

disadvantage based on only one incident in which the individual's status held him or her back in the business world. Typically, a number of incidents illustrating a person's social disadvantage would be necessary to make a successful claim. Usually, only by demonstrating a series of obstacles which he or she has faced in the business world can an individual demonstrate chronic, longstanding social disadvantage—the type of social disadvantage which the 8(a) program was designed to ameliorate.

Fifth, the individual's social disadvantage cannot be established in the abstract. Instead, the individual must demonstrate how his or her social disadvantage has had a negative impact on professional or career development and has impeded advancement in the business world. The closer the individual can link impairment of business opportunities to social disadvantage, the stronger the case. For example, SBA would place little weight on annoying incidents experienced by an individual which have had little or no impact on the person's career or business development. On the other hand, SBA would place greater weight on concrete occurrences which have tangibly disadvantaged an individual in the business world.

There is no limit to the type of evidence an applicant can present to attempt to establish the causal relationship between his or her social disadvantage and impairment of business opportunities. SBA is particularly interested, however, in receiving information pertaining to the individual's educational experience, employment background, and business history. A person's experience in those areas often will shed light on the impediments which he or she has faced in acquiring business-related skills, income, and business contacts.

Accordingly, pursuant to Section 5(b)(6) of the Act, 15 U.S.C. 634(b)(6), SBA amends 13 CFR Part 124 by redesignating existing § 124.1-1(c)(3)(iii) as (iv); revising (c)(3) (i) and (ii) and adding a new subparagraph (iii) as follows:

§ 124.1-1 The Section 8(a) program.

(c) Eligibility.

(3) *Social Disadvantage.*—(i) *General.* Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities. The social disadvantage of individuals must stem

from circumstances beyond their control.

(ii) *Members of Designated Groups.* In the absence of evidence to the contrary, the following individuals are considered socially disadvantaged: Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans (persons with origins from Japan, China, the Philippines, Vietnam, Korea, Samoa, Guam, U.S. Trust Territory of the Pacific Islands, Northern Mariana Islands, Laos, Cambodia, or Taiwan); and members of other groups designated from time to time by SBA according to the procedures set forth at § 124.1-1(c)(3)(iv) of this section.

(iii) *Individuals Not Members of Designated Groups.* Individuals who are not members of the above-named groups must establish their social disadvantage on the basis of clear and convincing evidence. A clear and convincing case of social disadvantage must include the following elements:

(A) The individual's social disadvantage must stem from his or her color; national origin; gender; physical handicap; long-term resident in an environment isolated from the mainstream of American society; or other similar cause not common to small business persons who are not socially disadvantaged.

(B) The individual must demonstrate that he or she has personally suffered social disadvantage, not merely claim membership in a non-designated group which could be considered socially disadvantaged.

(C) The individual's social disadvantage must be rooted in treatment which he or she has experienced in American society, not in other countries.

(D) The individual's social disadvantage must be chronic, long-standing, and substantial, not fleeting or insignificant.

(E) The individual's social disadvantage must have negatively impacted on his or her entry into, and/or advancement in, the business world. SBA will entertain any relevant evidence in assessing this element of an applicant's case. SBA will particularly consider and place emphasis on the following experiences of the individual, where relevant: education, employment, and business history.

(1) *Education.* SBA shall consider, as evidence of an individual's social disadvantage, denial of equal access to business or professional schools; denial of equal access to curricula; exclusion from social and professional association with students and teachers; denial of

educational honors; social patterns or pressures which have discouraged the individual from pursuing a professional or business education; and other similar factors.

(2) *Employment.* SBA shall consider, as evidence of an individual's social disadvantage, discrimination in hiring; discrimination in promotions and other aspects of professional advancement; discrimination in pay and fringe benefits; discrimination in other terms and conditions of employment; retaliatory behavior by an employer; social patterns or pressures which have channelled the individual into non-professional or non-business fields; and other similar factors.

(3) *Business History.* SBA shall consider as evidence of an individual's social disadvantage, unequal access to credit or capital; acquisition of credit or capital under unfavorable circumstances; discrimination in receipt (award and/or bid) of government contracts; discrimination by potential clients; exclusion from business or professional organizations; and other similar factors which have retarded the individual's business development.

(Catalog of Federal Domestic Assistance Program No. 59.006, Minority Business Development—Procurement Assistance)

Dated: November 20, 1980.

A. Vernon Weaver,
Administrator.

[FR Doc. 80-37133 Filed 11-28-80; 8:45 am]

BILLING CODE 8025-01-M

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 80-NW-47-AD, Amdt. 39-3970]

Airworthiness Directives: Boeing Model 737 Series Airplanes Equipped With Auxiliary Body Fuel Tanks

Correction

In FR Doc. 80-34938 appearing on page 74467 in the issue for Monday, November 10, 1980, in the second column, first paragraph, second line "listed as 10-61707-711" should be corrected to read "listed as 10-61707-41 (Original Design); 10-61707-71 (Interim Design); and 10-61707-711".

BILLING CODE 1505-01-M

14 CFR Part 39

[Docket No. 80-SO-70; Amdt. No. 39-3984]

Airworthiness Directives; Teledyne Continental Motors Models GTSIO-520-L, -M, and -N Engines**AGENCY:** Federal Aviation Administration (FAA), DOT.**ACTION:** Final rule.

SUMMARY: This amendment adopts a new Airworthiness Directive (AD) which requires inspection of the oil filter for contamination, inspection of the propeller shaft end clearance for excessive thrust washer bearing wear and a preflight and post flight special engine oil pressure check on certain Teledyne Continental Motors Models GTSIO-520-L, -M, and -N engines installed on but not limited to certain Cessna Models 404 and 421C airplanes. This AD is necessary to detect malfunctioning propeller shaft thrust washers and subsequent loss of bearing material and propeller shaft thrust flange material which could result in low engine oil pressure, engine oil contamination, propeller shaft damage and subsequent engine failure.

DATE: Effective December 5, 1980. Compliance required as indicated.

ADDRESS: The applicable service bulletin may be obtained from Teledyne Continental Motors, P.O. Box 90, Mobile, Alabama 36601.

A copy of the service bulletin is also contained in the Rules Docket, Room 275, Engineering and Manufacturing Branch, FAA Southern Region, 3400 Norman Berry Drive, East Point, Georgia 30344.

FOR FURTHER INFORMATION CONTACT: Gil Carter, ASO-214, Engineering and Manufacturing Branch, FAA, Southern Region, P.O. Box 20636, Atlanta, Georgia 30320, telephone (404) 763-7435.

SUPPLEMENTARY INFORMATION: There have been reports of failed thrust washers which have resulted in low engine oil pressure, contaminated engine oil and friction heat damage to the propeller shaft thrust flange on certain Teledyne Continental Motors Models GTSIO-520-L, -M, and -N engines with 100 hours or less time in service. Since this situation is likely to exist or develop on other engines of the same type design, an Airworthiness Directive is being issued which requires inspection of the oil filter element to detect excessive quantities of bearing and thrust flange material, inspection of the propeller shaft end clearance to detect excessive thrust washer bearing wear, and a preflight and postflight special

engine oil pressure check on these engines.

Since a situation exists that requires the immediate adoption of this regulation, it is found that notice and public procedure hereon are impracticable and good cause exists for making this amendment effective in less than 30 days.

Adoption of The Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, § 39.13 of Part 39 of the Federal Aviation Regulations (14 CFR 39.13) is amended by adding the following new Airworthiness Directive (AD):

Teledyne Continental Motors: Applies to Models GTSIO-520-L, serial numbers 608324 and up; GTSIO-520-M, serial numbers 606619 and up; and GTSIO-520-N, serial numbers 610001 and up, engines with 100 hours or less time in service on the effective date of this AD, installed on but not limited to certain Cessna Models 404 and 421C model airplanes certificated in all categories.

Compliance required as indicated, unless already accomplished.

To prevent engine failure due to loss of engine oil pressure, damage due to contaminated oil, and propeller shaft damage resulting from a malfunctioning thrust washer accomplish the following:

(a) Before each flight and immediately after each flight until the accumulation of 100 hours total time in service, perform a special oil pressure check to determine the oil pressure with engine power at the same level as the magneto check. If oil pressure fluctuates or is less than 30 psi, accomplish paragraphs (b)(1) and (b)(2) before further flight. This oil pressure check may be accomplished by the pilot as provided in FAR 43.3(h).

(b) Prior to the next flight and at each oil change until the accumulation of 100 hours total time in service:

(1) Remove the oil filter, disassemble the canister, and inspect the paper element between the pleats to determine the quantity of metallic material visually and by using a clean magnet. If total metallic contaminants are in excess of the quantity necessary to cover a ¼ inch diameter surface, before further flight take the necessary maintenance action to replace those parts that are malfunctioning.

Note.—Exercise caution to prevent contamination of the filter element during disassembly.

(2) Inspect to determine the end clearance (shaft end play) of the propeller drive shaft with engine at ambient temperature. If axial movement is in excess of .020 inch, before further flight take necessary maintenance action to replace those parts that are malfunctioning.

(c) Prior to the next flight, inspect the engine and airplane records and change oil if necessary to ensure that SAE No. 50 oil is installed for ambient temperature above 40°F or SAE No. 30 oil is installed for ambient temperatures below 40°F.

(d) Upon or before the accumulation of 25 hours, 50 hours and 100 hours total time in service, change oil and oil filter. At the 25 and 50 hour oil change, install either SAE No. 50 or SAE No. 30 oil as appropriate. For engines with 100 hours or more time in service, SAE No. 10W-30 may be substituted for SAE No. 30 oil.

(e) Make appropriate maintenance record entry when accomplishing each requirement of this AD.

The airplanes equipped with affected engines may be flown in accordance with FAR 21.197 to a location where the AD compliance procedures can be accomplished.

An equivalent method of compliance may be approved by the Chief, Engineering and Manufacturing Branch, Federal Aviation Administration, Southern Region.

This amendment becomes effective December 5, 1980.

(Secs. 313(a), 601, and 603, Federal Aviation Act of 1958, as amended (49 U.S.C. 1354(a), 1421, and 1423); Sec 6(c), Department of Transportation Act (49 U.S.C. 1655(c)); 14 CFR 11.89).

Note.—The FAA has determined that this document involves a regulation which is not significant under Executive Order 12044, as implemented by DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979). A copy of the final evaluation prepared for this action is contained in the regulatory docket. A copy of it may be obtained by contacting the person identified above under the caption "For further information contact."

Issued in East Point, Georgia, on November 19, 1980.

George R. LaCaille,
Acting Director, Southern Region.

[FR Doc. 80-37294 Filed 11-28-80; 8:45 am]

BILLING CODE 4910-13-M

COMMODITY FUTURES TRADING COMMISSION**17 CFR Part 1****[Form 1-FR]****Minimum Financial and Related Reporting Requirements**

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: The Commodity Futures Trading Commission ("Commission") is amending certain of its minimum financial and related reporting requirements for futures commission merchants ("FCMs"), as well as the basic financial reporting form for FCMs, Form 1-FR. The amendments will alter, for certain FCMs, the amount of adjusted net capital which must be maintained. In addition, the Commission

is adopting amendments to the minimum financial regulations regarding the treatment of undermargined accounts and debit/deficit accounts, and the treatment of collateral used to secure receivables, as well as conforming changes to the financial early warning system and Commission Form 1-FR to reflect all the new amendments.

DATES: The rule amendments shall be effective on December 31, 1980.

ADDRESS: Send comments to: Commodity Futures Trading Commission, 2033 K Street, NW., Washington, D.C. 20581. Attention: Secretariat.

FOR FURTHER INFORMATION CONTACT: Daniel A. Driscoll, Chief Accountant, Division of Trading and Markets, at the address listed above. Telephone: (202) 254-8955.

SUPPLEMENTARY INFORMATION:

A. Introduction

On June 25, 1980, the Commission published proposed amendments to the minimum financial and related reporting requirements for FCMs (45 FR 42633). The Commission originally permitted ninety days for public comment thereon,¹ and later extended the comment period for an additional fifteen days.² Fifty-two written comments were received in response to the proposed amendments, from forty-seven commentators.³ The commentators included thirty-five FCMs, four contract markets, three public accounting firms, and two trade associations, as well as a clearing organization, another government agency, and a law foundation. The Commission has carefully considered each of the comments, including those submitted after the close of the comment period extension.

B. Minimum Net Capital Requirement

The first proposed amendment was to delete one of the two methods by which FCMs compute minimum required levels of adjusted net capital (17 CFR 1.17(a)(1) (1980)). Specifically, the Commission proposed to eliminate the method of computation which, in effect, permits an FCM to maintain adjusted net capital equal to 6½ percent of its aggregate indebtedness. Under the proposal, all references to aggregate indebtedness would be deleted from the minimum

financial and related reporting requirements, and the current "alternative" method of computing the required amount of adjusted net capital would become the required method of computation for all FCMs, except those FCMs which are also securities brokers or dealers. This method of computation requires adjusted net capital equal to 4 percent of the funds required to be segregated under the Commodity Exchange Act, as amended ("Act") and the Commission's regulations. All FCMs which are also securities brokers or dealers would be required to compute the required minimum level of adjusted net capital, as under the present alternative method, based on the greater of 4 percent of the aggregate debit items computed in accordance with the formula for determination of reserve requirements under SEC regulations (Exhibit A to rule 15c3-3, 17 CFR 240.15c3-3), or 4 percent of segregated funds. In the June 25, 1980 release the Commission proposed no change in the required minimum dollar levels of adjusted net capital, which are currently \$50,000 for an FCM which is a member of a designated self-regulatory organization⁴ and \$100,000 for an FCM which is not a member. Six commentators recommended increasing the minimum dollar levels, although they did not agree on what those levels should be. Based upon those comments, and its own further experience with the operation of the minimum financial regulations, the Commission believes that such an increase may be necessary. Accordingly, the Commission is today proposing, in a separate release, to increase the minimum dollar levels for adjusted net capital to \$100,000 for members, and \$250,000 for non-members.

Commentators frequently cited two criticisms of the proposal to make the amount of adjusted net capital which must be maintained by an FCM equal to 4 percent of the funds required to be segregated pursuant to the Act and the

Commission's regulations. One is that if the proposal were adopted, it would create an incentive to FCMs to reduce the amount of margin which they assess their customers to the exchange minimum levels, and to return any excess customer funds to the customer. It was argued that the consequence of such actions might be an increase in the risks to the financial stability of FCMs. The second objection is that the 4 percent proposal is anti-competitive. Arguments supporting this contention were as follows: The proposal will have the greatest impact on smaller and newer firms. It will inhibit the growth of all firms. It will cause upward pressure on commissions due to increases in the cost of doing business. And, finally, it will give an advantage to FCMs who are securities brokers or dealers over FCMs which are not and will favor FCMs who are subsidiaries of large corporations, and thus able to obtain subordinated loans from the parent firm, over those FCMs not so situated.

While many of the commentators opposed the 4 percent of segregated funds proposal, a number of them also agreed with the principle that required minimum adjusted net capital for FCMs should be related to the amount of customer business undertaken by such firms and the amount of segregated funds. Alternative proposals presented by these commentators included using one, two, or three percent of segregated funds as the required minimum level of adjusted net capital; a percentage of the exchange minimum margin levels for customer positions; four percent of segregated funds for non-member FCMs, but a smaller percentage for members; and a graduated percentage scale based on the amount of segregated funds.

The Commission has carefully considered the comments on the four percent of segregated funds proposal. The Commission continues to believe, as it stated when it announced the proposal, that:

[A] net capital requirement based on a percentage of customers' segregated funds is a more accurate measure of the level of net capital which an FCM should maintain than is such a requirement based on (aggregate indebtedness). (Aggregate indebtedness) excludes amounts owed to customers by an FCM, and, thus, for those FCMs which are principally involved in servicing customer accounts, a potentially serious financial condition may go undetected. An FCM's net capital may be well below 4 percent of segregated funds, yet the FCM's computation of net capital based on (aggregate indebtedness), and the early warning system based on that computation, could fail to

¹ The June 25, 1980 Federal Register release incorrectly listed August 25, 1980 as the close of the comment period. This error was corrected in a subsequent release which gave the correct original closing date for the comment period, September 23, 1980 (45 FR 44966, July 2, 1980).

² 45 FR 62847 (September 22, 1980).

³ Three commentators submitted two letters each, and one commentator submitted three letters.

⁴ The term "self-regulatory organization" ("SRO") means a contract market (as defined in 17 CFR 1.3(h)), or a registered futures association under Section 17 of the Act (no such association presently exists). The term "designated self-regulatory organization" ("DSRO") means a self-regulatory organization of which an FCM is a member or, if the FCM is a member of more than one self-regulatory organization and such FCM is the subject of an approved plan under 17 CFR 1.52, then a self-regulatory organization delegated the responsibility by such a plan for monitoring and auditing such FCM for compliance with the minimum financial and related reporting requirements of the self-regulatory organizations of which the FCM is a member, and for receiving the financial reports necessitated by such minimum financial and related reporting requirements from such FCM. 17 CFR 1.3 (ee) and (ff).

reflect the potential danger to the FCM's financial condition.⁵

The Commission also remains convinced that four percent of segregated funds is the proper minimum adjusted net capital level (and, thus, falling below six percent would require notice to be given under the early warning system). While this will reduce the excess net capital of many firms if those firms maintain their current amounts of capital, the Commission believes that this is a necessary consequence of increasing capital requirements from the present level, which is too low, to a more appropriate level. The studies which the Commission has conducted, as well as the studies submitted by certain commentators, have shown that while many firms would have a reduced amount of excess net capital if the four percent of segregated funds requirement were applied to their present capital situation, relatively few firms would be undercapitalized. The firms that would be undercapitalized are those that should have more capital to carry on their current volume of business.

Of course, the studies of the effect of the four percent of segregated funds requirement are made under existing conditions, and do not take into account the fact that firms will be able to increase their amounts of capital. In addition, the Commission believes that there will be an incentive for firms to maintain higher margin levels than exchange minimums since this serves as a cushion for the firm's financial stability, and because firms are free to invest segregated funds in statutorily-authorized instruments, which many firms utilize to derive a significant portion of their income. Firms will have a further incentive to maintain higher margin levels than exchange minimum levels to avoid having to take capital charges for undermargined accounts, especially since the treatment of undermargined accounts is being tightened (*See discussion infra*).

As to the comments that the four percent of segregated funds requirement is anti-competitive, the Commission does not agree that growth will be unduly inhibited or that newer and smaller firms will be impacted disproportionately. Since the present financial rules became effective on December 20, 1978, and significantly increased the capital requirements from those previously in existence, the volume of commodity futures trading has continued to grow, as have the number of new firms of all sizes entering the industry. Moreover, in adopting this

regulation the Commission has, as required by Section 15 of the Act,⁶ taken into consideration the public interest to be protected by the antitrust laws and endeavored to take the least anti-competitive means of achieving the objectives of the Act, as well as the policies and purposes of the Act.⁷ As the Commission stated when it proposed the four percent of segregated funds requirement, such a requirement will

enhance the protection of customers' segregated funds and better protect the financial condition of FCMs, and those two results are of the greatest importance to the security and overall well-being of individual participants and institutions involved in the futures markets. [It will also] cause the minimum financial requirement to reflect more accurately the amount of customer business of an FCM, help to safeguard customers' funds and provide an improved system of early warning of the deterioration of an FCM's financial condition.⁸

Customer protection and the financial stability of the marketplace are central objectives of the Act, and their achievement by insuring an adequate minimum capital requirement for FCMs, when balanced against the public interest to be protected by the antitrust laws, must clearly take precedence.

Several commentators suggested changes in the treatment of various assets included in the net capital computation, and the Commission agrees that one such suggested change from the proposed amendments should be made. The Commission had proposed to delete § 1.17(c)(2)(v) because it referred to aggregate indebtedness, but, as one commentator pointed out, deletion of that entire paragraph would be incompatible with the financial rules of the Securities and Exchange Commission ("SEC"). The Commission's intended deletion was only for the purposes of eliminating the reference to aggregate indebtedness. Accordingly, consistent with the Commission's continuing effort to preserve as much uniformity as possible between the Commission's regulations and those of the SEC, § 1.17(c)(2)(v) will be amended to delete only the reference to aggregate indebtedness, and to make clear that current assets include fixed assets or other assets acquired in the ordinary course of the trade or business which collateralize long-term debt.

Another commentator correctly notes that, in connection with omnibus

accounts, both the originating FCM and the clearing FCM are required to segregate funds under the Act and Commission regulations. The commentator further notes that the four percent of segregated funds requirement would require that both such entities maintain minimum capital based on the same funds. The commentator requests consideration of relief on this point. The Commission has considered this comment but continues to believe that the proposed requirement is necessary and appropriate.

C. Undermargined Accounts

The Commissioner's June 25, 1980 release announced four proposed changes in the treatment of undermargined accounts (17 CFR 1.17(c)(5)(viii) and (ix)(1980)). These changes relate to the charges which an FCM is required to take against net capital because of such accounts, and offsets to be applied against the required charges due to outstanding margin calls.

The first such proposed change would shorten the period within which an FCM may collect margin on an undermargined customer account before the full charge against net capital for the undermargined amount must be incurred. The regulations currently allow five business days for such collection, and this period is scheduled to be reduced, under the regulations now in effect, to four business days beginning in 1981, and to three business days in 1983.⁹ Essentially, the proposed amendment would accelerate the three-business-day standard by two years.

The Commission also proposed, in connection with the proposed amendments to the treatment of undermargined accounts, to change its interpretation of how to count the business days for purposes of § 1.17(c)(5) (viii) and (ix).¹⁰ The proposed new interpretation was to have been applied to the amount of time allowed to collect margin calls discussed above. The new interpretation would have required that business day number one be the first day after an account becomes undermargined.

⁹ The Commission had proposed, during the rulemaking process culminating in the adoption of the current minimum financial and related reporting requirements, to have § 1.17(c)(5)(viii) of the regulations require the three-business-day standard beginning in 1981 (43 FR 15072, at 15088 (April 10, 1978)), but, after further deliberation, the Commission decided to permit the present schedule for phasing in the three-day requirement (43 FR 39956, at 39964, 39975 (September 8, 1978)).

¹⁰ See 43 FR 39956, at 39964; "Financial and Segregation Interpretation No. 1—Safety Factors on Undermargined Accounts," 1 Comm. Fut. L. Rep. (CCH) ¶7111, at 7071-72.

⁵ 45 FR 42633, at 42634-5 (June 25, 1980).

⁶ 7 U.S.C. 19 (1976).

⁷ *Id.* See also, *British American Commodity Options Corp. v. Bagley*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,245, at 21,334 (S.D.N.Y. 1976), *aff'd and rev'd in part on other grounds*, 552 F. 2d 482 (2d Cir.), *cert. denied*, 434 U.S. 938 (1977).

⁸ 45 FR 42633, at 42635 (June 25, 1980).

according to the following example. On Monday, market action causes a customer's account to become undermargined, and the resulting margin call is sent on Tuesday. Under the proposed new interpretation, Tuesday would be the first day the margin call would be outstanding; Wednesday would be the second day; and Thursday would be the third day. Thus, if no margin were received by the close of business on Thursday, the firm would be required, on that day, to take a charge against net capital. In this example, if the margin call were not made until Wednesday, or even if the call for margin had been made on Monday, the firm would still be required to make a charge to net capital if the funds are not received by the close of business on Thursday. Of course, if a margin call is not made, a charge to capital for the undermargined amount is made immediately.¹¹

The commentators who addressed the proposal to accelerate the institution of the three-business-day standard opposed it by a ratio of seven to one. The objection raised most frequently regarding the proposal was that the present banking, communications and mail systems make it impossible or extremely difficult to collect margin calls within the time frame allowed by the proposal. Several commentators stated that the three-business-day proposal would disadvantage customers in rural areas, small businesses and customers who were likely to transact business with banks which do not provide for wire transfer of money. Such customers, it was argued, have to use the mails to respond to margin calls, and, thus, are unable to respond to such calls as quickly as urban area customers and those larger customers normally transacting business with banks that do provide wire transfer services. A few commentators objected to the proposal as it would affect foreign accounts, citing problems with international wire transfers and currency regulations. The effect of the proposals, according to the majority of commentators, is that FCMs would be forced either to absorb additional capital charges, or frequently to liquidate positions for those without access to wire transfer services, and positions in foreign accounts.

Many of the commentators who objected to the acceleration of the three-business-day standard were especially opposed to the acceleration when combined with the proposed change in

the method of counting business days. These commentators, while objecting to the acceleration proposal, stated that if it were adopted, the Commission should at least continue to maintain the current method for counting days.

The Commission has reevaluated the acceleration of the three-business-day standard in conjunction with the proposed new method for counting days, and has determined to adopt the three-business-day standard but to retain the present method of counting days. The present method of counting business days for purposes of the capital charge to be taken for an undermargined account provides that business day one is the second business day following the business day upon which the account became undermargined. Thus, if an account becomes undermargined on Monday, Wednesday is counted as business day one.¹² The effect of the proposed three-day-standard plus the new counting method would have been to eliminate two days. The Commission's decision to adopt the three-business-day standard but retain the present method for counting days will reduce the days allowed for collection of margin by one, rather than two. In view of the retention of the present method for counting business days, the Commission believes that acceleration of the effectiveness of the three-day collection period will not unduly inconvenience customers in rural areas, small businesses, and other customers without access to wire transfer services.

The Commission's third proposal related to undermargined accounts was to prohibit any reduction in the required charge to be taken against net capital for an undermargined account with respect to any customer commodity futures accounts for which any portion of a margin call remains outstanding for six (6) or more business days (for non-customer or omnibus accounts, the applicable time period would be four (4) or more business days). The Commission believes that undermargined accounts, in general, pose significant financial risks for an FCM. The Commission further believes that accounts remaining undermargined for longer than the periods of time specified in this paragraph pose significant additional risks to an FCM's financial condition which should be reflected in the computation of adjusted net capital.

Only a few commentators addressed this issue, and some of those stated that

extensive studies should be conducted to assess the impact of such a rule. While the Commission continues to view with concern the particular threats imposed by outstanding margin calls, particularly those outstanding for six or more business days, it recognizes that most commentators directed their attention to assessing the impact of other proposed changes, principally the four percent of segregation requirements for computing minimum adjusted net capital. The Commission, therefore, has decided not to adopt the proposed amendments to paragraphs (c)(5)(viii) (customer accounts) and (c)(5)(ix) (non-customer and omnibus accounts) of § 1.17 at this time but to repropose them so that interested persons, particularly those directly affected, may have a greater opportunity to study the effects of such a six-day cutoff and so that the Commission may further evaluate the rule in light of additional, more detailed, comments. The reproposal of these amendments is set forth in a separate release issued today. Comments already received on this issue will be considered as part of the record of this further rulemaking proceeding.

The fourth proposal in the undermargined account area was to require an FCM to take an immediate charge against its net capital when the FCM executes a new trade for an account which is already undermargined, or if such new trade would cause an account to become undermargined and in such circumstances not to permit any offset for a margin call. One commentator agreed with this proposal as it would apply to an account which was undermargined before the new trade was executed, but not to a new trade which causes an account to become undermargined. Another commentator agreed with the proposal in principle but stated that, with current data processing systems, the calculations which would be required would be very complicated or difficult to make. The remaining commentators who addressed this proposal expressed opposition, most frequently citing the problems that would be encountered in trying to make the required calculations. The Commission has reevaluated this proposal and has determined that the comments concerning the practical difficulties of making the calculations which would be required have merit. The Commission has, therefore, decided not to adopt this proposal. The Commission is concerned, however, that an FCM might attempt to use multiple or excess calls for margin, or margin calls for new trades, to improve its net capital

¹¹ If the above situation involved an undermargined non-customer or omnibus account, the FCM would be required to take a charge against its net capital if the margin call was not met by the close of business on Wednesday.

¹² This counting method will not apply to the treatment of debit/deficit accounts. See discussion *infra*.

position at a time when its net capital position is actually deteriorating,¹³ and wishes to emphasize that such a practice is impermissible under the regulations. An FCM may not apply as an offset to a charge against its net capital any portion of a call for margin that would have the effect of making prior, but non-current, margin calls appear current.

D. Debit/Deficit Accounts

The Commission also proposed to eliminate the one-business-day grace period relating to the exclusion from current assets of any unsecured commodity futures or option accounts consisting of a ledger balance and open trades which, when combined, would liquidate to a deficit, or which contain a debit ledger balance (17 CFR 1.17(c)(2)(i)(1980)). At present, for example, if market activity occurs on a Monday, and such market activity causes an account to be in a debit or deficit status, the FCM must collect money, securities or property which would alleviate the debit or deficit situation in the account by the close of business on Wednesday or exclude the account from current assets for net capital purposes. The proposal would have required such exclusion from current assets as of the close of business on Monday.

Of the twenty-three comments on this issue, twenty were opposed. Many of the arguments in opposition were similar to those made in response to the proposal to shorten the time within which to collect margin or undermargined accounts before the full capital charge must be incurred. (See discussion *supra*.) Several commentators stated that the proposal to eliminate the one-business-day grace period for debit/deficit accounts is unreasonable because there exists no on-line computer system which is capable of constantly updating accounts, and, thus, an FCM could not determine until the following business day whether, and by how much, an account is in a debit or deficit status. It was also frequently asserted in the comments on the debit/deficit proposal that it is impossible, even with wire transfer of funds, to collect margin calls and have them credited on the same day, especially when the markets involved are those, such as the financial futures markets, which close late in the day.

¹³ See discussion in "Financial and Segregation Interpretation No. 1—Safety Factors on Undermargined Accounts," 1 Comm. Fut. L. Rep. (CCH) ¶7111, at 7072-73.

While the majority of commentators objected to the proposal to completely eliminate the grace period for debit/deficit accounts, many indicated that they would not be opposed to an exclusion of debit or deficit accounts from current assets provided the FCM had twenty-four hours in which to alleviate the debit or deficit situation. The Commission has considered the comments on the debit/deficit proposal, reevaluated the proposal, and determined to adopt a somewhat less stringent requirement than the one proposed but one which strengthens § 1.17(c)(2)(i) as follows. Using the example referred to above, if market activity occurs on a Monday, and such market activity causes an account to be in a debit or deficit status, the FCM will have until the close of business on Tuesday to collect money, securities or property which would alleviate the debit or deficit situation in the account. If the debit or deficit were not alleviated on Tuesday, the FCM could not include the amount owed as a current asset in a capital computation as of the close of business on Tuesday.

The Commission wishes to emphasize that the method for counting business days with respect to undermargined accounts will, after the effective date of the new amendments, have no bearing on the calculation of business days for purposes of § 1.17(c)(2)(i). The Commission has determined that such differing treatment is necessary because any account liquidating to a deficit or containing a debit ledger balance presents a significantly greater risk to an FCM than one which is undermargined (frequently an account in a debit or deficit status will have been undermargined for quite some time).

E. Non-Cash Assets

The Commission proposed two amendments to the regulation which sets forth the standards for determining whether receivables are secured (17 CFR 1.17(c)(3)(1980)). For purposes of making such a determination, § 1.17(c)(3) currently allows the collateral for a receivable to be valued at 100 percent of its market value. The first proposed amendment would change the valuation method so that receivable would be considered secured only to the extent of the market value of the collateral after making the percentage deductions that would be required by § 1.17(c)(5) if the collateral were owned by the FCM. Only two commentators directly addressed this proposal. One commentator stated that the proposed amendment seemed reasonable and appropriate. The other commentator generally agreed with the amendment,

but expressed the view that commodities eligible for delivery on a contract market should be exempted from this provision. The Commission disagrees with this suggestion. Uncovered deliverable commodities, while readily marketable, are subject to potential adverse market movements and consequently should not be valued at 100 percent of market value.¹⁴ The Commission feels that the 20 percent safety factor which an FCM must apply to its uncovered commodity inventory which is eligible for delivery is also appropriate in the context of valuing the collateral for secured receivables. Therefore, this amendment will be adopted as proposed.

The second proposed amendment to § 1.17(c)(3) concerns certain situations in which a physical commodity is deposited to collateralize a loan, advance or other receivable, the proceeds of which are deposited with the FCM by the borrower to margin, guarantee or secure a futures account. The proposal was that the physical commodity so deposited would be given no value when determining to what extent the loan, advance or other receivable is secured. The Commission also proposed similar amendments to the safety factor charges relating to undermargined customer or non-customer accounts (paragraphs (c)(5)(viii) and (ix) of § 1.17). These proposed amendments would prevent an FCM from attributing any value to a physical commodity deposited to margin, guarantee or secure an account, if such account has an open futures contract in such commodity, unless the futures contract "covered" the deposited physical commodity.

Most commentators who addressed these proposed amendments expressed opposition to their adoption. The most frequently voiced concern was that a physical commodity will always have some value and that the proposal seemed to treat them as though that value could decline to zero. Commentators generally agreed that some percentage deduction from market value is appropriate, but argued that a 100 percent deduction would be excessive. Several individuals also asserted that the proposed amendments would interfere with the delivery

¹⁴ In general, commodities deposited as collateral by any person will not be considered as covered for purposes of this provision unless the futures contracts or fixed-price commitments that represent cover for the collateral are carried on the books of the FCM for such person. The Commission's Division of Trading and Markets will, however, consider, on a case-by-case basis, requests from FCMs for a "no-action" position with respect to situations where such person is covered but not on the books of the FCM.

process and restrict liquidity on the contract markets.

The experiences which led to the proposal of the above charges continue to be of significant concern to the Commission. However, based upon its own further study in this area and upon the comments, the Commission has determined to adopt a somewhat less stringent standard than the one proposed and to monitor its implementation with a view to possible further rulemaking on this subject. Accordingly, the second proposed amendment to § 1.17(c)(3) will not be adopted. Likewise, the Commission has chosen not to adopt this aspect of the proposed amendments to paragraphs (c)(5)(viii) and (ix) of § 1.17. Instead, the value attributed to any non-cash item deposited to margin, guarantee or secure a futures account (regardless of the commodities traded in the account) will be the lesser of (A) the value attributable to such item under the margin rules of the applicable board of trade, or (B) the market value of such item after application of the percentage deductions specified in § 1.17(c)(5).

The Commission continues to believe, however, that a more stringent safety factor may be appropriate in situations where a person or related group of persons have deposited significant amounts of a non-cash item with an FCM to margin, guarantee or secure a futures account or to collateralize a debt to the FCM and that person or related group of persons have a net long futures position in the same non-cash item so deposited. Accordingly, the Commission is today proposing, in a separate release, to add a new paragraph (c)(5)(iii) to § 1.17 which would provide that if, in the above circumstances, the total amount of all loans, advances or other receivables owed to, and included in the current assets of, the FCM, plus the amount of the maintenance margin requirements of the applicable boards of trade for all of the open futures contracts of such person or persons held by the firm, exceed 20 percent of the FCM's net capital, the FCM must first apply the non-cash item, at a rate not to exceed 50 percent of its market value, to the exchange maintenance margin requirements for such net long futures position. An exemption would be provided for obligations of the United States and obligations which are fully guaranteed as to principal and interest by the United States. An exemption would also be provided in a situation where an applicant or registrant has received collateral through the delivery process of a contract market and has not

held such collateral for more than five business days.

F. Miscellaneous Items

One contract market reaffirmed its long-standing position that the Commission is without legal authority to require contract markets to adopt the financial requirements for FCMs which are at least as stringent as the Commission's, as well as any amendments to the Commission's requirements, and it further stated that "[s]erious questions under Sections 5a(12) and 8a(7) of the Commodity Exchange Act are also posed by the proposed amendments." The Commission has previously considered these issues and fully expressed its views thereon in connection with its rulemaking proceeding in adopting the current minimum financial and related reporting requirements.¹⁵ The Commission wishes to reiterate those views.

The Commission also wishes to reiterate that central to the operation of its minimum financial and related reporting requirements for FCMs is that each contract market have in effect, and be responsible for enforcing, financial and reporting rules for their member FCMs which are at least as stringent as those contained in §§ 1.10 and 1.17. Most of the contract markets' rules in this regard incorporate, by reference, the requirements of §§ 1.10 and 1.17 and, hence, the amendments to § 1.17 will be incorporated automatically into the rules of those contract markets upon the effective date of the amendments. Two contract markets do not follow this approach, however, and instead have detailed financial and reporting rules of their own, and these exchange rules will require amendment to bring them into conformity with the amendments to § 1.17. If it would work an undue hardship on those latter contract markets to adopt conforming amendments to their rules prior to the effective date of the amendments described in this release, such markets may request that the Commission's Division of Trading and Markets take a "no-action" position, for a reasonable period of time, to allow the process of amending rules to be completed.

No comments were received on the Commission's proposed technical amendments to the regulations governing the filing of subordination agreements, and the proposals will be adopted. One commentator did, however, request clarification regarding the effect of the amendments concerning aggregate indebtedness upon existing

subordination agreements which refer to this concept.

Five technical changes are being adopted to eliminate reference to aggregate indebtedness from subordination agreements (17 CFR 1.17(h) (1980)). These concern collateral for secured demand notes, permissive prepayments, suspended repayment, notice of maturity or accelerated maturity, and temporary subordinations. Any subordination agreement which has been approved by a contract market or the Commission prior to the adoption of the new amendments will continue to be considered a "satisfactory subordination agreement" for net capital purposes.

The Commission has also examined standard form subordination agreements now in use and it believes that such forms could continue to be used after the new amendments become effective. The agreements are generally phrased in terms which permit an FCM to use either an aggregate indebtedness-based minimum net capital computation, or a computation based on four percent of segregation requirements. The existing forms may thus be used, and all FCMs which use them for future agreements will be considered to be operating under the four percent of segregated funds formula, previously referred to as the "alternative" method. Of course, FCMs and contract markets are free to amend any subordination agreement forms which they might have used previously to eliminate language which is not applicable.

In addition to the rule changes proposed by the Commission in the June 25 release, the Commission stated that it was considering the development and implementation of a capital charge for FCMs which would take into consideration large concentrations of positions in customer, non-customer or proprietary accounts held in a particular commodity or a particular group of commodities.¹⁶ The Commission expressed its concern that such concentrations of positions can greatly increase an FCM's financial exposure in the event of large price movements. The Commission stated that it was considering several possible approaches. One approach would compare a standard fluctuation based upon historical price changes in the concentrated future to the net capital of the firm, and require an FCM to make deductions from its capital based upon the comparison.¹⁷ Another approach would be to group certain commodity futures contracts based upon the

¹⁵ See 43 FR 39956, at 39966-7 (September 8, 1978).

¹⁶ 45 FR 42633, at 42637.

¹⁷ See 42 FR 27166, at 27171, 27175 (May 26, 1977).

historical tendency of their prices to move together. An FCM would calculate the total exchange margin required for all positions with the firm in each group, and be required to take a charge against its net capital equal to all or some percentage of the largest amount of margin that would be necessary for any one group. The Commission invited interested persons to submit comments which would assist in the development of such a capital charge.

The Commission received fifteen comments on this issue. One commentator stated that concentration was the issue of primary importance in the context of the financial rules, and that any new rules should be tied to a certain concentration formula. That commentator went on to state that, for example, if the amount of a margin call for an undermargined account(s) of a customer or related group of customers exceeds 10 percent of the FCM's net capital, a credit for such margin call(s) should be allowed only to the extent that it is outstanding three business days or less (for smaller calls, the present five-day rule should apply). Two other commentators suggested a similar approach when a physical commodity is used as margin so that if the margin requirements for one customer or related group of customers exceeds twenty percent of an FCM's net capital, a fifty percent deduction would be applied to the market value of the unhedged physical commodity. This suggestion, as discussed above, is being proposed for public comment, in a separate release. Other commentators suggested that the problem of concentration would best be addressed by exchange-established speculative position limits for all commodities (with Commission-established charges for any commodities without such limits), or by differential margin levels based on the number of open positions in a particular commodity in an account, or by predetermined limits on an FCM's business based on its net capital. Two commentators expressed the desire to study the issue further, and six commentators opposed any concentration charge.

The Commission expects to study this issue further, and it invites, in a separate release issued today, further comments from interested persons which will assist in the development of appropriate regulations respecting concentration charges. For the present, however, the only measure which will be formally proposed is the one previously discussed respecting physical commodities used, in essence, to margin

long futures contracts in the same commodity.

In consideration of the foregoing, the Commission, pursuant to the authority contained in Sections 4d, 4f, and 8a of the Act, 7 U.S.C. 6d, 6f, and 12a, as amended, 92, Stat. 865 *et seq.*, hereby amends 17 CFR Chapter I and Commission Form 1-FR in the manner set forth below. Certain non-substantive, technical changes (such as commas for clarity and capitalization) have also been made.

1. 17 CFR Part 1 would be amended by revising paragraph (b) of § 1.12 to read as follows:

§ 1.12 Maintenance of minimum financial requirements by futures commission merchants.

(b) Each person registered as a futures commission merchant, or who files an application for registration as a futures commission merchant, who knows or should have known that its adjusted net capital at any time is less than the greatest of 150 percent of the appropriate minimum dollar amount required by § 1.17, or 6 percent of the funds required to be segregated pursuant to section 4d(2) of the Act and these regulations, or, for securities brokers or dealers, 6 percent of aggregate debit items computed in accordance with the formula for determination of reserve requirements (§ 240.15c3-3 of this title), must file written notice to that effect as set forth in paragraph (g) of this section within five (5) business days of such event. Such applicant or registrant must also file a Form 1-FR (or, if such applicant or registrant is registered with the Securities and Exchange Commission as a securities broker or dealer, it may file (in accordance with § 1.10(h)) a copy of its Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934, Part II, in lieu of Form 1-FR, or such other financial statement designated by the Commission and/or the designated self-regulatory organization, if any, as of the close of business for the month during which such event takes place and as of the close of business for each month thereafter until three (3) successive months have elapsed during which the applicant's or registrant's adjusted net capital is at all times equal to or in excess of the minimums set forth in this paragraph (b) which are applicable to such applicant or registrant. Each financial statement required by this paragraph (b) must be filed within 30 calendar days after the end of the month for which such report is being made.

2. 17 CFR Part 1 is further amended by revising paragraphs (a)(1), (b)(1), (c)(2)(i) and (v), (c)(3), (c)(4)(v), (c)(5)(viii) and (ix), (e), (f)(1), (f)(2)(i), (f)(3), (f)(4), (h)(2)(vi)(C), (h)(2)(vii), (h)(2)(viii), (h)(3)(ii), (h)(3)(v), and (h)(3)(vi) and by removing and reserving paragraphs (c)(6) and (g) of § 1.17 to read as follows:

§ 1.17 Minimum financial requirements—futures commission merchants.

(a)(1) Except as provided in paragraph (a)(2) of this section, each person registered as a futures commission merchant must maintain adjusted net capital equal to or in excess of the greatest of \$50,000, (\$100,000 for each person registered as a futures commission merchant who is not a member of a designated self-regulatory organization), or 4 percent of the funds required to be segregated pursuant to the Act and these regulations, or, for securities brokers and dealers, 4 percent of aggregate debit items computed in accordance with the formula for determination of reserve requirements (Exhibit A to Rule 15c3-3, 17 CFR 240.15c3-3).

(b) (1) Where the applicant or registrant has an asset or liability which is defined in Securities Exchange Act Rule 15c3-1 (§ 240.15c3-1 of this title) the inclusion or exclusion of all or part of such asset or liability for the computation of adjusted net capital shall be in accordance with § 240.15c3-1 of this title, unless specifically stated otherwise in this § 1.17.

(c) (2)

(i) Exclude any unsecured commodity futures or option account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only: *Provided, however,* Deficits or debit ledger balances in unsecured customers', non-customers' and proprietary accounts, which are the subject of calls for margin or other required deposits may be included in current assets until the close of business on the business day following the date on which such deficit or debit ledger balance originated;

(v) Include fixed assets and assets which otherwise would be considered noncurrent to the extent of any long-term debt adequately collateralized by assets acquired for use in the ordinary course of the trade or business of an applicant or registrant and any other long-term debt adequately collateralized

by assets of the applicant or registrant if the sole recourse of the creditor for nonpayment of such liability is to such asset: *Provided*, Such liabilities are not excluded from liabilities in the computation of net capital under paragraph (c)(4)(v) of this section;

(3) A loan or advance or any other form of receivable shall not be considered "secured" for the purposes of paragraph (c)(2) of this section unless the following conditions exist:

(i) The receivable is secured by readily marketable collateral which is otherwise unencumbered and which can be readily converted into cash: *Provided, however*, That the receivable will be considered secured only to the extent of the market value of such collateral after application of the percentage deductions specified in paragraph (c)(5) of this section; and

(ii)(A) The readily marketable collateral is in the possession or control of the applicant or registrant; or

(B) The applicant or registrant has a legally enforceable, written security agreement, signed by the debtor, and has a perfected security interest in the readily marketable collateral within the meaning of the laws of the State in which the readily marketable collateral is located.

(4) * * *

(v) Excludes liabilities which would be classified as long term in accordance with generally accepted accounting principles to the extent of the net book value of plant, property and equipment which is used in the ordinary course of any trade or business of the applicant or registrant which is a reportable segment of the applicant's or registrant's overall business activities, as defined in generally accepted accounting principles, other than in the commodity futures, commodity option, security and security option segments of the applicant's or registrant's business activities: *Provided*, That such plant, property and equipment is not included in current assets pursuant to paragraph (c)(2)(v) of this section.

(5) * * *

(viii) For undermargined customer commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding three business days or less. If there are no such maintenance

margin requirements or clearing organization margin requirements on such accounts, then the amount of funds required to provide margin equal to the amount necessary after application of calls for margin, or other required deposits outstanding three days or less to restore original margin when the original margin has been depleted by 50 percent or more. *Provided*, to the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(viii). In the event that an owner of a customer account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this subparagraph shall be the lesser of (A) the value attributable to the asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of the asset after application of the percentage deductions specified in this paragraph (c)(5);

(ix) For undermargined non-customer and omnibus commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or if there are no such maintenance margin requirements clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding two business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements, then the amount of funds required to provide margin equal to the amount necessary, after application of calls for margin, or other required deposits outstanding two days or less to restore original margin when the original margin has been depleted by 50 percent or more. *Provided*, to the extent a deficit is excluded from current assets in accordance with paragraph (c)(2)(i) of this section such amount shall not also be deducted under this paragraph (c)(5)(ix). In the event that an owner of a non-customer or omnibus account has deposited an asset other than cash to margin, guarantee or secure his account the value attributable to such asset for purposes of this subparagraph shall be the lesser of (A) the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of such asset after application of the percentage deductions specified in this paragraph (c)(5);

(6) [Reserved].

(e) No equity capital of the applicant or registrant or a subsidiary's or affiliate's equity capital consolidated pursuant to paragraph (f) of this section, whether in the form of capital contributions by partners (including amounts in the commodities and securities trading accounts of partners which are treated as equity capital but excluding amounts in such trading accounts which are not equity capital and excluding balances in limited partners' capital accounts in excess of their stated capital contributions), par or stated value of capital stock, paid-in capital in excess of par or stated value, retained earnings or other capital accounts, may be withdrawn by action of a stockholder or partner or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor, or employee if, after giving effect thereto and to any other such withdrawals, advances, or loans and any payments of payment obligations (as defined in paragraph (h) of this section) under satisfactory subordination agreements and any payments of liabilities excluded pursuant to paragraph (c)(4)(v) of this section which are scheduled to occur within six months following such withdrawal, advance or loan, either adjusted net capital of any of the consolidated entities would be less than the greatest of 120 percent of the appropriate minimum dollar amount required by § 1.17 or 7 percent of the amount required to be segregated pursuant to the Act and these regulations or, for securities brokers or dealers, 7 percent of the aggregate debit items computed pursuant to § 240.15c3-3 of this title, or in the case of any applicant or registrant included within such consolidation, if equity capital of the applicant or registrant (inclusive of satisfactory subordination agreements which qualify as equity under paragraph (d) of this section) would be less than 30 percent of the required debt-equity total as defined in paragraph (d) of this section: *Provided*, That this provision shall not preclude an applicant or registrant from making required tax payments or preclude the payment to partners of reasonable compensation. The Commission may, upon application of the applicant or registrant, grant relief from this paragraph (e) if the Commission deems it to be in the public interest or for the protection of non-proprietary accounts.

(f)(1) Every applicant or registrant, in computing its net capital pursuant to

this section must, subject to the provisions of paragraphs (f)(2) and (f)(4) of this section, consolidate in a single computation, assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses, or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the applicant or registrant may also be so consolidated if an opinion of counsel is obtained as provided for in paragraph (f)(2) of this section.

(2)(i) If the consolidation, provided for in paragraph (f)(1) of this section, of any such subsidiary or affiliate results in the increase of the applicant's or registrant's adjusted net capital or decreases the minimum adjusted net capital requirement, and an opinion of counsel called for in paragraph (f)(2)(ii) of this section has not been obtained, such benefits shall not be recognized in the applicant's or registrant's computation required by this section.

(3) In preparing a consolidated computation of adjusted net capital pursuant to this section, the following minimum and non-exclusive requirements shall be observed:

(4) No applicant or registrant shall guarantee, endorse, or assume directly or indirectly any obligation or liability of a subsidiary or affiliate unless the obligation or liability is reflected in the computation of adjusted net capital pursuant to this section except as provided in paragraph (f)(2)(i) of this section.

(g) [Reserved]

(h) * * *

(2) * * *

(vi) * * *

(C) The secured demand note agreement may also provide that, in lieu of the procedures specified in the provisions required by paragraph (h)(2)(vi)(B) of this section, the lender with the prior written consent of the applicant or registrant and the designated self-regulatory organization or if the applicant or registrant is not a member of a designated self-regulatory organization, then the Commission, may reduce the unpaid principal amount of the secured demand note: Provided, that after giving effect to such reduction the adjusted net capital of the applicant or registrant would not be less than the greater of 7 percent of the funds required to be segregated pursuant to the Act and these regulations, or, for securities brokers or dealers, 7 percent of the

aggregate debit items computed in accordance with § 240.15c3-3 of this title: *Provided, further*, That no single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No designated self-regulatory organization shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, adjusted net capital would be less than 120 percent of the appropriate minimum dollar amount required by this section.

(vii) *Permissive prepayments.* An applicant or registrant at its option but not at the option of the lender, may, if the subordination agreement so provides, make a payment of all or any portion of the payment obligation thereunder prior to the scheduled maturity date of such payment obligation (hereinafter referred to as a "prepayment"), but in no event may any prepayment be made before the expiration of one year from the date such subordination agreement became effective: *Provided, however*, That the foregoing restriction shall not apply to temporary subordination agreements which comply with the provisions of paragraph (h)(3)(v) of this section. No prepayment shall be made, if, after giving effect thereto (and to all payments of payment obligations under any other subordinated agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such prepayment is to occur pursuant to this provision, or on or prior to the date on which the payment obligation in respect to such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the applicant or registrant, the adjusted net capital of the applicant or registrant is less than the greater of 7 percent of the funds required to be segregated pursuant to the Act and these regulations or, for securities brokers or dealers, 7 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title, or its adjusted net capital is less than 120 percent of the appropriate minimum dollar amount required by this section. Notwithstanding the above, no prepayment shall occur without the prior written approval of the designated self-regulatory organization and the Commission.

(viii) *Suspended repayment.* (A) The payment obligation of the applicant or registrant in respect of any subordination agreement shall be

suspended and shall not mature if, after giving effect to payment of such payment obligation (and to all payments of payment obligations of the applicant or registrant under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such payment obligation), the adjusted net capital of the applicant or registrant would be less than the greater of 6 percent of the funds required to be segregated pursuant to the Act and these regulations or, for securities brokers or dealers, 6 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title, or its adjusted net capital would be less than 120 percent of the minimum dollar amount required by this section: *Provided*, That the subordination agreement may provide that if the payment obligation of the applicant or registrant thereunder does not mature and is suspended as a result of the requirement of this paragraph (h)(2)(viii) of this section for a period of not less than six months, the applicant or registrant shall then commence the rapid and orderly liquidation of its business, but the right of the lender to receive payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this section.

(3) * * *

(ii) *Notice of maturity or accelerated maturity.* Every applicant or registrant shall immediately notify the designated self-regulatory organization and the Commission if, after giving effect to all payments of payment obligations under subordination agreements then outstanding which are then due or mature within the following six months without reference to any projected profit or loss of the applicant or registrant, its adjusted net capital would be less than 120 percent of the minimum dollar amount required by § 1.17, or its adjusted net capital would be less than the greater of 6 percent of the funds required to be segregated pursuant to the Act and these regulations or, for securities brokers or dealers, 6 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title.

(v) *Temporary Subordinations.* To enable an applicant or registrant to participate as an underwriter of securities or undertake other extraordinary activities and remain in compliance with the adjusted net capital requirements of this section, an applicant or registrant shall be permitted, on no more than three

occasions in any 12-month period to enter into a subordination agreement on a temporary basis which has a stated term of no more than 45 days from the date the subordination agreement became effective: *Provided*, That this temporary relief shall not apply to any applicant or registrant if the adjusted net capital of the applicant or registrant is less than the greater of 7 percent of the funds required to be segregated pursuant to the Act and these regulations or, for securities brokers or dealers, 7 percent of the aggregate debit items computed in accordance with § 240.15c3-3 of this title, or its adjusted net capital is less than 120 percent of the appropriate minimum dollar amount required by this section, or the amount of equity capital as defined in paragraph (d) of this section is less than the limits specified in paragraph (d) of this section. Such temporary subordination agreement shall be subject to all the other provisions of this section.

(vi) *Filing*. Two signed copies of any proposed subordination agreement (including nonconforming subordination agreements) shall be filed with the Commission at the Office of the Chief Accountant, Division of Trading and Markets, in Washington, D.C. at least ten days prior to the proposed effective date of the agreement or at such other time as the Commission for good cause shall accept such filing. Copies of the proposed agreement shall be filed in such quantities and at such time as the designated self-regulatory organization may require with the designated self-regulatory organization, if any, of which the applicant or registrant is a member. The applicant or registrant shall also file with said parties a statement setting forth the name and address of the lender, the business relationship of the lender to the applicant or registrant and whether the applicant or registrant carried funds or securities for the lender at or about the time the proposed agreement was so filed. All agreements shall be examined at the Commission or the designated self-regulatory organization with whom such agreements are required to be filed prior to their becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the designated self-regulatory organization or the Commission has found the agreement acceptable and such agreement has become effective in the form found acceptable.

3. By amending Form 1-FR as follows:

Form 1-FR

General Instructions

The terms "current assets," "liabilities," "net capital," and "adjusted net capital" are all defined terms. The definitions of these terms may be found in § 1.17 of the Commission's regulations.

Form 1-FR.—Statement of Financial Condition as of ————/———/——— —Liabilities and Ownership Equity

Liabilities	Total
19. Bank loans payable:	\$
A. Secured.....	
B. Unsecured.....	
20. Securities sold under repurchase agreement.....	
21. Payable to clearing organizations:	
A. Securities accounts.....	
B. Commodities accounts:	
i. Customer segregated.....	
ii. Customer non-segregated.....	
iii. Noncustomer & firm.....	
22. Payable to other futures commission merchants or brokers:	
A. Payables relating to securities transactions (attach details or the FOCUS report).....	
B. Payables relating to commodities transactions:	
i. Customer segregated.....	
ii. Customer non-segregated.....	
iii. Noncustomer & firm.....	
23. Payable to customers:	
A. Securities accounts.....	
B. Commodities accounts:	
i. Regulated futures.....	
ii. Regulated options.....	
iii. Non-regulated.....	
24. Payable to non-customers:	
A. Securities accounts.....	
B. Commodities accounts:	
i. General partners (not included in capital).....	
ii. Other non-customers.....	
25. Securities sold not yet purchased at market value—including arbitrage.....	
26. Accounts payable, accrued liabilities and expenses:	
A. Drafts payable.....	
B. Accounts payable.....	
C. Income taxes payable.....	
D. Deferred income taxes.....	
E. Accrued expenses and other liabilities.....	
F. Salaries, wages and commissions payable.....	
G. Advances against commodities.....	
H. Notes, mortgages and other payables due within twelve months of the date of this statement (See item 27).....	
I. Other (itemize here or on a separate page).....	
27. Notes, mortgages and other payables not due within twelve months of the date of this statement:	
A. Unsecured.....	
B. Secured.....	
28. Liabilities subordinated to claims of general creditors:	
A. Subject to a satisfactory subordination agreement.....	
B. Not subject to a satisfactory subordination agreement.....	
29. Total Liabilities.....	
14. Undermargined commodity futures accounts—amount in each account required to meet maintenance margin requirements less the amount of current margin calls in that account:	
A. Customer accounts.....	
B. Noncustomer accounts.....	
C. Omnibus accounts.....	
15. Uncovered open futures contracts in proprietary accounts—percentage of margin requirements applicable to such contracts.....	
Less: equity in proprietary accounts not otherwise includable in adjusted net capital.....	
16. Amount of any commodity option premiums used to increase adjusted net capital where registrant or applicant is a taker of a commodity option.....	

Form 1-FR.—Statement of Financial Condition as of ————/———/——— —Liabilities and Ownership Equity—Continued

Liabilities	Total
17. Amount of any commodity option premium which has not been previously recognized as income by a grantor of commodity options.....	
18. Ten percent (10%) of the market value of commodities which are the subject of commodity options carried long by the applicant or registrant which has value and such value increased adjusted net capital (this charge is limited to the value attributed to such options).....	
19. Five percent (5%) of all unsecured receivables from unregistered futures commission merchants or securities brokers or dealers.....	
20. Secured demand note deficiency.....	
21. For securities brokers or dealers all other deductions specified in § 240.15c3-1.....	
22. Total Charges.....	
23. Adjusted Net Capital.....	
24. For minimum net capital required, enter the greatest of lines A, B, or C:	
A. Enter \$50,000 (\$100,000 if registrant is not a member of a designated self-regulatory organization).....	
B. Enter 4% of the amount of funds required to be segregated for commodity futures and options customers.....	
C. If a securities broker-dealer, enter 4% of the aggregate debit items computed in accordance with the formula for determination of reserve requirements (attach the computation of Exhibit A to SEC Rule 15c3-3).....	
25. Adjusted net capital—Item 23 this statement.....	
26. Excess net capital.....	
27. Enter the greatest of \$75,000 (\$150,000 for an FCM who is not a member of a designated self-regulatory organization) or 6% of funds required to be segregated for commodity futures and options customers, or, for securities broker-dealers, enter 6% of the aggregate debit items computed in accordance with the formula for determination of reserve requirements (if the amount on line 25 is less than the amount on line 27, the applicant or registrant must immediately notify its designated self-regulatory organization and the Commission and commence filing monthly statements of its financial condition pursuant to Regulation 1.12).....	

*References are to item numbers on the Statement of Financial Condition.

Issued in Washington, D.C. on November 25, 1980, by the Commission.

Jane K. Stuckey,
Secretary of the Commission.

[FR Doc. 80-37150 Filed 11-28-80; 8:45 am]

BILLING CODE 6351-01-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-17321]

Record Production Obligations and Record Destruction and Disposition Rights of Registered Clearing Agencies, the Municipal Securities Rulemaking Board, National Securities Exchanges and Registered Securities Associations

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.