	433	44
PowerShares Capital Management LLC, et al. (Order)	18-May-07	7-Jan-08	1-Feb-08	27-Feb-08	259	26	285	51
MLIG Variable Insurance Trust (Order)	9-Oct-07	8-Feb-08	31-Jan-08	26-Feb-08	114	26	140	18
Schroder Series Trust, et al. (Order)	21-Dec-07	19-Jan-08	24-Jan-08	25-Feb-08	34	32	66	37
The TIGERS Revenue Trust and VTL Associates, LLC (Order)	8-Feb-07	8-Feb-08	18-Jan-08	13-Feb-08	344	26	370	5
Morgan Stanley Investment Management Inc., et al. (Order)	7-Jul-05	30-Jan-08	18-Jan-08	13-Feb-08	925	26	951	14
Northern Institutional Funds, Northern Funds, Northern Trust Investments, N.A. (Order)	12-Sep-07	4-Feb-08	16-Jan-08	12-Feb-08	126	27	153	8
The UBS Funds, et al. (Order)	23-Nov-07	14-Dec-07	19-Dec-07	16-Jan-08	26	28	54	33
Millennium India Acquisition Company, Inc. (Order)	18-Dec-07	21-Dec-07	21-Dec-07	16-Jan-08	3	26	29	26
Main Street Capital Corporation, et al. (Order)	27-Jul-07	28-Dec-07	21-Dec-07	16-Jan-08	147	26	173	19
					Days from Filing to Notice	Days from Notice to Order	Days from Filing to Order	Days from Last Amendment to Order
AVERAGES					353.9	26.3	301.5	29.2
MEDIAN					162	26	190	28

Investment Company Act Notices and Orders for 2007

INVESTMENT COMPANY	DATE				DATA			
	Filing	Last Ammendment	Notice	Order	Days from Filing to Notice	Days from Notice to Order	Days from Filing to Order	Days from Last Amendment to Order
Wortham Finance, L.P. et al. (Notice)	9-Jan-00	30-Oct-08	10-Nov-08		3228			
Calamos Convertible Opportunities and Income Fund, et al. (Order)	27-Jan-04	24-Jul-08	7-Oct-08	4-Nov-08	1715	28	1743	103
Wells Fargo Funds Trust, et al. (Notice)	21-Jul-08	29-Oct-08	31-Oct-08		102			
Allianz Life Insurance Company of North America, et al. (Notice)	11-Jan-08	30-Oct-08	30-Oct-08		293			
Aberdeen Asset Management Inc. and Aberdeen Funds (Order)	8-May-08	17-Oct-08	30-Sep-08	28-Oct-08	145	28	173	11
MCG Capital Corporation, et al. (Order)	25-Sep-07	10-Oct-08	30-Sep-08	28-Oct-08	371	28	399	18
HLHZ Investments II, L.L.C. and Houlihan, Lokey, Howard & Zukin, Inc. (Order)	26-Aug-04	23-Oct-08	30-Sep-08	28-Oct-08	1496	28	1524	5
H&Q Healthcare Investors, et al. (Order)	30-May-07	30-Sep-08	30-Sep-08	28-Oct-08	489	28	517	28
WisdomTree Asset Management, Inc. and WisdomTree Trust (Order)	5-Dec-07	26-Sep-08	29-Sep-08	27-Oct-08	299	28	327	31
Dodge & Cox Funds and Dodge & Cox Incorporated (Order)	18-Jan-08	1-Oct-08	29-Sep-08	27-Oct-08	255	28	283	26
Forward Funds and Forward Management, LLC (Order)	19-May-08	25-Sep-08	29-Sep-08	27-Oct-08	133	28	161	32
First Trust Advisors L.P., et al. (Order)	14-Jan-08	16-Oct-08	29-Sep-08	27-Oct-08	259	28	287	11
Invesco PowerShares Capital Management LLC, et al. (Order)	12-Feb-08	8-Oct-08	29-Sep-08	27-Oct-08	230	28	258	19
Reserve Municipal Money-Market Trust, et al. (Notice of Application and Temporary Order)	14-Oct-08	24-Oct-08	24-Oct-08		10			
The Reserve Fund (Notice)	22-Sep-08		24-Oct-08		32			
Eaton Vance Floating-Rate Income Trust, et al. (Order)	10-Jun-08	2-Sep-08	2-Oct-08	23-Oct-08	114	21	135	51
Delaware Management Business Trust, et al. (Order)	15-Apr-08	19-Sep-08	24-Sep-08	21-Oct-08	162	27	189	32
Morgan Stanley Series Funds, et al. (Order)	18-May-08	19-Sep-08	23-Sep-08	21-Oct-08	128	28	156	32
Aberdeen Asset Management Inc., et al. (Order)	8-May-08	14-Oct-08	25-Sep-08	21-Oct-08	140	26	166	7
Boulder Total Return Fund, Inc., et al. (Notice)	9-Apr-04	22-Aug-08	20-Oct-08		1655			
The Zweig Total Return Fund, Inc., et al. (Notice)	14-Feb-08	30-Jul-08	20-Oct-08		249			
Van Kampen Retirement Strategy Trust, et al. (Order)	7-Mar-08	19-Sep-08	25-Sep-08	17-Oct-08	202	22	224	28
Trust for Professional Managers, et al. (Order)	31-Mar-08	7-Oct-08	19-Sep-08	15-Oct-08	172	26	198	8
Triangle Capital Corporation, et al. (Order)	3-Jan-07	16-Sep-08	19-Sep-08	14-Oct-08	625	25	650	28
Rafferty Asset Management, LLC, et al. (Order)	23-Jan-08	12-Sep-08	12-Sep-08	6-Oct-08	233	24	257	24
Global X Funds and Global X Management Company LLC (Order)	14-Apr-08	20-Aug-08	10-Sep-08	3-Oct-08	149	23	172	44
Prudential Financial, Inc., et al. (Order)	5-Sep-08		5-Sep-08	1-Oct-08	0	26	26	
Fidelity Aberdeen Street Trust, et al. (Order)	29-Feb-08	2-Sep-08	5-Sep-08	30-Sep-08	189	25	214	28
PIMCO Municipal Income Fund, et al. (Order)	2-May-07	29-Aug-08	29-Aug-08	29-Sep-08	485	31	516	31
Phoenix Equity Trust, et al. (Order)	23-Apr-08	22-Sep-08	3-Sep-08	29-Sep-08	133	26	159	7
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INVESTMENT COMPANY	DATE				DATA			
John Hancock Income Securities Trust, John Hancock Investors Trust, John Hancock Patriot Premium Dividend Fund II, John Hancock Preferred Income Fund, John Hancock Preferred Income Fund II, John Hancock Preferred Income Fund III, John Hancock Tax-Advantaged Dividend Income Fund, John Hancock Tax-Advantaged Global Shareholder Yield Fund, and John Hancock Advisers, LLC (Order)	18-Jan-07	18-Jul-08	29-Aug-08	24-Sep-08	589	26	615	68
Aberdeen Asset Management Inc., et al. (Order)	8-May-08	11-Sep-08	25-Aug-08	22-Sep-08	109	28	137	11
Allianz Life Insurance Company of North America, et al. (Order)	19-Nov-07	27-Aug-08	28-Aug-08	19-Sep-08	283	22	305	23
Prudential Financial, Inc., et al. (Notice and Temporary Order)	5-Sep-08		5-Sep-08		0			
Advanced Series Trust, et al. (Order)	2-Jun-08	26-Aug-08	8-Aug-08	3-Sep-08	67	26	93	8
Prudential Annuities Life Assurance Corp., et. al. (Order)	7-May-08	15-Jul-08	8-Aug-08	3-Sep-08	93	26	119	50
DNP Select Income Fund Inc. and Duff & Phelps Investment Management Co. (Order)	11-Apr-07	24-Jul-08	31-Jul-08	26-Aug-08	477	26	503	33
Javelin Exchange-Traded Trust, et al. (Order)	21-Sep-07	31-Jul-08	31-Jul-08	26-Aug-08	314	26	340	26
Goldman Sachs Trust, et al. (Order)	27-Nov-07	4-Aug-08	31-Jul-08	26-Aug-08	247	26	273	22
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ING Clarion Real Estate Income Fund, et al. (Order)	26-Mar-04	8-Jul-08	8-Jul-08	5-Aug-08	1565	28	1593	28
Van Eck Associates Corporation, et al. (Notice)	10-Mar-08	29-Jul-08	31-Jul-08		143			
The Penn Mutual Life Insurance Company, et al. (Order)	29-Jun-07	2-Jul-08	2-Jul-08	25-Jul-08	369	23	392	23
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Harris & Harris Group, Inc. (Order)	9-Apr-08			30-May-08			51	
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The RBB Fund, Inc. and Abundance Technologies, Inc. (Order)	7-Feb-08	12-May-08	30-Apr-08	28-May-08	83	28	111	16
Fidelity Rutland Square Trust, et al. (Order)	16-Jan-08	29-Apr-08	30-Apr-08	28-May-08	105	28	133	29
ING USA Annuity and Life Insurance Company, et al. (Order)	27-Dec-07	18-Apr-08	28-Apr-08	23-May-08	123	25	148	35
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U.S. Bank National Association FAF Advisors, Inc. (Order)	14-Nov-05	13-Mar-08	16-Apr-08	7-May-08	884	21	905	55
ALPS Advisers Inc., et al. (Order)	2-Oct-07	15-Apr-08	9-Apr-08	1-May-08	190	22	212	16
Franklin California Tax-Free Income Trust, et al. (Order)	22-Feb-08		31-Mar-08	28-Apr-08	38	28	66	
Kohlberg Capital Corporation (Order)	27-Feb-07	17-Apr-08	28-Mar-08	23-Apr-08	395	26	421	6

INVESTMENT COMPANY	DATE				DATA			
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RSI Retirement Trust (Order)	4-Mar-08	5-Mar-08		26-Mar-08			22	21
Eaton Vance Mutual Funds Trust, et al. (Order)	18-Jan-08	30-Jan-08	26-Feb-08	25-Mar-08	39	28	67	55
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NETS Trust (Order)	1-Nov-07	29-Feb-08	25-Feb-08	17-Mar-08	116	21	137	17
Pioneer Bond Fund, et al. (Order)	24-Sep-07	16-Jan-08	5-Feb-08	4-Mar-08	134	28	162	48
WisdomTree Trust, et al. (Order)	8-Jan-08	22-Feb-08	6-Feb-08	27-Feb-08	29	21	50	5
Barclays Global Fund Advisors, et al. (Order)	25-Jan-08	14-Feb-08	6-Feb-08	27-Feb-08	12	21	33	13
Bear Stearns Asset Management, Inc., et al. (Order)	21-Dec-06	14-Jan-08	5-Feb-08	27-Feb-08	411	22	433	44
PowerShares Capital Management LLC, et al. (Order)	18-May-07	7-Jan-08	1-Feb-08	27-Feb-08	259	26	285	51
MLIG Variable Insurance Trust (Order)	9-Oct-07	8-Feb-08	31-Jan-08	26-Feb-08	114	26	140	18
Schroder Series Trust, et al. (Order)	21-Dec-07	19-Jan-08	24-Jan-08	25-Feb-08	34	32	66	37
The TIGERS Revenue Trust and VTL Associates, LLC (Order)	8-Feb-07	8-Feb-08	18-Jan-08	13-Feb-08	344	26	370	5
Morgan Stanley Investment Management Inc., et al. (Order)	7-Jul-05	30-Jan-08	18-Jan-08	13-Feb-08	925	26	951	14
Northern Institutional Funds, Northern Funds, Northern Trust Investments, N.A. (Order)	12-Sep-07	4-Feb-08	16-Jan-08	12-Feb-08	126	27	153	8
The UBS Funds, et al. (Order)	23-Nov-07	14-Dec-07	19-Dec-07	16-Jan-08	26	28	54	33
Millennium India Acquisition Company, Inc. (Order)	18-Dec-07	21-Dec-07	21-Dec-07	16-Jan-08	3	26	29	26
Main Street Capital Corporation, et al. (Order)	27-Jul-07	28-Dec-07	21-Dec-07	16-Jan-08	147	26	173	19
					Days from Filing to Notice	Days from Notice to Order	Days from Filing to Order	Days from Last Amendment to Order
AVERAGES					353.9	26.3	301.5	29.2
MEDIAN					192	27	232	28

About the Author

JONATHAN G. KATZ

Jonathan Katz was Secretary of the U. S. Securities and Exchange Commission for twenty years. Katz's tenure as Secretary spanned seven SEC Chairmen and four Acting Chairmen. In this position, Katz coordinated and managed the Commission's agenda and participated in all Commission meetings. He participated in all aspects of the Commission's regulatory and enforcement programs, providing advice to the Commissioners and the staff of the SEC on policy and procedure and past practices. Because these duties entailed regular involvement in all aspects of the agency's work, Katz acquired an extensive knowledge of the wide range of regulatory responsibilities of a financial regulator and how they can be best performed.

Since his retirement in January 2006, Katz has served as a consultant on SEC regulatory requirements. He has been a panelist or featured speaker at numerous conferences in the United States and internationally. He has also served as an advisor to international organizations and foreign governments on the development and regulation of capital markets in developing countries. During the past two years, Katz has worked with foreign governments and markets in Mexico, India, Thailand, Vietnam, Russia, and South Africa.

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