

SEC Submits Credit Rating Standardization Report to Congress

The U.S. Securities and Exchange Commission (“SEC”), as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), submitted a report to Congress on the Credit Rating Standardization Study (the “Study”) on September 7, 2012. Enacted on July 21, 2010, section 939(h) of the Dodd-Frank Act required the SEC to adopt certain rules applicable to nationally recognized statistical rating organizations and to conduct certain studies. One such study included the standardization of credit rating terminology and market stress conditions.

The Study compiled and published information submitted during a public comment period, as well as reviewed publicly available information to help answer the questions posed by the Dodd-Frank Act. SEC staff also recommended that “no further action be taken at this time with respect to:

1. Standardizing credit rating terminology, so that all credit rating agencies issue credit ratings using identical terms;
2. Standardizing the market stress conditions under which ratings are evaluated;
3. Requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and
4. Standardizing credit rating terminology across asset classes, so that names ratings correspond to a standard range of default probabilities and expected losses independent of asset class entity.”

SEC staff further recommended promoting transparency throughout the credit rating market.

To read the complete Study submitted to Congress, please follow [this link](#).

SEC Study Prompts Fund Board Focus on Financial Literacy

According to a report published by *Fund Director Intelligence* on September 21, 2012, the SEC Office of Investor Education and Advocacy released a study on August 30, 2012 (the “Study”) which raised the concerns of mutual fund boards regarding the overall lack of financial literacy displayed by U.S. retail investors. Mandated by Section 917 of the Dodd-Frank Act, the SEC findings revealed that American investors “have a weak grasp of elementary financial concepts and lack critical knowledge of ways to avoid investment fraud.” These findings, according to the Study, were especially magnified within particular subgroups including women, minorities, and the poorly educated.

Attorney Marco Adelfio, partner at Goodwin Proctor, referencing his work with fund boards stated “a dialogue that the board may well want to have with the management company is to discuss not only what the fund company can and is doing as part of its overall effort to inform investors about particular funds, but also what it can do to inform them about investing basics.” While trustees do not have a fiduciary responsibility to educate shareholders about the markets in which they invest, Joseph Ahern, independent chairman of Advance Capital Funds, noted that his board frequently questions “how funds are being positioned when presented to clients and how expense ratios and other costs are being explained.” The complete Study may be accessed at: <http://sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf>.

Sources:

<http://sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf>

www.funddirectorintelligence.com/articlefeature.aspx?articleid=3092706&p=2

HIGHLIGHTS

Credit Rating Standardization report and SEC staff recommendations submitted to Congress

Increased trustee focus on financial literacy

Transaction Tax legislation introduced

NYSE agrees to settle charges by paying first-ever SEC financial penalty against an exchange

Financial Transaction Tax Legislation Introduced

On September 17, 2012, a bill was introduced by Rep. Keith Ellison (D-MN) and six other House Democrats to impose a transaction tax on the mutual fund industry. The bill would impose a tax of 0.5% on the sale of stocks, 0.1% on the sale of bonds and 0.005% on the sale of derivatives and other investments. During his press conference, Rep. Ellison stated that the legislation would raise billions, and that revenue could be used to support state and federal investments aimed to improve health, rebuild infrastructure, and create good paying jobs. He further noted that, “almost 30 nations have some form of financial tax and the U.S. had a similar tax from 1914 until 1966.”

The Investment Company Institute (“ICI”) has been outspoken in its opposition to the concept of a transaction tax. “It was a bad idea in earlier versions of bills and it’s a bad idea now,” stated the ICI. “Regardless of how it is structured, any financial tax directly reduces investment returns for individual fund investors who are saving to meet retirement, education and other financial goals.”

Sources:

http://ellison.house.gov/index.php?option=com_content&view=article&id=906:congressman-keith-ellison-introduces-bill-taxing-wall-street-to-restore-main-street-&catid=1:latest&Itemid=16

http://www.ignites.com/c/411591/46381/house_dems_propose_financial_transaction?referrer_module=categoryListing&module_order=2

SEC Charges NYSE for Improper Distribution of Market Data

On September 14, 2012, the SEC ordered cease-and-desist proceedings against the New York Stock Exchange LLC (“NYSE”) and NYSE Euronext (collectively, “Respondents”) for violating Rule 603(a) of the National Market System. National securities exchanges, such as the NYSE, are required to satisfy among the most significant regulatory responsibilities of any market participant. Due to the Respondents’ integral roles in the national market system, the regulatory responsibilities include both an exchange’s own operations and its role as a self-regulated organization, acting in coordination with the SEC and other regulatory authorities.

Rule 603(a) prohibits the practice of improperly sending market data to proprietary customers before sending that

data to consolidated feeds. Exchanges are required to distribute trade and quote data to the public in a “fair and reasonable” and “not unreasonably discriminatory” manner. This, in turn, ensures that the public has fair access to the most current market information. Consolidated data feeds play an important role in price discovery and compliance functions, and are relied upon to make order decisions and execute trade orders. Exchanges are required to send both their best-priced quotations (or “quotes”) and trade reports to be included in the consolidated feeds. SEC proceedings allege that the NYSE gave certain customers an improper head start on trading information through two proprietary feeds. One feed sends real-time depth-of-book market data, which included information about current best-priced quotations and execution prices. The other feed sends quote data to subscribers and makes quotes and trades available for sale to the public on a consolidated basis. The NYSE and NYSE Euronext have agreed to pay a \$5 million dollar penalty, as well as make significant improvements to their proprietary feed system. This marks the first-ever penalty against an exchange.

Sources:

<http://sec.gov/news/press/2012/2012-189.htm>

<http://sec.gov/litigation/admin/2012/34-67857.pdf>

For more information, please speak to your relationship manager or visit jpmorgan.com/wss.

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