

Financial Services Regulatory Highlights

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House Financial Services Committee Addresses Key Pieces of Financial Regulatory Reform

The House Financial Services Committee (Committee) commenced legislative mark-ups of key elements of the Obama Administration's financial regulatory reform agenda on October 14, 2009. The Committee has approved the OTC Derivatives Market Act (H.R. 3763), the Consumer Financial Protection Agency Act (H.R. 3606), The Private Fund Investment Advisers Act (H.R. 3818), and the Accountability and Transparency in Rating Agencies Act (H.R. 3890). The Committee is currently marking-up the Investor Protection Act, which it expects to approve next week.

OTC Derivatives Market Act of 2009

On October 15, 2009, the Committee approved the OTC Derivatives Markets Act of 2009 that would, for the first time, require comprehensive regulation of the over-the-counter (OTC) derivatives marketplace. Under the bill, all standardized swap transactions between dealers and large market participants, referred to as "major swap participants," would have to be cleared, and subsequently traded only on an exchange or electronic platform.

The legislation sets out parallel regulatory frameworks for the regulation of swap markets, dealers, and major swap participants. The CFTC, which has jurisdiction over swaps and the SEC, which has jurisdiction over security-based swaps under the bill, would hold Rulemaking authority jointly. The Treasury Department is given the authority to issue final rules if the CFTC and SEC cannot decide on a joint approach within 180 days. The Commissions must agree to subsequent interpretations of rules jointly.

Clearing

The legislation provides a mechanism to determine which swap transactions are sufficiently standardized that they must be submitted to a clearinghouse. For transactions that are clearable, clearing is a requirement when both counterparties are either dealers or major swap participants. Clearing organizations must seek approval from the appropriate regulator — either the CFTC or the SEC — before a swap or class of swaps can be accepted for clearing.

Transactions in standardized swaps that involve end-users are not required to be cleared. Such customized transactions, however, must be reported to a trade repository.

Mandatory Trading on Exchange or Swap Execution Facility

A standardized and cleared swap transaction in which both counterparties are either dealers or major swap participants must either be executed on a board of trade, a national securities exchange, or a “swap execution facility” — as defined in the legislation. If none of these venues makes a clearable swap available for trading, the trading requirement would not apply. Counterparties, however, would have to comply with transaction reporting requirements established by the appropriate regulator. The legislation also directs the regulators to eliminate unnecessary obstacles to trading on a board of trade or a national securities exchange.

Registration and Regulation of Swap Dealers and Major Swap Participants

Swap dealers and major swap participants must register with the appropriate Commission, and dual registration is required in applicable cases. Capital requirements for swap dealers' and major swap participants' positions in cleared swaps must be set at greater than zero. Capital for non-cleared transactions must be set higher than for cleared transactions. The prudential regulators will set capital for banks, while the Commissions will set capital for non-banks at a level that is “as strict or stricter” than that set by the prudential regulators.

The regulators are directed to set margin levels for counterparties in transactions that are not cleared. The regulators are not required to set margin in transactions where one of the counterparties is not a dealer or major swap participant. In cases where an end user is counterparty to a transaction, any margin requirements must permit the use of non-cash collateral.

Reporting and Public Disclosure of Swap Transactions

Reporting and recordkeeping is required for all over-the-counter derivative transactions. Clearing organizations must provide transaction information to the relevant Commission and a designated trade repository. Swap transactions that are not cleared and for which no trade repository exists, must be reported directly to the relevant Commission. The legislation also provides for public disclosure of aggregate data on swap trading

volumes and positions — in a manner that does not disclose the business transactions or market position of any person. Large positions in swaps must also be reported directly to regulators.

Swap Execution Facilities

Swap execution facilities, or facility for the trading of swaps that are not Boards of Trade or National Securities Exchanges, must register with the relevant regulator as a swap execution facility (SEF). SEFs must also adhere to core regulatory principles relating to enforcement, anti-manipulation, monitoring, information collection, and conflicts of interest, among others. The CFTC and SEC are required to prescribe joint rules governing the regulation of swap execution facilities. A Commission may exempt a SEF from registration if it is subject to comparable, comprehensive supervision and regulation by another regulator.

Consumer Financial Protection Agency (CFPA)

Under the bill reported by the Committee, the CFPA (the Agency) will be an independent agency headed by a Director who will be a Presidential appointee. The Agency will be responsible for rulemaking, examination and enforcement of federal consumer banking/protection laws and regulations for both bank and nonbank financial institutions. In addition to taking over rulemaking authority currently exercised by the Federal Reserve for a host of laws -- Truth-in-Lending, Equal Credit Opportunity, etc., -- the CFPA will have broad rulemaking authority to address "unfair, deceptive, and abusive" acts and practices that the CFPA defines in the future.

Examination Authority Over Regulated Entities.

The Administration's original CFPA legislation would have given the Agency jurisdiction to conduct examinations for consumer compliance at all financial institutions, including banks and others currently regulated by the Federal prudential regulators. However, the bill was amended in Committee to leave primary responsibility for conducting compliance examinations with the appropriate federal prudential regulator for banks with assets less than \$10 billion (about 95% of banks). The bill also gives the CFPA the ability to

delegate its examination authority for larger banks to the appropriate federal regulators.

Authority Over Nonbank Financial Firms.

All nonbank financial institutions that provide consumer financial products and services will be required to register with the CFPB, which will be their federal regulator. The Committee made a number of amendments clarifying that the bill would not apply to nonfinancial businesses -- such as merchants and retailers that allow customers to buy on credit or doctors, or other businesses that bill after a service is provided. Specific exemptions from CFPB coverage are now provided for accountants and tax preparers, real estate brokers and agents, lawyers, auto dealers and providers of pensions or retirement plans. The bill was also amended to include a definition of a "service provider" to cover entities that have a direct relationship to an underlying product or service, including facilitating the design or operation of a service or that has direct contact with a consumer or processing related transactions. Service providers providing only "ministerial" support services would be excluded.

Federal/State Law Preemption.

The Administration's bill would have negated traditional federal preemption of state consumer protection laws for national banks and federal thrifts. The Committee approved an amendment based on a 1996 court decision that would permit the OCC or OTS to preempt state consumer financial consumer protection laws only with a written finding that the state law "prevents or interferes" with a national bank/thrift's exercise of its powers. State-chartered subsidiaries of national banks/federal thrifts would enjoy no right to preemption. State attorneys general and other state regulators would be able to enforce state laws against national banks and federal thrifts and even enforce CFPB regulations providing they consult first with the CFPB.

Private Fund Investment Advisers Registration Act -- H.R. 3818

The Committee also approved H.R. 3818, the Private Fund Investment Advisers Registration Act. The Committee passed H.R. 3818 by a vote of 67-1. Chairman Kanjorski of the House Financial Services Subcommittee on Capital Markets stated that "The

Private Fund Investment Advisers Registration Act, which passed today with wide-ranging bipartisanship support, will force many more financial providers to register with the Securities and Exchange Commission. The past year has shown that the deregulation or in many cases, lack of regulation, of financial firms is an idea of the past. Advisors to financial firms must receive government oversight and we must understand the assets of financial firms, including for hedge funds, private equity firms, and other private pools of capital. Under this legislation, private investment funds would become subject to more scrutiny by the SEC and take more responsibility for their actions. I look forward to moving this legislation to the House floor for a vote."

HR 3818 was based on draft legislation prepared by the Treasury Department, as registration of advisers to hedge and other private funds is one of thirteen legislative measures included within the President's package of financial sector reforms. The two main objectives of HR 3818 are to require registration with the SEC under the Investment Advisers Act of 1940 (Advisers Act) of advisers to private pools of capital and to require such advisers to maintain and file with the SEC systemic risk data on private funds they advise. This data is to be shared by the SEC with the Federal Reserve (Fed) or any other entity with systemic risk responsibilities. HR 3818 also gives the SEC the authority to prescribe disclosures to "investors, prospective investors, counterparties, and creditors" of any private fund advised by a registered adviser.

At the Committee's mark-up, the Committee approved language providing that the amendments made by HR 3818 to the Advisers Act will take effect at the end of a 1-year period beginning on the date of enactment. However, HR 3818 also allows an adviser to register prior to the effective date and requires the SEC to provide rules and regulations governing such early registration. The timing of joint SEC/CFTC rules regarding the form and content of reports required to be filed by advisers to private funds was also extended from 6 to 12 months after enactment.

HR 3818 directs the SEC to exempt from registration an adviser to a "venture capital fund," which the SEC is to define. Notwithstanding the exemption, the SEC will still have authority to require such exempt advisers to maintain records and provide such annual or other reports as the SEC may require. At the Committee mark-up, a number of other exemptions were proposed by members, prompting Chairman Frank to state that "Everyone supports the principles of the bill, but also believe that they should be exempt." Two exemption amendments were approved -- one for advisers to Small Business Investment Companies and one for an adviser to private funds that each have assets under \$150 million, though as with the venture capital adviser exemption the SEC would require records and annual reports.

Accountability and Transparency in Rating Agencies Act.

Most recently, the Committee approved the Accountability and Transparency in Rating Agencies Act, which builds on the Administration's proposal in this area and takes strong steps to reduce conflicts of interest, stem market reliance on credit rating agencies, and impose a liability standard on the agencies.

Creates Accountability by Imposing Liability.

The bill enhances the accountability of Nationally Recognized Statistical Rating Organizations (NRSROs) by clarifying the ability of individuals to sue NRSROs. The bill also clarifies that the limitation on the SEC or any State not to regulate the substance of credit ratings or ratings methodologies does not afford a defense against civil anti-fraud actions.

Duty to Supervise.

The bill adds a new duty to supervise an NRSRO's employees and authorizes the SEC to sanction supervisors for failing to do so.

Independent Board of Directors.

The bill requires each NRSRO to have a board with at least one-third independent directors and these directors must oversee policies and procedures aimed at preventing conflicts of interest and improving internal controls, among other things.

Mitigate conflicts of interests.

The legislation also contains numerous new requirements designed to mitigate the conflicts of interest that arise out of the issuer-pays model for compensating NRSROs. Additionally, the bill significantly enhances the responsibilities and accountability of NRSRO compliance officers to address conflicts of interest issues.

Greater Public Disclosure.

As a result of the bill, investors will gain access to more information about the internal operations and procedures of NRSROs. In addition, the public will now learn more about how NRSROs get paid.

Revolving-Door Protections.

When certain NRSRO employees go to work for an issuer, the bill requires the NRSRO to conduct a 1-year look-back into the ratings in which the employee was involved to make sure that its procedures were followed and proper ratings were issued. The bill also requires NRSROs to report to the SEC, and for the SEC to make such reports public, the names of former NRSRO employees who go to work for issuers.

Investor Protection Act of 2009

The Investor Protection Act of 2009, which is currently being marked-up by the Committee, will reform the SEC to strengthen its powers, better protect investors, and efficiently and effectively regulate the securities markets. An expeditious, independent, comprehensive study of the entire securities industry by a high-caliber body will identify reforms and force the SEC and other entities to put in place further improvements designed to ensure superior investor protection. The Draft Legislation also addresses doubling the authorized funding for the SEC over five years, and providing many new enforcement powers and regulatory authorities. By doing so, the SEC will be able to enhance its enforcement programs and gain the tools needed to better protect investors and police today's markets.

Furthermore, every financial intermediary that provides advice will have a fiduciary duty toward its customers. Through a harmonized standard, broker-dealers and investment advisers will have to put customers' interests

first. The draft legislation also addresses a whistleblower bounty program in order to create incentives to identify wrongdoing, reward individuals whose tips lead to successful enforcement actions, and end mandatory arbitration. By doing so, the SEC will gain the power to bar such clauses in customer contracts.

Finally, the Madoff fraud revealed that the Public Company Accounting Oversight Board lacked the powers it needed to examine the auditors of broker-

dealers. The \$65 billion Ponzi scheme also exposed faults in the Securities Investor Protection Act, the law that returns money to the customers of insolvent fraudulent broker-dealers. The Investor Protection Act closes these loopholes by fixing these shortcomings. The Committee began mark-up of the legislation on October 27 and is expected to approve a bill next week.

Treasury and House Financial Services Committee Propose The Financial Stability Improvement Act

[The House Financial Services Committee and the Treasury Department released draft legislation on October 27, 2009 to address the issue of systemic risk and "too big to fail" financial institutions.](#)

The bill:

Creates The Financial Services Oversight Council To Monitor Systemic Risks.

The Council will identify financial companies and financial activities that pose a threat to financial stability, and will subject those companies and activities to heightened prudential oversight, standards and regulation. The Council will also subject systemically important financial market "utilities" and payment, clearing and settlement activities to heightened oversight, standards and regulation.

Seeks To Harmonize And Consolidate Holding Company Regulation To Ensure Communication And Coordination Among Regulators And Maintain Clear Lines Of Authority

Removes the Gramm-Leach-Bliley Act's restraints on the Fed's authority over companies subject to consolidated regulation and provides specific authority to the Fed and other federal financial agencies to regulate for financial stability purposes and quickly address potential problems.

Puts safeguards on current Industrial Loan Company (ILC) and other non-bank bank institutions and closes the ILC and other non-bank bank exemptions going forward; current non-bank banks, industrial loan

companies, and similar companies that engage in commercial activities but are not currently subject to bank holding company regulation will not have to divest, but will have to restructure, creating a bank holding company to hold all financial activities, and will face limits on transactions between the bank holding company and any commercial affiliates. Going forward, no additional commercial companies will be allowed to own banks, ILCs or any other specialty bank charters.

Preserves the thrift charter for those thrifts dedicated to mortgage lending, but subjects thrift holding companies to supervision by the Fed to eliminate opportunities for regulatory arbitrage.

Subjects Firms Or Activities That Pose Significant Risks To The System To Heightened, Comprehensive Scrutiny By Federal Regulators

The bill's information gathering and sharing requirements for the Council and all of the financial regulators (including SEC and CFTC) is intended to ensure constant communication and the ability to look across markets for potential risks. Federal regulators will impose heightened standards through a variety of options tailored to the specific threat posed -- no one size fits all approach. The Fed will have back-up authority to step in if regulators do not act quickly to address developing problems identified by the Council.

Provides For The Orderly Wind-Down Of Failing Firms And Seeks To End Too Big To Fail By Ensuring That Industry And Shareholders Absorb The Risks And Costs Of Failure, Not Taxpayers.

Large, highly complex financial companies that fail will do so in an orderly and controlled manner, ensuring that shareholders and unsecured creditors bear the losses, not taxpayers, and the stability of the overall financial system is protected. The FDIC will be able to unwind a failing firm so that existing contracts can be dealt with, creditors' claims can be addressed, and parties required to bear losses do so. Unlike traditional bankruptcy, which does not account for complex interrelationships of such large firms and may endanger financial stability, this more flexible process will help prevent contagion and disruption to the entire system and the overall economy.

Costs to resolve a failing firm will be repaid first from the assets of the failed firm at the expense of shareholders and creditors, and to the extent of any shortfall, from assessments on all large financial firms. In this instance, the bill is said to follow the "polluter pays" model where the financial industry has to pay for their mistakes, not taxpayers. The Resolution Fund is structured to spread the cost over a broad range of financial companies with assets of \$10 billion or more, and provides for a flexible

repayment period to avoid potential procyclical effect of such assessments.

Provides New Accountability For The Fed When It Addresses Short-Term Credit Market Disruptions In Emergency Situations.

Requires approval by the Treasury Secretary for the Fed to provide temporary liquidity assistance using section 13(3) of the Federal Reserve Act, and confines that assistance to generally available facilities.

Credit Risk Retention (Securitization)

Directs the federal banking regulators and the SEC to jointly write rules to require creditors to retain 10 percent or more of the credit risk associated with any loans that are transferred or sold including for the purpose of securitization. Regulators can adjust the level of risk retention above or below 10 percent, but not lower than 5 percent. In the case of the securitization of assets that are not originated by creditors, the regulators will require the securitizer to retain the credit risk.

The House Committee held a hearing on the bill on October 29, 2009

SEC Approved New Exchange Rule for Breaking Clearly Erroneous Trades

On October 5, 2009, the SEC announced that it has approved new exchange rules for breaking stock trades that deviate so substantially from current market prices that they are considered "clearly erroneous." The rules would for the first time provide a consistent standard across stock exchanges and reduce uncertainty about what happens to a trade, depending on where it is executed. Clearly erroneous trades can result from a variety of causes, including human error or computer malfunction. Due to the speed of current market activities, an erroneous trade on one market can very rapidly trigger a wave of similarly erroneous trades on other markets.

Historically, the clearly erroneous execution rules varied from exchange to exchange, with some breaking trades only if the price exceeded an objective threshold based

on the preceding market price, and others relying more heavily on the subjective judgment of exchange officials. Therefore, to better assure consistent results across the equities markets, the exchanges worked together with SEC staff to develop "model" rules with more objective standards for breaking trades.

In general, the new rules allow an exchange to consider breaking a trade only if the price exceeds the consolidated last sale price by more than a specified percentage amount: 10 percent for stocks priced under \$25; 5 percent for stocks priced between \$25 and \$50; and 3 percent for stocks priced over \$50. In addition, the erroneous trade review process generally must commence within 30 minutes of the trade, and be resolved within 30 minutes of commencement.

Agencies Seek Comments on Guidance Regarding Correspondent Concentration Risks

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTC), collectively (the Agencies), are seeking comment on proposed Interagency Guidance on Correspondent Concentration Risks. The proposed guidance outlines the Agencies' expectations for identifying, monitoring, and managing correspondent concentration risks among financial institutions.

Correspondent relationships may result in both asset (credit) and liability (funding) concentrations, each of which heightens the need for a strong risk-management framework due to the lack of diversification. Such credit risks include exposures from federal funds sold, due from banks, loans, and investments. An institution's risk-management framework should ensure that management is scrutinizing funding concentrations and is prepared to oversee and administer the heightened liquidity risks associated with this activity. The following summarizes the major components of the Proposed Guidance.

Identifying Correspondent Concentrations

The Proposed Guidance details the Agencies' expectation that institutions implement procedures for identifying correspondent concentrations on a stand alone basis, as well as take into account exposures to other institutions' affiliates.

Monitoring Correspondent Concentrations

In monitoring correspondent relationships, the Proposed Guidance details the Agencies' expectation that institutions specify what information, ratios, and trends management will review for each correspondent on an

ongoing basis. The Proposed Guidance also stresses that an institution's policies should include procedures that ensure ongoing, timely review of correspondent relationships, establish documentation requirements for the reviews, and specify when relationships that meet or exceed internal criteria are to be reported to the Board of Directors or other management committee for an assessment of risk and risk-reducing strategies.

Managing Correspondent Concentrations

Prudent risk management of correspondent concentrations should include procedures for reducing concentrations that meet or exceed established limits, ranges, or tolerances in an orderly manner over reasonable timeframes. Contingency plans for managing risk should provide for a variety of actions that can be considered relative to changes in the correspondent's financial condition.

Performing Appropriate Due Diligence

The Proposed Guidance also reinforces the Agencies' ongoing expectation that financial organizations with credit or funding exposure to other financial organizations have effective risk-management programs for these credit and funding activities. An institution that maintains or contemplates entering into any credit or funding transaction with another financial institution should have written investment, lending, and funding policies and procedures, including appropriate limits that govern these activities. These procedures should also ascertain whether the institution conducts an independent analysis of credit transactions prior to committing to engage in the transactions.

The Agencies are requesting comments on all aspects of the Proposed Guidance on or before October 26, 2009.

Federal Reserve Board Proposes Rules Amending Credit Card Provisions of Regulation Z

On September 29, 2009, the Federal Reserve Board proposed amendments to Regulation Z (Truth in Lending). The new rules are geared toward protecting consumers from potentially costly practices when using credit cards. According to Federal Reserve Governor Elizabeth A. Duke, "The rule bans several harmful practices and requires greater transparency in the disclosure of the terms and conditions of credit card accounts." These proposed amendments would modify the final regulations prohibiting unfair credit card practices and improved disclosures adopted in December 2008, by incorporating provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit Card Act), enacted in May 2009, and represent the second stage of the Federal Reserves implementation of the Credit Card Act.

The proposed rule would:

- Prohibit increases in rate during the first year an account is opened, or increasing the rate of an

existing credit card balance, to protect consumers from unexpected rate increases;

- Prohibit the issuance of a credit card to consumers under the age of 21 who does not have the ability to make the required payments. The consumer can obtain the signature of a parent or cosigner to prove the ability of the consumer to make the payments;
- Require consumer approval for charging fees for transactions that exceed the credit limit;
- Limit the high fees that come with subprime credit cards;
- Ban the use of "two-cycle" billing method; and
- Ban creditors from allocating payments to balances with lower rates first.

Comments must be received on or before November 20, 2009.

FinCEN Issues Advisory to Financial Institutions on Filing SARs Regarding TARP-Related Programs

On October 14, 2009, FinCEN issued an Advisory so that financial institutions may better assist law enforcement when filing Suspicious Activity Reports (SARs) on activities potentially related to the federal government's Troubled Asset Relief Program (TARP). FinCEN has requested that financial institutions follow the instructions under the "Suspicious Activity Reporting" section of the Advisory for proper completion of SARs that involve TARP-related programs.

In many cases, the trends and indicators of potential suspicious activity associated with the TARP-related programs are similar to the trends and patterns that financial institutions recognize in the context of non TARP-related transactions. Financial institutions should

be able to utilize their Customer Identification Programs (CIP) and Anti-Money Laundering (AML) Programs to aid in:

- Identifying customers who qualify for any TARP-related program funding
- Anticipating the types of TARP-related transactions that may be conducted by such customers
- Identifying any suspicious activity attempted by these customers in the context of any TARP-related transactions

FinCEN has provided examples in the Advisory that may be revealed in a TARP-related transaction. These examples should be considered in light of a financial

institution's unique business plan, operations, customers, and customer transactions, to determine whether filing a SAR is appropriate. The examples are:

- Conflicts of interest
- Collusion
- Insider trading
- Advanced fee schemes
- Money laundering

In order to assist law enforcement in investigating and prosecuting possible criminal activity that involves TARP-related government programs, FinCEN requested that, when reporting suspicious activity, financial

institutions check the appropriate box on the SAR form to indicate the type of suspicious activity and include the term "SIGTARP" in the narrative portion of the SAR.

FinCEN has further requested that the Suspect/Subject Information Section of the SAR include all information available for each party suspected of engaging in the suspicious activity — including information such as individual or company name, address, phone number, and any other identifying information.

FinCEN will continue to monitor SARs that identify TARP-related fraud and related crimes, and will report findings and emerging trends in future advisories and guidance, as appropriate.

SEC Fines a Registered Broker-Dealer and Investment Adviser for Regulation S-P Violations

On September 29, 2009, the SEC issued an administrative cease-and-desist order against Commonwealth Equity Services, LLP (Commonwealth) for violating Rule 30(a) of Regulation S-P. Regulation S-P requires broker-dealers and SEC-registered investment advisers to adopt written policies and procedures reasonably designed to protect customer information. The SEC found that Commonwealth had violated Regulation S-P by recommending — not requiring — that its registered representatives maintain antivirus software on their computers, which the registered representatives used to access customer account information on the firm's intranet and trading platform. As a result, Commonwealth's customer information was left vulnerable to unauthorized access.

In addition, Commonwealth did not have procedures in place to adequately review its registered representatives' computer security measures. Its internal auditors did not audit branch office computers to determine whether antivirus software was installed, nor did Commonwealth have procedures in place to follow-up on potential computer security issues uncovered during branch audits or when registered representatives contacted

Commonwealth's information technology help desk for computer-related assistance.

In November 2008, an unauthorized party obtained the login credentials of a Commonwealth registered representative through the use of a computer virus (malware and keystroke) and was thereby able to access Commonwealth's intranet. The unauthorized party had access to account name, account number, account registration type, account net worth, cash balance, and the last four digits of the account owner's Social Security number for all of the representative's 368 customer accounts. The unauthorized party placed or attempted to place 18 unauthorized orders in eight of those accounts, totaling over \$523,000 of unauthorized purchases before the activity was detected by the clearing broker-dealer. Although Commonwealth absorbed the monetary losses, its failures allowed the unauthorized party to have access to certain customer information relating to 368 of the representative's customer accounts.

Commonwealth's policies for customer records and information prior to the November 2008 intrusions addressed Regulation S-P in certain respects; however,

by failing to require basic safeguards such as antivirus software on all Commonwealth registered representative's computers conducting business over the Internet, and by failing to follow up, or have written procedures addressing the follow up, on security issues

either uncovered in branch audits or reported to the IT help desk, Commonwealth failed to adhere to the standards of reasonable design imposed by the Safeguards Rule.

Small Public Companies to Begin Providing Audited Assessment of Internal Controls Over Financial Reporting

On October 2, 2009, the SEC announced that, in nine months, the smallest publicly reporting companies will begin complying with the final portion of a key provision of a 2002 corporate governance law that requires companies to report to the public about the effectiveness of their internal controls over financial reporting.

The smallest public companies with a public float below \$75 million had been given extra time to design,

implement, and document these internal controls before their auditors are required to attest to their effectiveness. SEC Chairman Mary L. Shapiro said, "Since there will be no further Commission extensions, it is important for all public companies and their auditors to act with deliberate speed to move toward full Section 404 compliance."

FINRA Warns Public of Scam Using Fake FINRA Emails in "Phishing" Scheme

On October 5, 2009, FINRA issued an Investor Alert titled Beware of Auction Rate Securities Settlement "Phishing" Scam. The alert warns of a scam that uses fake FINRA e-mails stating that each recipient is entitled to \$1.5 million regardless of their auction rate securities (ARS) investment and loss.

Recipients are asked to provide personal information such as occupation, e-mail, and address. The e-mails use language from a recent FINRA press release

announcing the settlements. In actuality, eligible investors will be notified as to their settlements by the brokerage firms, which will offer to repurchase the ARS sold to them. FINRA will not reach out to the investors directly. FINRA asks that anyone receiving one of these "phishing" e-mails should not respond or click through the link contained in the e-mail. They should instead forward the e-mail to FINRA's Office of the Whistleblower. A sample of the "phishing" e-mail is contained in the alert.

Appendix

SEC Publishes 2010–2015 Draft Strategic Plan for Public Comment

On October 8, 2009, the SEC published for public comment its Draft Strategic Plan, which outlines the strategic goals for fiscal years 2010 through 2015. The draft plan surveys the forces shaping the SEC's environment and outlines more than 70 initiatives designed to support its primary strategic goals. The four Strategic Goals, their related Outcomes, Initiatives, and Performance Metrics are outlined below:

Strategic Goal 1: Foster and enforce compliance with the federal securities laws

Fostering compliance with federal securities laws is interwoven through all of SEC's programs and is central to fulfilling its mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.

Outcome 1.1: The SEC fosters compliance with the federal securities laws

While detecting violations of the securities laws is important, working to prevent future violations can be even more important to protecting investors and enhancing market integrity. To accomplish this objective the SEC plans to implement the following initiatives: increase deterrence through enhanced communication strategies, expand outreach efforts for promoting compliance practices, and promote investor awareness. The SEC intends to use performance measures to gauge its progress in achieving the above outcomes. Some examples of the performance metrics are as follows: percentage of firms receiving deficiency letters that take corrective action in response to all exam findings, and percentage of non-sweep and non-cause exams that are concluded within 120 days.

Outcome 1.2: The SEC promptly detects violations of the federal securities laws

To accomplish this outcome the SEC plans to improve the management of tips and complaints, enhance effectiveness of the examination process, establish a whistleblower program, improve surveillance capabilities, analyze data more effectively, and bolster the expertise of SEC staff. The performance metrics that will be used to measure progress are: the percentage of investment advisers, investment companies, and broker-dealers examined during the year, and the percentage of advisers deemed "high risk" examined during the year.

Outcome 1.3: The SEC prosecutes violations of federal securities laws and holds violators accountable

In holding violators of the federal securities laws accountable for their actions, SEC staff seek to balance limited resources and leverage important cooperative relationships with other law enforcement agencies, regulators, SROs, and the PCAOB. To accomplish this outcome the SEC will implement initiatives, including but not limited to internal reforms of the enforcement program, maintaining specialty groups within the enforcement program, enhancing timeliness of distributors to wronged investors, and broadening the range of enforcement sanctions. The performance metrics that will be used to measure progress are: percentage of enforcement cases successfully resolved, and percentage of first enforcement cases filed within two years.

Strategic Goal 2: Establish an effective regulatory environment

The SEC has broad authority to shape the regulatory framework for the securities industry. Rulemaking is often required to remedy abusive practices or to respond to changing economic conditions. In addition, the SEC provides guidance when it sets forth its views on questions of current concern.

Outcome 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants

One of the outcomes of this goal is to have the SEC establish and maintain a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and prevents abusive practices by registrants, financial intermediaries, and other market participants. To accomplish this outcome, the SEC will implement initiatives, including but not limited to improving the quality of usefulness of disclosure, strengthening Proxy Infrastructure, modernizing beneficial ownership reporting, and enhancing disclosures related to asset-backed securities. The performance metrics that will be used to measure progress include: survey on quality of disclosure, and number of non-U.S. regulators trained.

Outcome 2.2: The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation

To accomplish this outcome, the SEC plans to put in place particular initiatives, such as: fostering a strong market structure, strengthening the viability of self-regulation, and improving transparency and oversight of small capitalization securities. The performance metrics that will be used to measure progress include: percentage of transaction dollars settled on time each year, and average institutional transaction costs for exchange listed stocks on a monthly basis.

Outcome 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws

To accomplish this outcome, the SEC wants to implement the following initiatives: improve agency-wide coordination of the rulemaking process, enhance the economic support for SEC rules and regulations, and assess the effect of prior rulemaking. Some of the performance measures are as follows: survey on whether SEC rules and regulations are clearly understandable, and time to complete the SEC review of SRO rules that are subject to SEC approval.

Strategic Goal 3: Facilitate access to the information investors need to make informed investment decisions

The federal securities laws require that corporations, investment companies, and other entities provide investors with timely and meaningful information about their operations and finances, among other things this will give investors the information they need to evaluate current and potential investments, while also providing agency staff with critical insight about emerging trends and factors shaping investor decision making.

Outcome 3.1: Investors have access to high-quality disclosure materials that are useful to investment decision making

To accomplish this outcome, the SEC plans to implement several initiatives, including revising disclosure and reporting requirements to reflect the informational needs of today's investors, evaluating filing review programs for the most effective disclosures to investors, as well as designing and implementing new disclosure regimes for specialized categories of issuers. The performance measures that the SEC will use to gauge its progress in achieving this outcome include: the percentage of public companies and investment companies with disclosures reviewed each year, the time to resolve comments on annual report filing reviews, and the access to broker-dealer and investment adviser background checks.

Outcome 3.2: Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs

Understanding the interests and concerns of investors is critical to carrying out the SEC's investor protection mission. To accomplish this outcome, the SEC plans to implement several initiatives, including informing rulemaking with research on investor behavior, reshaping how agency information is made available to investors, addressing Investor Advisory Committee input, modernizing technology and service offerings targeted at assisting the investing public, and expanding collaborative partnerships. The SEC intends to use performance measures to gauge its progress in achieving the above

outcome. Examples of these performance metrics include the number of investor educational initiatives organized and produced, and timeliness of responses to investor contacts.

Strategic Goal 4: Enhance the Commission's performance through effective alignment and management of human, information, and financial capital

Given the immense size of the securities markets the SEC regulates, the SEC's success in fulfilling its mission is highly dependent upon its ability to continually direct its resources toward the most productive uses for investors and the public.

Outcome 4.1: The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight

To accomplish this outcome the SEC plans to implement several initiatives, including increasing employee engagement and retention, enhancing employee development program, promoting a diverse talent pipeline, and implementing a new performance management program. The performance metrics that the SEC will use to gauge progress of this outcome include best places to work ranking, turnover, and size of competency gaps.

Outcome 4.2: The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce

To accomplish this outcome the SEC plans initiatives including leadership development programs and evidence-based selection. The performance metrics that the SEC will use to gauge progress of this outcome include satisfaction with leadership development program, quality of hire, and leadership competency gaps.

Outcome 4.3: Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment

The initiatives that the SEC plans to implement include making disclosure information more useful for analysis, improving SEC's information management and analysis functions, enhancing workflow and document management, enhancing the SEC's electronic discovery program, and enhancing operational resiliency. The performance metrics that the SEC will use to gauge progress of this outcome include deployment of document management and workflow tools, and system availability.

Outcome 4.4: Resource decisions and operations reflect sound financial and risk-management principles

The following initiatives will help the SEC meet this outcome: better integrating data from SEC administrative functions, achieving full integration of the SEC's financial systems, and continuing strong performance and accountability reporting. The performance metrics that the SEC will use to gauge progress of this outcome include milestones achieved toward establishment of a robust data-management program, and financial audit results.

Comments on the Draft Strategic Plan should be received by the SEC before November 16, 2009.

Additional Information

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