Company, Respondent. Opinion and order determining just and reasonable rates.

Miscellaneous Agenda

M-1.
Reserved

M-2.
Reserved

M-3.
Docket No. RM87-34-000, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol. Remand of Order No. 436.

I. Pipeline Rate Matters

RP-1.
Docket Nos. RP82-58-011 through 017, Panhandle Eastern Pipe Line Company
Docket Nos. RP82-105-001 through 004, Central Illinois Light Company. Order on rehearing of Opinion No. 265 including minimum bill and sole supplier issues.

RP-2.
Docket Nos. RP82-55-006 through RP82-5-020 and RP87-7-000. Transcontinental Gas Pipe Line Corporation. Order on rehearing on Opinion No. 260 concerning rate design and minimum bill.

RP-3.
Docket Nos. RP81-54-023 through 032, RP82-12-014 through 021, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. Order on rehearing of Opinion No. 249 concerning minimum bill, cost classification, allocation and rate design.

RP-4.
Docket Nos. RM83-71-040 and 041, Elimination of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions. Order on rehearing of Order No. 380-E concerning minimum commodity bills.

RP-5.
Docket Nos. RP82-124-000, RP81-53-000, RP81-55-000 and RP85-149-000, East Tennessee Natural Gas Company. Opinion and order on exceptions to initial decision and proposed settlement.

RP-6.
Docket Nos. RP87-26-000, 003, 004, 005, 006 and RP85-178-015, Tennessee Gas Pipeline Company, a Division of Tenneco Inc. Order on rates and terms for transportation and requests for rehearing.

RP-7.
Docket Nos. RP87-55-000 and TA81-1-21-022, Columbia Gas Transmission Corporation. Order concerning contract reformation cost issues.

RP-8.
Docket Nos. TA82-1-21-012, TA82-1-21-013, TA82-1-21-014, TA82-1-21-018 and TA82-1-21-020, Columbia Gas Transmission Corporation. Order on rehearing concerning the June 14, 1985, PGA settlement.

RP-9.
Docket Nos. TA81-1-21-022 through 027, Columbia Gas Transmission Corporation. Order on rehearing concerning remand of Opinion No. 204.

II. Producer Matters

CI-1.
Reserved

III. Pipeline Certificate Matters

CP-1.
Docket Nos. CP87-159-000 and CP87-304-000, Pacific Gas Transmission Company. Order No. 436 blanket certificate application.

CP-2.
Docket Nos. CP85-621-000, CP86-674-000, CP85-713-001, CP85-714-001, CP85-716-000, CP85-889-000 and CP86-53-000, ANR Pipeline. Opinion on initial decision regarding requests for section 7(c) authorization for transportation of gas.

CP-3.
Docket No. CP86-232-000, *et al.*, Panhandle Eastern Pipe Line Company
Docket No. CP86-584-000, Independent Petroleum Association of Mountain States v. Panhandle Eastern Pipe Line Company
Docket No. CP86-663-000, Independent Petroleum Association of Mountain States v. Colorado Interstate Gas Company. Opinion on initial decision regarding requests for section 7(c) authorization for transportation of gas.

Kenneth F. Plumb,
Secretary.

[FR Doc. 87-16930 Filed 7-22-87; 11:22 am]

BILLING CODE 6717-01-M

SECURITIES AND EXCHANGE COMMISSION

Notice is hereby given, pursuant to the provisions of the Government in the Sunshine Act, Pub. L. 94-409, that the Securities and Exchange Commission will hold the following meetings during the week of July 27, 1987:

Closed meetings will be held on Tuesday, July 28, 1987, at 2:30 p.m. and on Thursday, July 30, 1987, following the 2:30 p.m. open meeting. Open meetings will be held on Thursday, July 30, 1987, at 10:00 a.m. and 2:30 p.m., in Room 1C30.

The Commissioners, Counsel to the Commissioners, the Secretary of the Commission, and recording secretaries will attend the closed meeting. Certain staff members who are responsible for the calendared matters may also be present.

The General Counsel of the Commission, or his designee, has certified that, in his opinion, one or more of the exemptions set forth in 5 U.S.C. 552b(c)(4), (8), (9)(A) and (10) and 17 CFR 200.402(a)(4), (8), (9)(i) and (10), permit consideration of the scheduled matters at a closed meeting.

Commissioner Fleischman, as duty officer, voted to consider the items listed for the closed meeting in closed session.

The subject matter of the closed meeting scheduled for Tuesday, July 28, 1987, at 2:30 p.m., will be:

Institution of injunctive action.
Settlement of injunctive action.
Settlement of administrative proceedings of an enforcement nature.
Institution of an administrative proceedings of an enforcement nature.
Amendment of an administrative proceeding.

The subject matter of the open meeting scheduled for Thursday, July 30, 1987, at 10:00 a.m., will be:

1. Consideration of whether to authorize publication of a release proposing for comment two alternative versions of a new Rule 433 which would allow, if certain conditions are met, the prospectus meeting the requirements of section 10(a) of the Securities Act of 1933 ("final prospectus") to be sent to an investor no later than five (5) business days following the date a confirmation of sale is sent to an investor in a firm commitment offering of securities sold for cash. For further information, please contact Gerard S. DiFiore at (202) 272-2589.

2. Consideration of whether to authorize publication of a release proposing for comment proposed amendments to Rule 81 of the Commission's regulations on Information and Requests, which would permit immediate publication of interpretative and no-action letters written by the Commissioner's staff at the time such letters are sent or given to the requesting party, unless temporary confidential treatment is granted. For further information, please contact Michael Hyatte or Kenneth L. Wagner at (202) 272-2573.

3. Consideration of whether to authorize publication of a release which reproposes for comment a revised Rule 701, new temporary Rules 702 and 703 and a revised Form 701 to provide an exemption from the registration requirements of the Securities Act of 1933 for offers and sales of securities pursuant to employee benefit plans or compensation contracts of issuers that are not subject to the reporting requirements of the Securities Exchange Act of 1934. For further information, please contact John D. Reynolds at (202) 272-2644.

The subject matter of the open meeting scheduled for Thursday, July 30, 1987, at 2:30 p.m., will be:

Oral argument on an appeal by Adrian Antoniu from the decision of an administrative law judge. For further information, please contact R. Moshe Simon, at (202) 272-7400.

The subject matter of the closed meeting scheduled for Thursday, July 30, 1987, following the 2:30 p.m. open meeting, will be:

Post oral argument discussion.

At times changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact: Patrick Daugherty at (202) 272-3077.

Shirley E. Hollis,
Assistant Secretary.

July 21, 1987.

[FR Doc. 87-16969 Filed 7-22-87; 3:45 pm]

BILLING CODE 8010-01-M

Corrections

Federal Register
Vol. 52, No. 142
Friday, July 24, 1987

This section of the FEDERAL REGISTER contains editorial corrections of previously published Presidential, Rule, Proposed Rule, and Notice documents and volumes of the Code of Federal Regulations. These corrections are prepared by the Office of the Federal Register. Agency prepared corrections are issued as signed documents and appear in the appropriate document categories elsewhere in the issue.

DEPARTMENT OF DEFENSE

48 CFR Part 215

Department of Defense Federal Acquisition Regulation Supplement; Contracting by Negotiation

Correction

In proposed rule document 87-15848 appearing on page 26363 in the issue of Tuesday, July 14, 1987, make the following correction:

215.804-1 [Amended]

In the third column, in section 215.804-1, following the seventh line, insert "shall request only that data which the contracting officer".

BILLING CODE 1505-01-D

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 53

[FRL-3141-9(e)]

Ambient Air Monitoring Reference and Equivalent Methods

Correction

In rule document 87-13711 beginning on page 24724 in the issue of Wednesday, July 1, 1987, make the following correction:

On page 24725, in the third column, in the second complete paragraph, in the second line ".05"should read "0.5".

BILLING CODE 1505-01-D

ENVIRONMENTAL PROTECTION AGENCY

[OPTS-400005; FRL-3187-8]

Emergency Planning and Community Right-To-Know Programs; Denial of Toxic Chemical List Petition

Correction

In notice document 87-12348 beginning on page 20142 in the issue of Friday, May 29, 1987, make the following corrections:

1. On page 20143, in the first column, in the fourth paragraph, in the 16th line, "to" should read "of".

2. On the same page, in the third column, in the first complete paragraph, in the 16th line, insert a comma after "fluorosis".

3. On page 20145, in the table, in the second column, the last entry should be followed by a footnote reference "5".

BILLING CODE 1505-01-D

ENVIRONMENTAL PROTECTION AGENCY

[PP 4G3039/T543; FRL-3219-7]]

Renewal of Exemptions From Requirement of Tolerances

Correction

In notice document 87-13926 appearing on page 23718 in the issue of Wednesday, June 24, 1987, make the following correction:

On page 23718, in the third column, in the date line, "June 9" should read "June 8".

BILLING CODE 1505-01-D

Executive Office of the President

Office of Administration

3 CFR PART 102

Office of Personnel Management

5 CFR PART 723

Merit Systems Protection Board

5 CFR PART 1207

Office of the Special Counsel

5 CFR PART 1262

Federal Labor Relations Authority

5 CFR PART 2416

National Aeronautics and Space Administration

14 CFR PART 1251

Securities and Exchange Commission

17 CFR PART 200

Overseas Private Investment Corporation

22 CFR PART 711

African Development Foundation

22 CFR PART 1510

National Labor Relations Board

29 CFR PART 100

National Archives and Records Administration

36 CFR PART 1208

Veterans Administration

38 CFR PART 15

Federal Emergency Management Agency

44 CFR PART 16

Enforcement of Nondiscrimination on the Basis of Handicap in Federally Conducted Programs

Correction

In proposed rule document 87-14491 beginning on page 25124 in the issue of Thursday, July 2, 1987, make the following corrections:

§ __.150 [Corrected]

1. On page 25138, in the third column, in § __.150(a) introductory paragraph, in the fifth line, "usable" was misspelled.

§ __.160 [Corrected]

2. On page 25139, in the third column, in § __.160(d), in the eighth line, "program" should read "proposed" and in the ninth line, "proposed" should read "program".

BILLING CODE 1505-01-D

DEPARTMENT OF LABOR

Mine Safety and Health Administration

30 CFR Part 57

Safety Standards for Methane in Metal and Nonmetal Mines

Correction

In rule document 87-14978, beginning on page 24924, in the issue of Wednesday, July 1, 1987, make the following corrections:

§ 57.22005 [Corrected]

1. On page 24945, in the first column, in § 57.22005(f)(1), in the sixth line, "the" should read "an".

2. On the same page, in the second column, in § 57.22005(g), in the fifth line, "90" should read "30".

§ 57.22232 [Corrected]

3. On page 24948, in the second column, in § 57.22232, in the section heading, "0.25" should read "0.5", and in the first line "0.25" should read "0.5".

§ 57.22233 [Corrected]

4. On the same page, in the second column, in § 52.22233, in the section heading, "0.25" should read "0.5", and in the first line "0.25" should read "0.5".

§ 57.22240 [Corrected]

5. On page 24949, in the first column, in § 57.22240, in the fifth line, "the mine" should read "affected areas".

BILLING CODE 1505-01-D

federal register

Friday
July 24, 1987

Part II

Department of Education

34 CFR Part 646

Student Support Services Program; Final Regulations

DEPARTMENT OF EDUCATION

34 CFR Part 646

Student Support Services Program

AGENCY: Department of Education.

ACTION: Final regulations.

SUMMARY: The Secretary amends the regulations for the Student Support Service Program formerly called the Special Services for Disadvantaged Students Program. Amendments are needed to implement changes made in the statute authorizing the Student Support Services Program, Title IV–A–4 of the Higher Education Act of 1965, (HEA) by the Higher Education Amendments of 1986, Pub. L. 99–498.

EFFECTIVE DATE: These regulations take effect either 45 days after publication in the **Federal Register** or later if the Congress takes certain adjournments. If you want to know the effective date of these regulations, call or write the U.S. Department of Education contact person.

FOR FURTHER INFORMATION CONTACT: Mr. Richard Sonnergren, Division of Student Services, U.S. Department of Education, L'Enfant Plaza, P.O. Box 23772, Washington, DC 20026–3772. Telephone: (202) 732–4804.

SUPPLEMENTARY INFORMATION:

Background

The Student Support Services Program was formerly called the Special Services for Disadvantaged Students Program. Under the Student Support Services Program, the Secretary awards grants to institutions of higher education for the purpose of providing support services to low-income, first-generation or physically handicapped college students to enhance their academic skills, imcrease their retention and graduation rates, and as appropriate, facilitate entrance into four-year colleges or graduate and professional programs.

Explanation of Changes

The amended HEA changed the name of the program to the Student Support Services Program, and revised the definition of a "first generation college student." The definition was amended to address the situation where the student resided with, and was supported by, only one parent. Section 646.4(d) has been revised to accommodate the amended definition of a "first generation college student."

The amended HEA also expanded the services to be provided to students to include counseling and peer counseling to assist students at junior and community colleges enroll in four year institutions.

Waiver of Notice of Proposed Rulemaking

In accordance with section 431(b)(2)(A) of the General Education Provisions Act (20 U.S.C. 1232(b)(2)(A)), and the Administrative Procedure Act, 5 U.S.C. 553, it is the practice of the Secretary to offer interested parties the opportunity to comment on proposed regulations. However, since these amendments only incorporate statutory changes, public comment could have no effect on the content of these regulations. Therefore, the Secretary has determined that publication of a proposed rule is unnecessary and contrary to the public interest under 5 U.S.C. 553(b)(B).

Executive Order 12291

These regulations have been reviewed in accordance with Executive Order 12291. They are not classified as major because they do not meet the criteria for major regulations established in the Order.

Regulatory Flexibility Act Certification

The Secretary certifies that these final regulations would not have a significant economic impact on a substantial number of small entities. These regulations are technical in nature, and amend existing regulations which have been previously determined to not have had any significant impact on a substantial number of small entities.

Paperwork Reduction Act of 1980

These regulations have been examined under the Paperwork Reduction Act of 1980 and have been found to contain no information collection requirements.

Assessment of Educational Impact

The Secretary has determined that the regulations in this document do not require transmission of information that is being gathered by or is available from any other agency or authority of the United States.

List of Subjects in 34 CFR Part 646

Bilingual education, Education, Education of disadvantaged, Education of handicapped, Government contracts, Grant programs—education.

(Catalog of Federal Domestic Assistance Number 84.042—Student Support Services Program (formerly Special Services for Disadvantaged Students Program))

Dated: July 7, 1987.

William J. Bennett,

Secretary of Education.

The Secretary amends Part 646 of Title 34 of the Code of Federal Regulations, as follows:

PART 646—[AMENDED]

1. The authority citation for Part 646 is revised to read as follows:

Authority: 20 U.S.C. 1070, 1070d–1b.

2. In Part 646 remove the words "Special Services for Disadvantaged Students Program" and add, in their place, the words "Student Support Services", in the part title and in § 646.1.

§§ 646.1, 646.2, 646.3, 646.4, 646.5, 646.6, 646.10, 646.30, 646.31, 646.32, 646.40 [Amended]

3. In Part 646 remove the words "Special Services" and add, in their place, the words "Support Services" in the following places:

(a) Section 646.1;
(b) Section 646.2;
(c) Section 646.3 (introductory text);
(d) Section 646.4 (a) and (b);
(e) Section 646.5 (heading and introductory text);
(f) Section 646.6 (section heading);
(g) Section 646.10 (section heading), (a) and (b);
(h) Section 646.30 (b);
(i) Section 646.31 (f)(1) and (f)(1)(iii), (h)(1) and (h)(2)(iv);
(j) Section 646.32 (a)(1);
(k) Section 646.40 (introductory text).

4. Section 646.3 is amended by revising paragraph (c) to read as follows:

§ 646.3 Eligible project participants: General.

* * * * *

(c) Has a need for academic support, as determined by the grantee, in order to pursue successfully a postsecondary educational program; and

* * * * *

5. Section 646.4 is amended by revising paragraph (d)(1) to read as follows:

§ 646.4 Eligible project participants: Selection requirements.

* * * * *

(d)(1)(i) Except as provided in paragraph (d)(1)(ii) of this section, a student qualifies as a "first generation college student" if neither of the student's parents received a baccalaureate degree.

(ii) If a student regularly resided with and received support from only one parent, the student qualifies as a first

generation college student if that parent did not receive a baccalaureate degree.

* * * * *

6. Section 646.10 is amended by redesignating paragraph (a)(8) as paragraph (a)(9), adding a new paragraph (a)(8), and revising paragraphs (a)(4) and newly redesignated (a)(9) to read as follows:

§ 646.10 Kinds of projects the Secretary assists under the Student Support Services Program.

(a) * * *

(4) Tutorial services, counseling and peer counseling;

* * * * *

(8) Activities designed to assist students currently enrolled in two-year institutions in securing admission and financial assistance for enrollment in a four-year program of postsecondary education; and

(9) Programs and activities as described in paragraphs (a)(1) through (8) of this section which are specially designed for students of limited proficiency in English.

* * * * *

[FR Doc. 87-16732 Filed 7-23-87; 8:45 am]

BILLING CODE 4000-01-M

federal register

Friday
July 24, 1987

Part III

Department of the Treasury

Office of the Assistant Secretary (Domestic Finance)

17 CFR Ch. IV

Implementing Regulations for the Government Securities Act of 1986; Final Rule

DEPARTMENT OF THE TREASURY

Office of the Assistant Secretary (Domestic Finance)

17 CFR Ch. IV

Implementing Regulations for the Government Securities Act of 1986

AGENCY: Office of the Assistant Secretary (Domestic Finance), Treasury.

ACTION: Final rule.

SUMMARY: The Department of the Treasury is issuing final regulations as required by the Government Securities Act of 1986 (the "Government Securities Act" or "GSA"). These regulations reflect proposed regulations issued by the Treasury on February 25, 1987 (52 FR 5660), a temporary rule issued on May 26, 1987 (52 FR 19641) and the Treasury's response to comments received thereon. The final rule adopts the temporary rule, with amendments.

The GSA requires the Secretary of the Treasury (the "Secretary") to adopt rules and regulations concerning the financial responsibility, protection of investor securities and funds, recordkeeping, reporting and audit of brokers and dealers in government securities. The GSA also requires the Secretary to adopt regulations relating to the custody of government securities held by depository institutions. The regulations are designed to enhance the protection of investors in government securities while maintaining a fair, honest and liquid market in such securities. Subchapter A of the regulations covers government securities brokers and dealers. Subchapter B of the regulations deals with custody of government securities by depository institutions, including those that are government securities brokers or dealers.

The GSA requires that all government securities brokers and dealers either be registered with the Securities and Exchange Commission ("Commission" or "SEC") by July 25, 1987, or have provided notice of their status as a government securities broker or dealer to either the SEC (in the case of registered brokers or dealers) or the appropriate federal financial institution supervisory agency (in the case of commercial banks and thrift institutions) by July 25, 1987. This requirement has been delayed by these regulations to October 31, 1987 for certain futures commission merchants.

EFFECTIVE DATE: July 25, 1987. See also 17 CFR 402.1(f), 403.7, 404.2(c), 404.4(c), 404.5(b), 405.1(c) and 450.5.

FOR FURTHER INFORMATION CONTACT: Anne Meister (Federal Reserve Liaison Officer), Room 553, Bureau of Public Debt, Department of the Treasury, 999 E Street, NW., Washington, DC 20239, (202) 376-4304, or Ellen Seidman (Special Assistant to the Under Secretary), Room 4414, Main Treasury Building, 1500 Pennsylvania Ave., NW., Washington, DC 20220, (202) 566-2278.

For information concerning financial responsibility (capital) and Form G-405, contact: Norman Carleton (Assistant Director, Office of Government Finance & Market Analysis), Room 3044, Main Treasury Building, 1500 Pennsylvania Ave., NW., Washington, DC 20220, (202) 566-2330.

For information concerning possession or control of customer securities and Part 450, contact: Cindy Reese (Senior Attorney and Special Assistant), Room 503, Bureau of Public Debt, Department of the Treasury, 999 E Street, NW., Washington, DC 20239, (202) 376-4320, or Virginia Rutledge (Attorney-Advisor), Room 2025, Main Treasury Building, 1500 Pennsylvania Ave., NW., Washington, DC 20220, (202) 535-4890.

SUPPLEMENTARY INFORMATION:

I. Background

The GSA establishes, for the first time, a federal system for regulation of brokers and dealers who transact business exclusively in government securities, or a government securities business combined with business in non-security financial instruments, exempted securities and/or futures and other commodity interests regulated by the Commodity Futures Trading Commission ("CFTC"). The Secretary is to adopt rules and regulations concerning the financial responsibility, protection of investor securities and balances, recordkeeping, reporting and audit of government securities brokers and dealers.[1] Previously unregulated government securities brokers and dealers must also register with the SEC and join a self-regulatory organization.[2] Enforcement of the Secretary's regulations with respect to newly registered government securities brokers and dealers will be carried out by the SEC and the appropriate self-regulatory organizations.[3]

The GSA also provides for regulation of all other brokers and dealers in government securities, all of whom must, by July 25, 1987, notify their principal regulatory agency of their status as government securities brokers or dealers.[4] Enforcement of the regulations for such entities will be carried out by the appropriate regulatory agencies.[5]

The purpose of such registration and regulation is to enhance the protection of investors in government securities by establishing and enforcing appropriate financial responsibility and custodial standards for government securities brokers and dealers. At the same time, the standards must respect and protect the integrity, liquidity and efficiency of the world's largest securities market, which is vital to the effective implementation of fiscal and monetary policy in the United States.[6] In adopting regulations concerning those entities that are already regulated, such as brokers and dealers registered under sections 15 or 15B of the Securities Exchange Act of 1934 (the "Act") and financial institutions, the Secretary of the Treasury is to take into consideration already existing

---

[1] Section 15C(b) of the Securities Exchange Act of 1934 [15 U.S.C. 78o-5(b)]. All citations to the Securities Exchange Act (hereinafter the "Act") will refer to the section of the Act followed by the parallel citation to the United States Code in brackets. Title I of the GSA, which provides for regulation of government securities brokers and dealers, amends the Act, in part by adding Section 15C.

[2] Section 15C(a)(1)(A), (e) [15 U.S.C. 78o-5(a)(1)(A), (e)]. Currently unregulated persons (including subsidiaries and affiliates of financial institutions) and registered brokers or dealers uncertain of their status as government securities brokers or dealers are urged to contact the Office of the Chief Counsel, Division of Market Regulation, Mail Stop 5-1, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549, as soon as possible. Financial institutions uncertain of their status should contact their appropriate regulatory agency or the SEC.

[3] Section 15C(c)(1), 19(g)(1) [15 U.S.C. 78o-5(c)(1), 78s]. The Act also contains criminal penalties enforced by the Department of Justice. Section 32 [15 U.S.C. 78ff].

[4] Section 15C(a)(1)(B), (b) [15 U.S.C. 78o-5(a)(1)(B), (b)].

[5] Generally, the appropriate regulatory agency for a financial institution is that institution's federal supervisory agency. It is the SEC for all others, including brokers and dealers registered with the SEC under sections 15 or 15B of the Act and financial institutions that do not have a federal supervisory agency. Section 3(a)(34)(G) [15 U.S.C. 78c(a)(34)(G)].

Brokers and dealers in Small Business Administration ("SBA") individual loan certificates and pool certificates under the authority of sections 5(f)-5(h) of the Small Business Act (15 U.S.C. 634(f)-(h)) are government securities brokers or dealers. The SBA has informed the Department that, in addition to requirements under the Act, pool assemblers must be qualified with the SBA pursuant to 13 CFR 120.703. The SBA intends to take the position that, notwithstanding Chapter III, Part 2, of the Secondary Market Program Guide, pool assemblers may register under section 15C of the Act (if otherwise eligible) and thereby be subject to the Treasury financial responsibility rules, 17 CFR 402.2.

[6] Government Securities Act of 1986, Pub. L. 99-571, section 1, 100 Stat. 3208 (1986) (hereinafter cited as *GSA*).

regulation with a view toward preventing overly burdensome or duplicative regulation.[7]

The final regulations constitute the Secretary's third response to these mandates. As required by the GSA, they become effective on July 25, 1987.[8] All government securities brokers and dealers must register or give notice by July 25, 1987, and must be in compliance with the final regulations on that date.[9]

Consultation and Comments

As discussed in the preambles to the proposed and temporary regulations, in developing the regulations the Department has consulted extensively with other federal regulators, affected parties, and trade and professional associations. During the period since publication of the temporary regulations, that process has continued. In addition, representatives of the Department have continued to participate in conferences and seminars to discuss the proposed regulations. The Department received over 20 written comments in response to the temporary regulations. Among the commenters were 12 of the 40 primary dealers, two banks that are not primary dealers, three brokers, one self-regulatory organization, and three trade associations—the Public Securities Association ("PSA"), the Government Securities Brokers Association and the Institute of Foreign Bankers.

The comments generally supported the approach taken in the temporary regulations. Comments on the temporary regulations concentrated mainly on operational problems that could arise from the requirements of Part 403 relating to hold-in-custody repurchase agreements, confirmations and buying in of securities, and related sections of Part 450. In addition, a number of comments were received requesting delayed effective dates, transition rules and clarifications. These comments and the Department's response thereto are discussed in the following section-by-section analysis. The Department appreciates the commenters' general adherence to the Department's request that comments on the temporary regulations recognize the need of affected parties to rely on regulations known to the maximum extent possible before the July 25 effective date and therefore to limit comments to provisions likely to result in serious and widespread operational difficulties. The Department has responded by making changes in the temporary regulations only to respond to such problems and for clarification. As noted in the preamble to the temporary regulations, the rulemaking process under the GSA is a continuing one, and the Department therefore welcomes suggestions for changes or modifications to the final rule.

II. Section-by-Section Analysis of Regulations

A. Part 400—Rules of General Application

1. *Section 400.1.* No comments were received on this section of the temporary regulations and it is adopted without amendment.

2. *Section 400.2.* Four comments reflected continuing concern with the status of Treasury Department interpretations of SEC rules, and particularly with the potential for inconsistent interpretations. This potential is an inevitable consequence of the decision of the Treasury—supported by virtually all commenters—largely to adopt SEC rules.

Problems potentially can arise in several ways. First, Treasury may interpret rules uniquely its own, such as § 402.2a(a) (relating to haircuts on Treasury market risk instruments) in a manner at variance with analogous SEC regulations. Second, Treasury may interpret its modifications of SEC rules [10] in a manner that appears to conflict with the underlying rules. Third, Treasury and the SEC may differ on the appropriate interpretation of an SEC rule adopted by Treasury.

The Department and the SEC recognize these problems, and propose to deal with them as follows. First, § 400.2(c)(4) has been amended to provide that in responding to a request for an interpretation, the Department will, where appropriate, consult with the appropriate regulatory agencies. Particularly in the case of a request by a financial institution, this consultation will frequently include not only the requester's appropriate regulatory agency but also, in order to assure consistency, the other financial institution supervisory agencies and in certain cases the Commission.

Second, § 400.2(c)(4) has also been amended to provide for the possibility of formal concurrence by the staff of the appropriate regulatory agency in a Treasury interpretation. As a matter of practice, the Department believes this will be appropriate only when the Department is interpreting a Treasury-adopted SEC or financial institution supervisory agency regulation with respect to a registered government securities broker or dealer or with respect to the government securities transactions of a registered broker-dealer or financial institution. Treasury believes its interpretations will be followed by the appropriate regulatory agencies with respect to the entity that is the subject of the request without a formal concurrence, and the process of obtaining formal concurrence may substantially delay issuance of an interpretation.[11] However, where it is possible to obtain such concurrence within a reasonable period of time, the interpretation will thereby obtain the full force and effect of an interpretation issued by the staff of the appropriate regulatory agency.

---

[7] Section 15C(b)(3)(C) [15 U.S.C. 78o-5(b)(3)(C)]; 132 Cong. Rec. H9251 (Oct. 6, 1986).

[8] The requirement that the final regulations become effective immediately results from the confluence of the statutory requirements of section 402 of the GSA, mandating the date on which the rules are to take effect, and of the Administrative Procedure Act to receive and take into account comments on the proposed regulations published February 25, 1987 and the temporary regulations published May 26, 1987. See 5 U.S.C. 553 (b), (c). The Department notes, however, that since the final regulations largely adopt the temporary regulations and since section 401 of the GSA provides that the statutory requirements of the GSA do not become effective until July 25, 1987, as a practical matter the final rules have been published in the form of temporary rules with a 60-day delay of effective date. Moreover, the effective date of a number of the most difficult requirements in the rules is delayed beyond July 25. The Department therefore finds that there is good cause to provide for immediate effectiveness of the final rule. 5 U.S.C. 553(d)(3).

[9] *GSA, supra* note 6, section 402. See, however, the limited registration delays provided in §§ 401.7 and 401.8 of the regulations. In addition, because of the difficulties of achieving compliance with several of the regulations before July 25, 1987 several of the regulations, in particular the market risk ("haircut") calculations of Part 402 relating to financial responsibility, and related possession or control, recordkeeping and audit rules, will not become fully effective until the end of October 1987. The regulations in Part 403 relating to hold-in-custody repurchase agreements take effect in stages and become fully effective on January 31, 1988. The rules relating to custodial holdings of government securities by depository institutions (Part 450) also do not become effective until October 31, 1987.

Previously unregulated government securities brokers and dealers are reminded that, in addition to the regulations to be promulgated under the GSA, they are subject to the provisions of sections 10(b), 15(c)(1), 17(f)(1) and 17(f)(2) of the Act and the regulations promulgated by the SEC thereunder.

[10] This category will be quite small after final Treasury and SEC rules concerning repurchase agreements have been adopted. This is the major area in which modifications of SEC rules were made in the temporary rules, and as SEC and Treasury rules are brought into conformity with each other, Treasury modifications will be eliminated.

[11] Having adopted SEC regulations, the Treasury has adopted all existing relevant interpretations—this is the only manner in which any consistency can be obtained in the short run. To the extent that newly registered government securities brokers or dealers find any of these troublesome, they should so inform the Treasury, SEC and relevant self-regulatory agency, in general the National Association of Securities Dealers ("NASD"). To date, Treasury has found it possible to respond to these problems once they have been brought to its attention.

Finally, Treasury and the SEC have agreed that the staffs of the two agencies will meet quarterly to discuss issues that have arisen and questions that need to be resolved. These meetings may also include the other regulatory agencies and the self-regulatory organizations. It is the firm expectation of the Department, however, that the excellent day-to-day coordination and cooperation among all the agencies which has occurred to date will continue, rendering the quarterly meetings useful largely to review actions and to raise to higher policy levels issues that the staffs have been unable to resolve.

The Department recognizes that these procedures do not produce iron-clad assurances of perfect consistency. That would be obtainable only if Treasury ceased its rulemaking function or adopted regulations entirely distinct from SEC regulations—neither of which is contemplated by the GSA. However, the Department believes that these provisions for coordination, which in formality go beyond those provided in analogous situations,[12] will reduce to a minimum the incidence of inconsistency.

Other changes have been made in § 400.2 to direct inquiries to the Office of the Commissioner, Bureau of the Public Debt. As discussed in the preamble to the temporary regulations, the Department has determined that implementation of the regulations should be the continuing responsibility of that office. The Departmental Offices—particularly the Offices of the Assistant Secretary (Domestic Finance) and the General Counsel—intend to stay involved with the regulations, particularly with respect to major modifications or amendments. Section 400.2(b)(2) has been amended to clarify the Department's authority to interpret the statutory language of section 15C(b) of the Act and related sections. Except as described, § 400.2 of the temporary regulations is adopted as final.

One commenter asked that Treasury clarify what must be included in a request for an interpretation pursuant to § 400.2(c)(3)(iii). The requirement that the requester provide the "writer's opinion on the matter, and the basis of such opinion" is not meant to require that the writer prepare a proposed response letter, but merely to require that the writer include a reasoned basis for the requested response. The same commenter requested that Treasury clarify that a superseding interpretation that would nullify prospectively a prior interpretation is one made to the requester. This is the case, but the Department cautions that in such a situation others should not rely on the superseded interpretation. In addition, persons relying on identical interpretations previously issued to them in writing should be aware that the Department may issue a superseding interpretation without a request for one.

3. *Section 400.3.* This section of the temporary regulations is adopted with three amendments. Paragraph (j), the definition of "financial institution," has been amended to clarify that a subsidiary or affiliate of a financial institution may also be a financial institution, but only if the subsidiary or affiliate is *independently* (a) a bank, (b) a foreign bank, or (c) an institution insured by the Federal Savings and Loan Insurance Corporation. The SEC has informed the Department that it takes the position that for purposes of the GSA, any bank, including a savings bank, that is insured by the Federal Deposit Insurance Corporation is a "bank." Paragraph (n) has been amended to clarify that a bank municipal securities dealer is treated in these rules as a financial institution rather than as a registered broker or dealer.

The Department received a comment concerning the derivation of the definition of "associated person," § 400.3(c). This definition is derived from Rule G-3 of the Municipal Securities Rulemaking Board. The Department notes that the definition is "for the purpose of these regulations," and unless adopted by a self-regulatory organization it is in practice relevant only to financial institution government securities brokers and dealers. The Department also received several questions that indicated that the use in paragraph (c)(3)(i) of the term "fiduciary capacity," defined in paragraph (i) to refer to the financial institution, was confusing. Therefore paragraph (c) has been amended to refer to persons whose functions consist of carrying out a financial institution's activities in a fiduciary capacity, examined as such. This also conforms more completely to the exemption for fiduciary activities in § 450.3.

4. *Section 400.4.* Paragraph (d)(1) of this section has been amended at the request of the staff of the Board to require that the appropriate regulatory agency be provided with a list of all persons with respect to whom a financial institution is relying on a Form MSD-4 or U-4 in lieu of filing a Form G-FIN-4. This will provide the financial institution regulatory agencies with a complete list of all persons associated with a financial institution's government securities activities. The remainder of the section is adopted without amendment.

5. *Section 400.5.* This section of the temporary regulations is adopted as final.

6. *Section 400.6.* Subsection (a) of this section has been amended to clarify that the requirement to file a withdrawal notice arises whether or not a firm has originally registered or given notice, if such registration or notice was in fact required. The amendment is not in any way meant to exonerate the firm for failing to register or give notice. The remainder of the section is adopted without amendment.

B. Part 401—Exemptions

1. *Section 401.1.* No comments were received on this section of the temporary regulations, which provides an exemption from the provisions of section 15C of the Act and the regulations thereunder for those organizations whose government securities transactions are limited to savings bond transactions and any other activity exempt as provided in Part 401. Therefore, the temporary rule will become the final rule without change.

The Department notes that the recordkeeping requirements of Part 404 do not apply to any savings bond transactions of any government securities broker or dealer.[13] Furthermore, the Department does not consider that any other parts of these regulations are applicable to savings bond transactions.

2. *Section 401.2.* Section 401.2 of the temporary rules provides an exemption for depository institutions whose government securities transactions are limited to submitting tenders for customers on a fully disclosed basis for the purchase on original issue of United States Treasury securities and other exempt activities. Institutions relying on this exemption must comply with Part 450 of the regulations concerning custodial holdings of government securities. The Department received no comments on the temporary rule. Therefore, the temporary rule will become the final rule.

The Department has been asked whether financial institutions that, as an accommodation to customers, accept United States Treasury securities for redemption will be required to register.

[12] For example, there are no formal coordination procedures concerning SEC enforcement of Regulation T adopted by the Board of Governors of the Federal Reserve System ("Board") under section 7 of the Act.

[13] See 17 CFR 240.17a-3(c), 404.2(a)(6), 404.4(a)(1), and 12 CFR 12.2(e), 208.8(k)(1)(v), 344.2(e).

The Department does not consider this activity to be a government securities activity requiring registration under the Act.

3. *Section 401.3.* The Department received two comments on this section of the temporary regulations. One commenter objected to the Department's clarifications in the temporary regulations that: (i) The 500 transaction de minimis provision may not be added to networking transactions and (ii) the term "fully disclosed basis" with respect to networking means that the transacting government securities broker or dealer must receive and maintain customer information.

With respect to the first point, the position was adopted because the 500 transaction limitation is essentially a final screen to excuse from regulatory requirements an entity that *by definition* holds itself out or solicits business as a government securities broker. To allow such an institution to transact 500 brokerage transactions in addition to an unlimited number of networking transactions would be inconsistent with Congress's determination not to exclude financial institutions from the definition of government securities broker. The definition of "fully disclosed basis" in § 401.3(a)(2)(ii)(D) is not meant to require the financial institution to monitor the recordkeeping activities of the transacting government securities broker or dealer. Rather, it requires that the parties agree that such records will be kept by the transacting broker or dealer and that the financial institution provide the transacting broker or dealer with the information required for that purpose.

The second comment received concerned the applicability of §§ 401.3 and 401.4 to branches and agencies of foreign banks. As stated in the preamble to the temporary regulations, the Department was concerned that such entities might be able to use the exemptions in those sections to engage in government securities transactions (such as brokerage transactions and repurchase transactions) with United States customers without a sufficient capital base in the United States. The temporary regulations therefore precluded branches and agencies of foreign banks from using either of those exemptions.

The Institute of Foreign Bankers ("Institute") expressed serious concern that, in order for the Department to achieve its objective of requiring branches and agencies to have U.S. based capital for all U.S. customer government securities transactions through the reserve formula of § 403.5(e), the Department had excluded such entities from the definitions of "financial institution" in those sections. The Department notes that the exclusion was required to accomplish the desired result only because such entities *are* "financial institutions" for all other purposes of the Act and regulations. However, in recognition of the potential precedential issues cited by the Institute as well as the purpose of the exclusion, paragraphs (c) of §§ 401.3 and 401.4 of the final regulations have been amended to delete the exclusion and new paragraphs (b)(2) have been added to each section to condition use of the exemption on compliance with the reserve formula of § 403.5(e). Particularly since branches and agencies relying on the exemption will not have notified the Board or the Comptroller of the Currency of their government securities activities, the Department expects them to assist examining agencies in enforcement of this requirement. The Department will consider modification of the exemption if it becomes apparent that the condition is unenforceable.

The remainder of § 401.3 of the temporary regulations is adopted without amendment.

4. *Section 401.4.* Other than the comment of the Institute of Foreign Bankers discussed above, the Department received no comments on this section. Except for the modifications to paragraphs (b) and (c) discussed in connection with § 401.3, the temporary rule is adopted as final.

Three points should be made with respect to this exemption. First, it supplements but does not displace the exceptions in the statutory definition of "government securities dealer," section 3(a)(44) of the Act, in particular the exception for banks engaging in fiduciary activities. Second, all financial institutions engaging in repurchase transactions with customers should carefully examine § 403.5(d) of the regulations to determine whether that section is applicable to their activities and if so whether their activities are conducted in the manner described in that section. Finally, purchases and sales of government securities from or to customers without an agreement to resell or repurchase (other than brokerage transactions or transactions described in §§ 401.1 or 401.2), including "due bill" sales, will render a financial institution ineligible for the exemption.

5. *Sections 401.5, 401.6, 401.7, 401.8.* No comments were received on these sections of the temporary regulations. With the exception of correction of a typographical error in § 401.5(b)(2), the temporary regulations are adopted as final.

C. Part 402—Financial Responsibility

1. *Section 402.1.* This section provides that certain government securities brokers and dealers are not subject to this part, provides a special capital rule that certain government securities brokers may elect and a capital rule for futures commission merchants that are registered government securities brokers or dealers, and states the effective date of the part. Changes from the temporary regulations to this section (other than minor wording changes) are confined to paragraph (e), which relates to government securities interdealer brokers.

The Government Securities Brokers Association and two interdealer brokers submitted comments voicing concern that two aspects of the § 402.1(e)(2) definition of government securities interdealer broker could be interpreted as indicating that Treasury had determined that the government securities interdealer brokers function as principal rather than agent: (i) The use of the word "broker" rather than "agent"; and (ii) the use of the term "partially disclosed basis." In addition, they were concerned that the inclusion of the words "have the right to obtain [the name of a counterparty]" as an alternative basis for determining that a trade was made on a "partially disclosed basis" might raise concerns about whether trading was conducted on a truly blind basis.

The Department wishes to emphasize that it has not taken and is not taking any position on the legal status or liability of a government securities interdealer broker as principal or agent, and that nothing in this preamble or the regulations should be interpreted otherwise. Indeed, the decision to use the term "broker" rather than "agent" in the definition stems in part from this concern.

With respect to the term "partially disclosed basis," the commenters are correct in noting that this is a term of art usually implying a transaction as principal. To avoid this implication, the definition has been amended to use the term "identified group basis." This is also more descriptive of the manner in which blind brokering operates—that counterparties know a list of entities from which the counterparty will be chosen, but do not, at the time of the transaction, know or have the right to know the counterparty to a specific transaction.[14]

[14] Although settlement of mortgage-backed securities frequently is made on a name give-up basis, counterparties are not permitted to rescind the trade once the counterparty is known.

The same commenters objected to the haircut for net exposure to counterparties. The Department has decided to retain this haircut, which will encourage monitoring of exposure by the government securities interdealer brokers and assure that there is some capital cushion as the chance of problems occurring increases. By encouraging monitoring, this haircut helps to reduce the risks inherent in blind brokering. The idea of pooling exposure information from all the interdealer brokers to an independent party, as was suggested by several commenters, goes beyond the regulatory framework set up by the Government Securities Act and implies establishing a system of trading and monitoring that comes close to a formal exchange.

The counterparty exposure haircut also retains some parity of capital treatment between government securities interdealer brokers and other government securities brokers subject to § 402.2. The Department wishes to reiterate that it intends to re-examine the capital requirements for government security brokers after some experience is gained under the current rule in order to determine whether a capital to volume ratio test might be more appropriate, and, if so, what classes of brokers should be subject to a broker rule rather than the requirements of § 402.2.

Changes have been made to clarify that certain loans to commercial banks of immediately available funds (commonly referred to as "fed funds sales") held in connection with the clearance of securities need not be deducted from the net worth of a government securities interdealer broker nor are they included in net exposure. These changes, which were also made in § 402.2, are discussed in the context of § 402.2 below.

The grace period for net pair-off receivables and money differences has been lengthened. This is also discussed in more detail in connection with the same change made in § 402.2.

The Department wishes to clarify that election to meet the requirements of paragraph (e) need not be made effective until the last business day of October, and consequently until that date the capital requirement for interdealer brokers is liquid capital, as defined in § 402.2(d), of not less than $50,000.

2. *Sections 402.2 and 402.2a.* Section 402.2 is the capital rule for government securities brokers and dealers and § 402.2a (Appendix A) is the detailed description of the calculation of the market risk haircut.

Repurchase and Reverse Repurchase Agreement Deficits

The temporary regulations have been modified in these final regulations to incorporate deductions for repurchase agreement deficits that were adopted by the SEC on June 4, 1987, effective September 9, 1987.[15] New subparagraph 402.2(d)(3) modifies the deduction for repurchase agreement deficits adopted by the SEC and refers to paragraph numbers in SEC Rule 15c3–1 after the June 4 rule amendments become effective.

A repurchase agreement deficit occurs when the market value of the securities underlying the agreement exceeds the contract price. The basic deduction under the SEC rule is for the amount by which the value of the underlying securities exceeds 105 percent of the contract price in the case of Treasury securities, 110 percent of the contract price in the case of other government securities, including mortgage-backed securities, and 120 percent in the case of other securities.

The Department has adopted the basic SEC rule with respect to repurchase agreement deficits but has not adopted the additional concentration charge nor the aggregate repurchase agreement deficit test contained in the new SEC rule. The Department believes that these two additional aspects of the SEC repurchase agreement deficit rule are unnecessary in the context of § 402.2 because the problems they are meant to address—concentration and total exposure—are dealt with by the haircuts for net credit exposure in the Treasury rule. In addition, the deduction for aggregate repurchase agreement deficits, were it incorporated in § 402.2, would require an additional counterparty allocation rule in order to make possible the determination of net counterparty exposure.

As indicated in the preamble to the temporary regulations, these final regulations incorporate the deductions for reverse repurchase agreement deficits adopted by the SEC on June 4.[16] A reverse repurchase agreement deficit occurs when the contract price of the reverse repurchase agreement exceeds the market value of the underlying securities. The Department has not modified the SEC rule.

The Department has decided to adopt without modification the same grace periods for margin calls with respect to these deductions and the same threshold levels for determining required deductions for repurchase agreement deficits as provided in the SEC rule in order that all broker and dealer participants in these markets be subject to similar rules with respect to repurchase and reverse repurchase agreements, in particular with respect to the more constraining deductions.

"Excess" Margin on Reverse Repurchase Agreements

The Department has decided not to incorporate at this time a rule similar to the SEC rule, adopted June 4, 1987, which increases the minimum required net capital when "excess" margin on a reverse repurchase agreement is received. The SEC rule is tailored to the SEC net capital rule and would require modification in order to be incorporated in § 402.2, which imposes a ratio test. Excess margin on reverse repurchase agreements is not in itself risk to the dealer but risk to counterparties, which is not generally addressed by rules concerning required capital, but if it develops that there are abuses concerning excess margin on reverse repurchase agreements by government securities dealers and brokers subject to § 402.2, the Department will have to revisit this issue.

Deductions for "Fed Funds Sales"

The Department has decided to clarify that government securities brokers and dealers subject to § 402.2 (or, as mentioned above, to § 402.1(e)) need not deduct as unsecured receivables certain overnight loans to commercial banks (commonly referred to as "fed funds sales") of funds held in connection with the clearance of securities. Also, as two commenters suggested, these loans have been removed from net credit exposure.

From the point of view of a government securities broker or dealer, these loans are similar to bank deposits, including time deposits, for which there is no deduction. The Department is aware, though, of concern that these overnight loans can become for certain dealers quite large in relation to their capital. While the Department feels it important to clarify the treatment of these loans under these final regulations, it is the Department's intention to study this matter further along with the SEC and the Federal Reserve. A 100 percent deduction for these loans appears inappropriate, but some partial credit or concentration charge may be indicated. The Department wishes to emphasize that the treatment of these loans for the purposes of the Treasury capital rule may well be changed at a later date.

[15] Securities Act Release No. 34–24553, 52 FR 22295 (June 11, 1987).

[16] Ibid.

Grace Period for Net Pair-Off Receivables and Money Differences

Six commenters suggested a longer grace period than one business day for net pair-off receivables and money differences. The final regulations in new subparagraph § 402.2(d)(5) grant a longer grace period and clarify when the grace period terminates. The grace period terminates immediately before the close of the third business day following the day the funds are due. The Department decided to extend the grace period in order not to discourage pair-offs and in order to grant a reasonable amount of time to collect funds before there is a capital charge. Of course, during the grace period the amounts owed to the dealer are included in net credit exposure for the purposes of the counterparty exposure and concentration of credit haircuts.

For example, trades in the same security with the same counterparty are made on Monday for settlement Tuesday. The trades are paired off, and funds arising from the pair off are not received by the dealer on Tuesday. If the dealer does not receive the funds on Friday, then at the close of the business day on Friday a deduction is taken for the net pair-off receivable. A capital computation reflecting the situation as of the close on Friday would include this deduction for the purposes of this rule.

As mentioned above, the same change was made to the government securities interdealer broker rule (§ 402.1(e)).

Net Credit Exposure and Counterparty Exposure Haircut

Several commenters criticized the counterparty exposure haircut of 5 percent as too high. However, the Department has decided to leave this factor at 5 percent. This is the same factor that the Federal Reserve Bank of New York used in its voluntary capital adequacy guidelines. There are also some significant omissions from net credit exposure (see § 402.2(g)(1)(i)). As mentioned above, the rule has been changed to clarify that certain overnight loans to commercial banks are not included in net credit exposure. Demand deposits, marketable certificates of deposit, commercial paper, and other marketable instruments are also not included.

This is a new haircut and the Department intends to monitor how it is working. As experience is gained by market participants, examiners, and regulators with this new type of haircut for securities firms, certain adjustments may need to be made. Also, as discussed above, some type of capital charge may be appropriate for the overnight loans made by dealers to depository institutions. In the context of reviewing how the credit charges are operating in practice, the Department will reconsider at a later date the appropriate level of the haircut.

With respect to the interaction of the determination of net credit exposure and the charges for repurchase agreement and reverse repurchase agreement deficits, net credit exposure to a counterparty may be reduced by the amount of the net charge taken for such deficits to the same counterparty. The Department notes that the SEC rules incorporated in § 402.2 allow the deficit charge to be reduced by, among other items, margin calls outstanding for one business day. If the deficit charge is reduced, then the resulting reduction in net credit exposure is lowered by the same amount. There is, of course, no grace period for items included in net credit exposure.

The Department has decided not to impose a haircut on exposure to a Federal Reserve bank.

Definition of Treasury Market Risk Instruments and Unlisted Options

The Department specifically asked in the preamble to the temporary regulations for comments concerning the treatment of unlisted options. Three commenters supported the treatment of unlisted options in the temporary regulations. However, SEC and NASD staff have expressed concern about the valuation of unlisted options which are defined to be Treasury market risk instruments.

In light of these comments, the Department has decided to include only unlisted options on Treasury securities in the definition of Treasury market risk instrument. These unlisted options are to be included in the determination of net worth at their approximate market value (i.e., intrinsic value plus time value) and are included in the determination of the Treasury market risk haircut. Other unlisted options are included in the determination of net worth at intrinsic value and the haircut to be included in the other securities haircut is the deduction required by Appendix A to SEC Rule 15c3-1.[17]

In arriving at this decision, the Department took seriously the concerns expressed about the practical difficulties of valuing unlisted options. This task, while still new to examiners, is easier with respect to Treasury securities because of the availability of reliable price data and the certainty of the payment stream. This cannot be said with respect to mortgage-backed securities.

The Treasury expects that examiners will be able to determine whether the valuation given by government securities brokers and dealers to unlisted options on Treasury securities is reasonable. A number of accepted option pricing models are available and assumptions concerning Treasury securities, such as volatility, should be easier to arrive at than for unlisted options on other types of securities.

The Department notes that to the extent that positions in Treasury market risk instruments form part of a hedge with unlisted options now defined not to be Treasury market risk instruments, these positions can be used to lower the haircuts required by the SEC rules and removed from the Treasury market risk haircut calculation.

The Department realizes that the treatment of options is perhaps not optimal and hopes that if there is dissatisfaction with the rule, either because of problems that develop in the examination process or because of the risk ascribed to option positions as a result of the workings of the rule, that a better treatment can be developed in cooperation with the SEC, the NASD, and market participants.

The definition of Treasury market risk instrument has also been clarified to make explicit that only *marketable* certificates of deposit are included.

Credit Volatility Haircut (§ 402.2(g)(1)(iv))

Options have been removed from the credit volatility haircut. The temporary regulations were ambiguous on how to include them, and because of this difficulty, it was judged best to exclude them.

The maturity of money market instruments subject to the credit volatility haircut has been changed to greater than 44 days so that all money market instruments that fall in Category B are included.

Haircut Factors (§ 402.2(f)(2))

The net position haircut factor for Category H has been lowered from 5 percent to 4.5 percent. The offset haircut factor for this category has consequently been lowered to 0.9 percent (20 percent of 4.5 percent). There has been a reduction in price volatility of longer maturity securities since the Department last looked at volatility at the beginning of the year.

As indicated earlier, the Treasury plans to review the haircut factors periodically and make adjustments

[17] 17 CFR 240.15c3-1a.

when there has been a significant change in market developments.

Haircuts for Primary Dealers

Four commenters suggested that the Treasury lower the haircuts for primary dealers. However, because of the generally greater recognition of risk reduction through hedging under the Treasury rule than under the SEC rule and because other dealers appear to have good access to the market, the Department has decided that all dealers subject to § 402.2 should use the same haircut factors in determining their liquid capital to haircut ratio.

Definition of "Gross Short Immediate Position" (§ 402.2a(a)(1)(ii)(A))

Two commenters suggested that the words "term financings" replace "bank loans" in the definition of gross short immediate position. This change has been made.

Other Securities Haircut (§ 402.2a(b))

The language of § 402.2a(b)(1) has been modified to state that a Treasury market risk instrument may be excluded from the Treasury market risk haircut calculation and included in the other securities haircut calculation if it forms part of a hedge with a position subject to the other securities haircut. In other words its inclusion in the other securities haircut must serve to reduce this haircut.

New § 402.2a(b)(3) has been added to clarify that the haircut resulting from undue concentration [18] is determined by reference to 10 percent of liquid capital.

One commenter suggested that use of haircut factors which are used for the SEC's alternative net capital requirement [19] be allowed to government securities dealers and brokers subject to § 402.2 in determining the other securities haircut. The Department has not adopted this suggestion. The alternative net capital requirement is tied to a greater reserve requirement under SEC Rule 15c3–3. There is no such direct link between the Treasury capital rule and the Reserve formula; consequently, it was decided that the haircut factors of the alternative net capital requirement should not be incorporated in § 402.2.

Charges for Fails to Deliver and for Nondelivery to a Customer

One broker asked for lower haircuts on aged fails to deliver. This will be decided on a case by case basis but such reductions will not be included in the general rule.

The Department also realizes that under current SEC interpretations these rules result in no charge for nondelivery of a security to a customer for 35 days and then only if there is a deficit (*i.e.*, the market value of the security has declined below the contract price). This contrasts with a charge after five days for an aged fail to deliver (which by definition can only be with respect to another dealer or broker). The Department decided that to change this situation in the final regulations without opportunity for comment is inappropriate but plans to consider alternatives in consultation with the SEC.

TBA ("To Be Announced") Transactions in Mortgage-Backed Securities

The Department wishes to clarify that long TBA positions in mortgage-backed securities that are Treasury market risk instruments may not be offset against short positions in such mortgage-backed securities in determining the gross long or gross short immediate position in mortgage-backed securities because of the uncertainty of what will be delivered. However, a short TBA position may be offset against a long position if the long position could be used to make delivery on the TBA. Consequently, long TBA positions and short TBA positions can be offset if whatever is delivered on the long TBA can be used for delivery on the short TBA. In general, net immediate positions in mortgage-backed securities are determined by netting long and short positions in such securities with the same pool number.

Forward Positions

The Department wishes to clarify that in determining gross long and gross short forward positions, if a long and short forward contract mature on the same day and are on the same security, they may be netted. Of course, if these contracts are with different counterparties, they will enter separately into the determination of net credit exposure for the separate counterparties.

3. *Section 402.2c (Appendix C).* The language of Appendix C has been modified to clarify that the consolidation rules are similar to the SEC's rule.[20]

The rules require a parent government securities broker or dealer to recognize all guaranteed obligations or liabilities of subsidiaries or affiliates in the parent's liquid capital calculation. Unless the parent has obtained an opinion of counsel that the subsidiary's or affiliate's assets would be available to the parent if needed, the parent must also add the haircuts of any guaranteed subsidiary or affiliate to the parent's own haircuts. Flow-through of capital benefits and consolidated calculation of haircuts of the parent and guaranteed subsidiaries and affiliates are permitted only if the opinion of counsel described above has been obtained. A parent firm may obtain flow-through capital benefits from its non-guaranteed majority owned and controlled subsidiaries and affiliates only if it has obtained the required counsel opinion.

The subsidiaries, if subject to the capital requirements of Part 402, must meet the capital requirement on a stand-alone basis. Two commenters suggested that only the consolidated entity be required to meet the capital requirement if the subsidiary were fully guaranteed by the parent firm. This proposal was not accepted in order to maintain consistency with the SEC rule.

4. *Section 402.2d (Appendix D).* Appendix D concerns satisfactory subordination agreements. No comments were received, and no modifications have been made to this section.

D. Part 403—Protection of Customer Securities and Balances

Seventeen comment letters addressed various provisions in Part 403. Most of these comments related to the provisions governing the treatment of securities that are the subject of hold-in-custody repurchase transactions and provisions requiring buy-ins of securities under certain circumstances.

1. *Section 403.2.* The temporary regulations required registered government securities brokers and dealers to comply with SEC Rule 8c–1,[21] concerning the hypothecation of customer securities, with certain minor modifications. Two comments were received on this provision.

One commenter requested Treasury to exempt from this rule any government securities dealer that may qualify for the exemption in paragraph (k)(2)(i) of SEC Rule 15c3–3. This commenter argued that if a dealer does not hold any customer securities or funds and thus qualifies for the (k)(2)(i) exemption, then it should not be considered to have "securities carried for the account of any customer" for purposes of SEC Rule 8c–1. The specific concern that prompted this comment was the situation where a dealer receives only

[18] SEC Rule 15c3–1(c)(2)(vi)(M), 17 CFR 240.15c3–1(c)(2)(vi)(M).

[19] SEC Rule 15c3–1(f), 17 CFR 240.15c3–1(f).

[20] See 17 CFR 15c3–1c.

[21] 17 CFR 240.8c–1.

part of the aggregate amount of securities needed to make a delivery to a customer. If the customer will not accept a partial delivery, then the dealer may retain the securities received overnight but may need to use them in a repurchase transaction or to collateralize a bank loan to finance the position.

The SEC has indicated that the phrase "securities carried for the account of any customer" is not interpreted to include securities that are to be paid for by the customer only upon delivery.[22] As a result, the rule is inapplicable in the situation described above and the Department does not believe an explicit exemption is necessary.

Another comment was made to the effect that the Treasury modification of the clearing lien exemption in this provision had the result of narrowing the clearing lien to loans made to acquire specific securities. This commenter pointed out that a lien on a particular security that resulted from the extension of credit may be released when that security is delivered out and other securities become subject to the lien. It was suggested that any loan incidental to the clearing of transactions in securities through a clearing bank should qualify for the exemption.

The Department agrees that the exemption should apply to a "floating" clearing lien without regard to the particular security that gave rise to the lien. The suggested language is broader than necessary, however, since the Department is of the opinion that a lien that qualifies for this exemption should arise from the actual extension of credit for securities transactions. Therefore, a change has been made in this provision to substitute the word "any" for the word "the" in the phrase "for a loan made to acquire the securities subject to said lien."

2. *Section 403.4.* Section 403.4 contains the rules concerning protection of customer funds and securities that are applicable to registered government securities brokers and dealers. With the exception of § 403.4(e), which governs hold-in-custody repurchase transactions, the rule requires compliance generally with SEC Rule 15c3–3.[23] For ease of reference, discussion of issues relating to hold-in-custody repurchase transactions has been organized under appropriate subparagraph headings. Since § 403.4(e) and § 403.5(d) contain parallel provisions dealing with hold-in-custody repurchase transactions that are applicable respectively to registered government securities brokers and dealers and financial institutions that are government securities brokers and dealers, issues common to both subsections are discussed jointly here.

Sections 403.4(e) and 403.5(d)

Restrictions on Hold-in-Custody Transactions of Less Than $1,000,000

The temporary regulations provided that for hold-in-custody repurchase transactions with a contract price of less than $1,000,000, substitution of securities that are the subject of the transaction is permitted only if the broker or dealer is granted the right to substitute in the repurchase agreement and if the broker or dealer additionally has obtained the prior consent of the counterparty to substitution on the trading day on which the substitution is to occur.

Four commenters objected to the provision because they felt that it would significantly impact smaller investors by excluding them from the repurchase market altogether. The commenters felt that most brokers and dealers would discontinue offering hold-in-custody repurchase transactions to smaller investors, rather than incur the cost and burden of obtaining those investors' additional consent or forgo intra-day use of the investors' securities. The commenters also indicated such investors would find it too costly to use tri-party or deliver-out repurchase arrangements and therefore may be forced into less safe investments. Finally, the commenters noted that the disclosure requirements and other provisions of the Treasury regulations should provide counterparties with sufficient protection. One commenter also proposed an exception to the rule in which, if a customer is engaged in any hold-in-custody repurchase transaction of $1,000,000 or more with a broker or dealer, the customer would not be required to consent to specific substitutions for any simultaneous transactions of less than $1,000,000 with the same broker or dealer.

The Department has carefully reviewed the comments received on this provision and discussed such comments at length with the SEC, which recently published for comment a virtually identical rule.[24] The concerns of commenters on both the proposed and temporary regulations that such a provision could eliminate the availability of hold-in-custody repurchase transactions for smaller investors have been given additional consideration. As a result, the Department has eliminated the restriction in the final rule. Accordingly, references to a requirement for specific prior consent to substitution (other than a general consent in the repurchase agreement) have been eliminated from §§ 403.4(e) and 403.5(d) in the final rule. The Department understands that the SEC staff concurs with this approach and will recommend to the Commission that it adopt a conforming change to its recently proposed rule.

In its reconsideration, the Department has taken into account the significant increases in customer protection that will be afforded in repurchase transactions by virtue of other measures contained in the rule, such as the requirements for registration and examination of all government securities brokers and dealers, the financial responsibility and recordkeeping rules being imposed, the requirement that repurchase agreements be in writing, the requirement for confirmation of specific securities that are the subject of hold-in-custody repurchase transactions, and the new disclosure requirements advising counterparties of the risks that they incur with hold-in-custody repurchase transactions, particularly if they grant the right of substitution.

Pool Repurchase Transactions; Confirmation of Specific Securities

In the preamble to the temporary regulations, the Department discussed a practice referred to as pool or bulk repurchase transactions, in which a dealer does not identify specific securities as belonging to specific counterparties. Instead, the dealer will set aside or otherwise designate a pool of securities to collateralize its outstanding repurchase transactions. In the proposed regulations, the Department had included a requirement that a dealer confirm specific securities to its counterparty in a hold-in-custody repurchase transaction. Four commenters had opposed this requirement since it effectively eliminated the ability to engage in pool repurchase transactions.

In the temporary regulations, the Department concluded that pool repos should not be permitted and continued its requirement to confirm specific securities to counterparties in hold-in-custody repurchase transactions. That decision was based primarily on a concern that it was unclear whether such transactions would be effective to convey any sort of enforceable property interest to the counterparties to the transaction.

In response to the temporary regulations, five commenters objected to

[22] Securities Exchange Act Release No. 34–2822, 11 FR 10983 (March 17, 1941).

[23] 17 CFR 240.15c3–3.

[24] Securities Exchange Act Release No. 34–24554, 52 FR 22493 (June 12, 1987).

this decision and asked that the Department reconsider. One of these commenters suggested that the added costs resulting from allocating and confirming specific securities for each hold-in-custody repurchase transaction would dry up the market for such transactions altogether. Another suggested that increased costs would eliminate such transactions for the smaller investor. A sixth commenter did not express a view as to the need for the ability to engage in pool repurchase transactions, but expressed concern over the Department's discussion of its uncertainty as to the interest conveyed in such transactions. This commenter suggested that the expression of our concerns might work to the disadvantage of innocent investors in the event of litigation involving such a transaction or in a similar type of transaction involving an undivided interest in a pool of securities. Some of the five that objected to the elimination of pool repurchase transactions expressed similar concern over the potential effect of the discussion in the temporary regulations.

Since the publication of the temporary regulations, the Department has made a number of inquiries to understand better how pool repurchase transactions are handled operationally and to examine more closely its concerns as to the interest conveyed. Based on these inquiries and on consideration of the issues raised by the practice, the Department has concluded that its original decision was appropriate and has determined to continue to require the confirmation of specific securities in connection with all hold-in-custody repurchase transactions.

However, the Department believes the concerns expressed by the commenters about a possible negative impact of statements made in the temporary regulations is not unreasonable and wishes to emphasize that those statements should not be viewed in any way as authoritative or conclusive. The Department is viewing these transactions as a general concept in an environment in which there can be many variations in both operational practices and in applicable law. To express concern as to the interest conveyed is not to say that, in a given case, a valid and enforceable interest has not been conveyed. However, even with respect to repurchase transactions involving specific securities, several issues arise from the fact that the transactions can be characterized either as sales and repurchases or as secured transactions and that they can involve different types of securities that are subject to different laws of transfer. Because of these complexities, which relate to legal issues beyond the scope of these rules, it is not possible to assure in every case that an enforceable interest is conveyed to the counterparty. The Department believes that the practice of pool repurchase transactions adds to the complexities to an extent that is unacceptable in the context of customer protection rules.

Pool repurchase transactions also present certain concerns of a more practical nature that are nevertheless important to the decision to require confirmation of specific securities. It is crucial to the compliance and examination process that a broker or dealer have an internal records system that assures the capability to monitor both customer securities positions and its own inventory. One means of imposing a discipline that will help assure the integrity of the internal records systems is to require allocation and confirmation of specific securities to specific counterparties. In addition to the operational concern, the Treasury is concerned that a confirmation referring to "various securities" is not entirely accurate in that it may suggest to a counterparty it has been allocated specific securities while the interest it should be receiving is more properly characterized as an undivided interest in a pool of securities.

For all of the foregoing reasons, the Treasury has decided to retain the requirement that a broker or dealer confirm specific securities to the counterparty in a hold-in-custody repurchase transaction. Because both the PSA and individual dealers have indicated that compliance with this requirement will require systems changes that cannot be completed by July 25, 1987, the Treasury has decided to delay the effective date of the requirement to confirm specific securities until January 31, 1988.

Information Required on Confirmations

Under the temporary rule, all government securities brokers or dealers that engage in hold-in-custody repurchase transactions are required to send confirmations of the securities that initially are the subject of a repurchase transaction, as well as any substitute securities. The confirmation was required to include the issuer, maturity date, coupon rate, and market value of the securities, as well as, in some cases, the CUSIP number, or the pool number for mortgage-backed securities.

Ten commenters, including the Public Securities Association, raised concerns or requested clarification relating to various aspects of the confirmation requirements. Comments relating to the use of confirmations not identifying specific securities have been addressed in the preceding discussion.

Eight commenters objected to the requirement that the confirmation include the market value of the specific securities, stating that the requirement would be difficult operationally to implement, particularly within a very short time frame; that the requirement raises questions on methods that would be appropriate to determine market value; and that the broker-dealer's valuation of the securities would be of no real benefit to the counterparty and, in fact, may be confusing. A few commenters proposed that, in lieu of noting the market value specifically, brokers and dealers be required to include a statement that the market value of the securities equals or exceeds the contract price of the repurchase transaction. Several commenters also requested that, if the Department retains the rule to confirm market value specifically, it clarify that the broker-dealer may use, as a means of determining market value for purposes of the confirmation, the bid price of the securities, plus accrued interest, obtained by any reasonable and consistent methodology.

The Department believes that requiring market value on confirmations serves an important customer protection function in focusing the attention of both the counterparty and the broker-dealer on ensuring that securities of sufficient value have been allocated to the transaction. This is particularly the case since it appears that in some sectors of the government securities market, dealers allocate securities to repurchase transactions based on the par amount or face value of the securities, and counterparties are unaware that the market value can differ substantially. Another concern addressed by the requirement to confirm market value is to ensure that any securities substituted for the securities initially allocated to the transaction are of adequate market value. For these reasons, the Department has decided to continue to require confirmations to include the market value of the securities confirmed. However, in recognition of the operational modifications that may be required by many brokers and dealers to implement the market value requirement, the effective date for this requirement has been delayed until January 31, 1988, as noted in the discussion of § 403.7.

The Department understands that there is no single source for determining market value and that various sources

that may be appropriate will not reflect precisely the same valuation of the same security on a given day. It is also noted, however, that appropriate market valuation is necessary for other purposes and, for this reason, the Department does not believe that the concerns about the appropriate methodology for confirmations are significant enough to warrant elimination of the requirement. For purposes of the confirmation requirement, the Department agrees with and has incorporated into the rule the suggestion that market value be determined by reference to the bid price of the securities plus accrued interest, obtained by any reasonable and consistent methodology.

One commenter also requested clarification of the language that confirmations be made "at the end of the trading day." The commenter pointed out that confirmations ordinarily are printed as part of the end-of-the-day processing. The Department recognizes that a certain amount of time is required, after trading is completed, for finishing the normal processing of the day's transactions and generally would consider that the issuance of confirmations as part of this process would satisfy the requirement to confirm at the end of the trading day. However the Department also believes that, in order to maximize protection of counterparties, the confirmations should be issued as quickly as possible and that no unnecessary delay should occur.

With respect to the provision describing the specific data to be included in confirmations, clarification was requested on whether the clause "unless other records of the broker or dealer issuing such confirmation identify the specific security in which the counterparty has an interest" refers to all of the confirmation data or just CUSIP and pool number. Clarification was also requested on whether a written or computer notation of CUSIP or pool number maintained on a separate list or computer file would constitute adequate identification on other records of the broker or dealer.

In the provision of the temporary rule describing the specific data to be included in the confirmations, the Department intended: (i) That the issuer, maturity date, coupon rate, par amount and market value of the relevant securities be shown in all cases, and (ii) that the CUSIP number of each security or, in the case of mortgage-backed securities carrying a pool number, the pool number, also be shown, unless the internal records of the broker or dealer that allocate specific securities to specific counterparties also reflect the CUSIP numbers of the securities or, where applicable, the pool number. The Department has modified the wording of the rule to clarify its intent that only the CUSIP number or pool number may be excluded from the confirmation on the basis of other records of the broker or dealer. In addition, the rule has been clarified to provide that the par value of the securities must also appear on all confirmations.

Finally, the Department believes that whether a written or computer notation of the CUSIP or pool number as described above would constitute adequate identification on the records of the broker or dealer for purposes of the confirmation provision would depend on how that information is integrated into the other records. However, the Department agrees that, as a general matter, such information may be included in a secondary record or subledger of a broker or dealer's security position ledger provided that, together, the two records are sufficient to designate specific securities of specific counterparties.

One commenter also suggested that foreigners be permitted to waive the right to receive confirmations. The final rule has been amended to provide that the requirement to send confirmations may be waived by non-resident non-U.S. persons, if such persons elect, in writing, not to receive confirmations. It should be noted that the confirmation requirement may not be waived by any other persons.

Overnight Hold-in-Custody Repurchase Transactions

In the preamble to the temporary rule, the Department indicated that it was unwilling to exempt overnight hold-in-custody repurchase transactions from the general requirements of §§ 403.4 or 403.5 because of a concern that such an exemption would encourage the conversion of term transactions to rolling overnight transactions as a means of avoiding the consent and disclosure requirements. Several commenters again suggested that either all overnight transactions or that overnight transactions with a contract price of $1,000,000 or more be exempt from all of the provisions relating to hold-in-custody transactions. A primary reason for the requested exemption was that the provisions of §§ 403.4(e) and 403.5(d) focus on the risks associated with substitution of securities, which ordinarily does not occur with overnight transaction.

The Department believes that a counterparty's risk in a rolling overnight repurchase transaction may be the same as the risks associated with a term repurchase transaction. If the funds are not returned to a counterparty each day, a rolling overnight repurchase transaction has the same practical effect as a term repurchase transaction in which daily substitutions occur. Therefore, unless the funds are credited to an account of the counterparty each day, the consent and disclosure provision would be applicable. Furthermore, it should be clarified that the Department's objectives in formulating rules relating to hold-in-custody transactions were not focused solely on the widespread practice of intraday substitution of securities. The Department believes that the provisions of the rule requiring a written agreement, confirmations, possession or control of securities, and applicable insurance disclosures are relevant and appropriate protection measures for counterparties in *all* hold-in-custody repurchase transactions, regardless of the size or duration of the transaction.

Two commenters also suggested that non-financial institution brokers and dealers that do not retain the right of substitution should be exempt from the hold-in-custody provisions of § 403.4, since the temporary regulations provided such an exemption to financial institutions in § 403.5. Although it was not stated explicitly in the temporary rule, the Department indicated in the preamble that the exemption for financial institutions from the hold-in-custody provisions would also be dependent on the delivery of the securities to safekeeping.

The rationale was that if the securities were moved away from the dealer function of the financial institution and into an independent function that had responsibility solely for safekeeping customer securities and that would itself be subject to the requirements of Part 450, the transaction would be more similar to a tri-party or deliver-out repurchase transaction. Therefore, any difference in treatment of transactions under §§ 403.4(e) and 403.5(d) was unintended. To clarify this and to avoid confusion, the introductory language in § 403.5(d) has been modified clearly to indicate that delivery to safekeeping without retention of a right to substitution is required in order to avoid applicability of § 403.5(d).

For purposes of this provision, a new definition of safekeeping has been added as new paragraph (f)(3). Under that definition, securities are deemed to be in safekeeping if the employees responsible for the custody of the securities: (i) Are not directly involved in securities transactions, (ii) are not

subject to the control of any employees that have responsibility for securities transactions, and (iii) have the affirmative responsibility to maintain books and records relating to the securities maintained in safekeeping for the account of customers. Safekeeping employees would be considered subject to the control of an employee with responsibility for securities transactions if, for example, they were in the same managerial reporting chain as such employee, the safekeeping employees were subject to evaluation by such employee, or the safekeeping employees' compensation was linked to profits or fees arising from securities transactions.

Control Locations

The temporary regulations omitted as an acceptable control location for hold-in-custody repurchase transactions subject to § 403.4 those securities that have been transmitted for transfer by a broker or dealer to the issuer or its transfer agent (Rule 15c3–3(c)(3)). As explained in the preamble to the temporary regulations, the Department concluded that it would be unlikely that this control location would be relevant to a hold-in-custody repurchase transaction and that it would be inapplicable in the case of book-entry securities, in any event.

Two commenters said this control location should be permitted because some government securities, particularly GNMA securities, are still in certificated form, and that it is possible for a dealer to be the owner of securities that are "bona fide items of transfer" and to do a repurchase transaction with such securities. They also said that disallowing this control location could inadvertently discourage the re-registration of certificated securities. In response to these comments, the final regulations include "bona fide items of transfer" as an acceptable control location for hold-in-custody repurchase transactions.

Disclosures

One commenter noted, with respect to the disclosure to be provided concerning the coverage of the Securities Investor Protection Act ("SIPA"), that the rules do not specifically permit the disclosure to be set forth in the master repurchase agreement. This commenter also raised a question about whether Treasury will publish new regulations in the event of changes in the SIPC position. The Department contemplates that the SIPA disclosure will be provided in the repurchase agreement and this requirement has been clarified in the rule. It need not be included on each confirmation. However, until a written repurchase agreement is in place, the appropriate insurance disclosure under either § 403.4(e) or § 403.5(d) must be provided as part of the interim disclosure statement described in § 403.7. If, as a result of judicial or legislative developments, the Securities Investor Protection Corporation changes its position with respect to the coverage of repurchase transactions under the SIPA, the Department will make appropriate changes to the regulations.

Another commenter proposed that once the requirement to obtain a written repurchase agreement is fully effective, a broker or dealer should be permitted to read the disclosures to a new customer over the telephone, provided that a written repurchase agreement with the required disclosure statements is executed within ten days. The Department has concluded that a disclosure statement should be in writing to achieve its purpose in the most effective manner. Thus, once the written agreement requirement is effective, a broker or dealer may not enter into a hold-in-custody repurchase transaction with a customer until the written agreement with the required disclosure provisions has been executed.

Another question was raised about the meaning of the requirement in §§ 403.4(e) and 403.5(d) that the required disclosure statement concerning commingling of securities must be "prominently displayed" in the written repurchase agreements. The Department contemplates that the requirement would be satisfied if the disclosure is emphasized in any fashion that would visually distinguish it from other terms of the agreement. For example, the disclosure could be in larger print than the text of the agreement, or in boldface type.

In accordance with the elimination of special consent to substitution rules for transactions of under $1,000,000, the disclosure statement regarding the risks of substitution has been modified in the final rule. As mentioned above, an interim disclosure statement is also provided in § 403.7 of the final rule and is discussed further in the portion of the preamble relating to that section.

Exemption Under Rule 15c3–3(k)(2)(i)

The preamble to the temporary regulations made clear that government securities brokers and dealers can qualify for the exemption in Rule 15c3–3(k)(2)(i) from possession or control rules, but that they must still comply with the hold-in-custody repurchase agreement rules. Three commenters mentioned this exemption, which applies to brokers and dealers that carry no margin accounts, promptly transmit all customer funds and deliver all securities, and do not otherwise hold customer funds or securities. Two of the commenters inquired about a proposed SEC interpretation of this exemption which the Department and the SEC had discussed.

The question that had arisen through telephone inquiries was whether the receipt or retention of funds representing principal and interest on government securities or money differences on government securities transactions attributable to customers would disqualify a broker or dealer from claiming the (k)(2)(i) exemption. It is the Department's understanding that in many cases a dealer conducting its business solely on a delivery-versus-payment basis may have difficulty tracing these amounts to the appropriate customer, since the dealer does not hold the securities in an account for a customer after settlement. Since the receipt of these funds will occur for reasons beyond a dealer's control, it was concluded that it would not be equitable to make the retention of the funds a basis for disqualification so long as the funds are set aside in a special account for the exclusive benefit of customers. The SEC has issued a no action letter to the NASD to this effect.

Section 403.4(f). This section describes the Segregated Account at a clearing bank that can qualify as an acceptable control location for purposes of Part 403. To qualify, the account must be subject to certain conditions "pursuant to a written clearing agreement" between a broker or dealer and its clearing bank. Two commenters requested clarification on whether this requirement would require an entirely new clearing agreement to be executed between the clearing banks and their dealer customers or whether the requirement could be satisfied by amendments to existing clearing agreements. The Department believes that amendments to existing agreements, including amendments by side letters that are styled as amendments to an existing clearing agreement, would be satisfactory for compliance with the requirements of this section.

3. *Sections 403.4 and 403.5(c)— Buy-ins—Fails to Receive.* In the case of registered government securities brokers or dealers, the temporary regulations adopted the provision in SEC Rule 15c3–3(d)(2) that a broker or dealer is required to take prompt steps to buy in customer fully paid and excess margin securities shown as failed to receive more than 30 days. For financial

institutions, a similar rule was adopted, but with a modification to provide that no action would be required in the case of mortgage-backed securities until the fail had been outstanding for 45 days. This modification was provided because under SEC Rule 15c3–3, the appropriate national securities exchange or association may grant extensions in exceptional circumstances, while the financial institution regulatory agencies did not have such authority. The eight commenters who addressed this issue objected to the buy-in requirement, especially in connection with securities of the Government National Mortgage Association ("GNMA"), in particular, or with respect to mortgage-backed securities more generally. They pointed out the frequent difficulties of buying in such securities, particularly where the customer has specified delivery of a particular pool with unique characteristics. The Department also understands that general problems with clearance and settlement of mortgage-backed securities, particularly those in physical form, contribute to the number of deliveries not accomplished on the scheduled settlement date. Although the general problems are expected to be substantially diminished by the development of a centralized clearance and settlement mechanism for mortgage-backed securities, the scarcity of the specific pools will continue to be problematic.

In addition to the difficulties in buying in mortgage-backed securities, a few commenters maintained that the buy-in requirements would also cause difficulties for STRIPS and "off the run" Treasury issues. One commenter also suggested that onerous buy-in requirements could have an impact on the willingness of market participants to trade in certain issues throughout the government securities market. Another commenter predicted that a buy-in requirement could be competitively disadvantageous for primary dealers, which are required to make markets in government securities. The commenter stated that forcing a buy-in of a security, regardless of its scarcity, could result in substantial costs to dealers. This commenter pointed out that this would be a problem even with straight Treasury issues which normally trade in a deep market. Such issues are occasionally in short supply, leading to the inability to obtain the security without substantial cost. Finally, commenters noted that before a buy-in requirement is imposed for mortgage-backed securities it would be necessary to establish buy-in procedures that would be workable for this type of security.

The commenters made a variety of proposals to exempt mortgage-backed securities from the buy-in rules and/or to exempt or extend the buy-in period for other government securities. These suggestions were made by several commenters without distinguishing between the buy-in requirement of paragraph (d)(2), which is discussed here, and the buy-in requirement of paragraph (m), which is discussed below. Some commenters, however, objected only to the applicability of paragraph (m). In its comment letter, the PSA suggested the establishment of an industry task force to develop buy-in procedures. One commenter suggested, in lieu of a buy-in requirement, a requirement to substitute collateral of equivalent market value during the time the fail continues. Finally, several commenters objected to the differential treatment of financial institutions in the rule and argued that the time frames for both groups should be the same and that the appropriate regulatory agencies should be given the authority to grant extensions.

The Department believes that a number of the concerns raised by the commenters are legitimate. However, the Department also notes that, since the buy-in requirement of paragraph (d)(2) relates only to customers' fully paid or excess margin securities, it does not apply to a delivery-versus-payment transaction. As a result, this buy-in requirement generally will have an impact only with respect to retail customers that have actually paid for securities as of the settlement date. In this area, the Department believes that a buy-in requirement is appropriate as part of the overall design of SEC Rule 15c3–3 to ensure that customer securities positions are covered. The Department understands that the SEC has suspended enforcement of this buy-in requirement as it applies to mortgage-backed securities and notes that the PSA has suggested that an industry task force will be formed to develop buy-in procedures that would be appropriate for these securities. It is anticipated that enforcement will continue to be suspended by the SEC pending development of buy-in procedures that address, among other things, the permissible range or type of securities with certain investment characteristics that may be bought in. In recognition of the difficulties of implementing this buy-in requirement with respect to mortgage-backed securities, in the final regulations the Department has expressly suspended the buy-in provision for fails to receive of mortgage-backed securities.

The final regulations also conform the rule for financial institutions to the rule for registered government securities brokers and dealers, and the financial institution regulatory agencies have been given the authority to grant extensions in appropriate cases. The Department concurs with the commenters that it would be undesirable to have differing rules applicable to various parties within a series of transactions related to the same security.

The Department did not suspend the rule on buy-ins for Treasury securities because it is of the opinion that problems with the unavailability of particular issues occur infrequently, and requests for extensions may be made in such cases.

Buy-Ins—Customer Sell Orders

The temporary regulations adopted, with certain modifications, paragraph (m) of Rule 15c3–3, a rule that had been suspended by the SEC for all exempted securities (including government securities). Paragraph (m) states that if a broker or dealer executes a sell order of a customer (other than a short sale) and the broker or dealer has not obtained the securities from the customer within ten days after the settlement date, the broker or dealer shall close the transaction with the customer by purchasing securities of like kind and quantity. The modifications in the temporary regulations extended the ten-day period to 30 days for mortgage-backed securities and defined a short sale to mean that the customer has told the broker or dealer that the sale is a short sale.

Several commenters opposed the application of this provision to government securities, questioning the rationale for the rule and its necessity. One commenter specifically requested a 60-day time frame for mortgage-backed securities.

The Department understands that the general goals of paragraph (m) are to assure the close-out of transactions after a given period of time and to prevent a customer from "playing the market" against a dealer and refusing to deliver a security when the price goes up after the customer's sell order has been executed. In addition, the rule is viewed as a customer protection rule on the assumption that a customer's not delivering a security to the executing broker or dealer will result in that broker or dealer's failure to deliver to its purchaser. That will likely result in a

non-delivery of the security to another customer.

Although the Department believes these are reasonable goals, the Department believes that the actual impact of paragraph (m) in protecting customers against fails is uncertain in the government securities market. The Department also notes that the capital rules of Part 402 and SEC Rule 15c3–1 contain incentives for clearing up fails on transactions. Given these considerations and the potential for disruption, the final regulations exclude the provision making paragraph (m) applicable to government securities.

On June 4, the SEC proposed amendments to Rule 15c3–3 that would conform paragraph (m) to the Treasury temporary regulations.[25] It is the Department's understanding that the SEC will withdraw that proposal in view of the change to the final regulations discussed here. The effect of such action would be to leave undisturbed the order suspending the applicability of the provision to exempt securities. Because the suspension of a provision in the Code of Federal Regulations means that the regulation is not currently in force with respect to the matters suspended, the exclusion of any mention of paragraph (m) in these final regulations has the effect of suspending the applicability of that paragraph to government securities. Both the Department and the SEC will continue to study the matter to determine if eventual application of paragraph (m) in the government securities market is desirable.

4. *Section 403.5.* The temporary regulations provided that if a financial institution has accepted funds from a customer for the purchase of a security and does not initiate the purchase of the specified securities by the close of the next business day after receipt of a customer's funds, the financial institution must deposit or redeposit the funds to the customer's account and notify the customer of the redeposit. As discussed in the temporary rule, this provision was intended to minimize the practice of issuing "due bills," the obligations that result when a bank sells a security to a customer and receives payment but does not deliver the security sold.

Three commenters objected to the provision because "due bills provide an important source of liquidity insofar as a financial institution can offer a security to a customer even when the security is unavailable in the market". Although the Department recognizes that the general ability to sell securities that one does not currently have in hand is an important factor in the overall liquidity of the government securities market, the interests of customer protection also demand that prompt action be taken to obtain the security sold. Therefore, the Department's intent in formulating the rule was to remove the incentive for a financial institution to delay action on initiating the purchase of a security for a customer; it is entirely reasonable for the customer to expect prompt placement of its purchase order, particularly when the customer has already paid for the security. It should be noted, however, that if a purchase is initiated timely but the security is not received, then the customer purchase would not fall within the terms of the provision requiring the deposit of funds to the customer's account. Instead, customer protection generally will be achieved under the rule governing buy-in of securities with respect to a fail to receive.

The commenters also suggested that Regulation D of the Board of Governors of the Federal Reserve System [26] and Office of the Comptroller of the Currency Banking Circular No. 182, a policy statement requiring certain disclosures with respect to due bills, would provide sufficient protection for customers, if the provisions of Circular No. 182 were extended to all financial institutions. The Department's concern with the practice of issuing due bills is that an entity may take advantage of the practice in a way that might leave a customer without access to either the security or the funds being used to purchase the security. Even though Regulation D permits collateralization of due bills in lieu of reserving against the funds paid for the securities, the Department continues to be concerned that such collateral would not be treated as a security belonging to the customer to whom the due bill was issued. In this context, the Department is not willing to rely solely on the disclosures required by Circular No. 182 as a means of customer protection.

Paragraph (e) of this section provided that a branch or agency of a foreign bank would be required to set aside the amount that would be required to be reserved pursuant to SEC Rule 15c3–3 with respect to customer balances. One commenter objected to the application of the rule to traditional deposit accounts. The commenter pointed out that while the SEC rule is premised on the idea that a broker or dealer should not use customer funds to expand its business, banks are expected to do just that. The Treasury recognizes this distinction, which has been the basis for other decisions regarding the way in which financial institutions are regulated under these rules. Accordingly, § 403.5(e) has been amended to exclude traditional deposits from the reserve calculation. In addition, certain other amendments have been added to clarify its applicability.

5. *Section 403.6.* In the temporary regulations, this section was added to make clear that a registered futures commission merchant ("FCM") that is also a registered government securities broker or dealer must comply with Part 403 with respect to customer funds or securities that are not incidental to the FCM's futures business.

One commenter criticized this rule as duplicative of the requirements imposed by the CFTC on investment of customer funds in repurchase transactions that are described in the CFTC's Financial and Segregation Interpretation No. 2—Use of Customer's Funds for the Purchase of Obligations under Repurchase Agreements.[27] ("Interpretation No. 2").

Although not explicitly stated in the preamble to the temporary regulations, the line drawn by this rule is intended to parallel the line drawn by proposed SEC Rule 3a43–1, which provides an exemption from the definition of government securities broker for an FCM that engages only in certain specifically described activities. Section 403.6 is intended to require compliance with Part 403 only with respect to the activities involving transactions in government securities that would require the FCM to register as a government securities broker or dealer. It is the Treasury's understanding that funds and securities involved in such activities generally may not be placed in the customer segregation account that is subject to CFTC regulation and that they therefore would not be subject to the restrictions of Interpretation No. 2. As a result, it is necessary to make such activities subject to the requirements of Part 403. Since the rule is designed to apply only to activities not subject to CFTC regulation, the Treasury does not believe that § 403.6 constitutes duplicative regulation.

6. *Section 403.7.* The temporary regulations provided for a delayed effective date until the last business day of October, 1987, of all the possession or control rules in Part 403 except for the requirements relating to confirmations,

[25] Securities Exchange Act Release No. 34–24554, 52 FR 22493 (June 12, 1987).

[26] 12 CFR 204.2(a)(1)(iv).

[27] 1 CCH Commodities Futures Law Reports ¶ 7112 (1986).

disclosures, and written agreements. The regulations specified that the confirmation requirements would be effective July 25, 1987. Written agreements would be required in the case of new customers by October 31, 1987, and in the case of existing customers by January 31, 1988, with disclosures to be provided to all customers beginning July 25.

Most commenters supported the delayed effective date for Part 403, although one commenter requested an extension to March 1988. Two commenters requested that the effective date for providing confirmations of substitution of securities subject to hold-in-custody repurchase transactions be moved to the end of October due to the systems changes that would be required if a specific description of the securities subject to a repurchase transaction and the market value of those securities must be included on the confirmations. One commenter urged that the date for obtaining written agreements for new customers be moved to January 1988.

One question raised by several commenters was how to define an "existing customer" for purposes of determining the effective date for the written agreement requirement. Suggestions for defining existing customers ranged from including every customer with whom a dealer has done any business to including only customers with whom a dealer has engaged in a repurchase transaction within the last 18 months.

Questions were also raised by the commenters in connection with the disclosures to be provided before written agreements are required to be revised or in place. Principally, these commenters pointed out that the required disclosure statement contains language about consent to substitution and inquired about the effect of such language before the consent requirements themselves are effective. Several commenters urged that the consent requirements not become effective before a written agreement with the required provisions is required to be in effect. Other questions that were raised about the interim disclosures included whether the disclosure relating to Securities Investor Protection Act or deposit insurance coverage was required also to be furnished, and whether the interim disclosures could be provided only once to each customer or whether they would be required with each confirmation.

Two commenters addressed the treatment of term repurchase transactions outstanding on the effective date of the final regulations. These commenters urged that consent to substitution not be required for outstanding term repurchase transactions. They argued that consent to substitution was not explicitly a term of these agreements and that imposition of a consent requirement would give customers the pretext for terminating a transaction that is no longer economically advantageous because of changes in market conditions.

The final regulations retain the last day of October effective date for the basic possession or control rules. However, in recognition of the systems changes that may be necessary for dealers to comply with the requirements to confirm specific securities and indicate the market value of those securities, the effective date for the requirement to provide specific confirmation of the securities subject to a hold-in-custody repurchase transaction and any substitutions of those securities has been changed in the final regulations to January 31, 1988. Although the Department views these requirements to be essential to the goal of customer protection, the Department recognizes that it is also important to provide sufficient time so that the systems developed to allocate and confirm specific securities for hold-in-custody repurchase transactions be properly designed to ensure accurate internal records.

With respect to the deadlines for obtaining written repurchase agreements, the final regulations define an "existing customer" as a counterparty with whom the government securities dealer has entered into a repurchase transaction during the period beginning January 1, 1986, and ending July 24, 1987. If a dealer has a written repurchase agreement with a customer on file, but the customer has not entered into a repurchase transaction since January 1, 1986, the customer will be treated as a new customer for the purposes of this rule.

The final regulations also clarify what disclosures must be made until the written agreement requirement is fully effective. The interim disclosure must be a separate document and must contain both (1) The statement concerning the Securities Investor Protection Act or the statement regarding deposit insurance coverage, as specified in §§ 403.4 and 403.5 and (2) the modified disclosure statement regarding substitution of securities set forth in § 403.7. These disclosures need only be provided once to each counterparty during the interim period, rather than with each repurchase transaction with a counterparty.

For counterparties who are engaged in transactions initiated before August 31 and ending thereafter, the disclosures must be provided by August 31; for other counterparties initiating a transaction on or after August 31, the disclosures must be mailed to the counterparties no later than the day on which the transaction is initiated. For counterparties required to receive the interim disclosure by August 31, the disclosure document may be mailed separately or furnished with a confirmation, but may not be printed on the confirmation itself.

The final regulations also provide that existing term repurchase transactions outstanding on August 31, 1987, shall not be subject to any of the requirements of § 403.4(e) or § 403.5(d) other than the requirement to confirm substitute securities which becomes effective January 31, 1988. This provision applies to specific transactions with a specified maturity date. It does not apply to master repurchase agreements, standing alone, that may be in effect on August 31. If a repurchase transaction has a specific maturity but is renewable, the renewed transaction would be viewed under this provision as a separate repurchase transaction to which the requirements would apply.

7. *Sections 403.1 and 403.3.* No comments were received on §§ 403.1 and 403.3 of the temporary regulations; accordingly they are adopted without change into the final regulations.

E. Part 404—Recordkeeping and Record Preservation

Part 404 of the temporary regulations imposes requirements to make, keep current, and preserve records relating to the operations of government securities brokers and dealers. The Department received six comments on this part. Two comments addressed the securities ledger requirements of § 404.2, two comments sought delayed effective dates for all or part of the requirements, one comment sought modification of the verification requirement of § 404.5 for securities subject to repurchase and reverse repurchase agreements and one comment requested that CFTC regulated entities be exempt from the requirements of Part 404.

1. *Section 404.2.* Two commenters asked for modification of the the various securities ledger requirements of § 404.2. One commenter asked that government securities dealers who qualify for the exemption in paragraph (k)(2)(i) of SEC Rule 15c3–3 be exempt from the securities position ledger requirement of § 404.2. The commenter stated that maintenance of this ledger serves no useful purpose when applied to dealers satisfying the requirements of (k)(2)(i) by engaging only in delivery-versus-

payment transactions. The second comment asked that delivery-versus-payment transactions be exempt from the ledger requirement or that the rule be modified to provide that a delivery-versus-payment transaction does not constitute a transaction involving a "cash account." The commenter stated that there is no benefit of maintaining a ledger account by customer of such transactions.

The Department has considered these comments but is of the opinion that dealers who qualify for the (k)(2)(i) exemption should not be exempt from the securities position ledger requirement. The securities position record is the main record of the location and movement of securities within the broker or dealer. It is a record relied upon in the examination process to follow the business of the broker or dealer. It is not limited to customer positions but also includes the dealer's own positions. The Department would note that dealers that qualify for the (k)(2)(i) exemption may do hold-in-custody repurchase transactions. Securities that are the subject of repurchase and reverse repurchase agreements must also be included on the securities position ledger. In addition, because of the importance of securities ledgers to the examination process, the Department has determined not to exempt delivery-versus-payment transactions from the ledger requirements.

2. *Section 404.4.* No comments were received on this section of the temporary regulations. However, a new paragraph (a)(2) has been added to clarify that a financial institution government securities broker or dealer must comply with the recordkeeping requirements of § 450.4(c), as well as with the new § 450.4(f), which specifies the retention period for records required by § 450.4(c).

3. *Section 404.5.* One commenter stated that the verification requirements of § 404.5 for repurchase and reverse repurchase transactions are unfair and unduly burdensome. The comment stated that the verification procedures available for other securities are not available for repurchase and reverse repurchase transactions. The commenter requested therefore that verification be required after forty-five business days instead of thirty days. The Department notes that verification of securities subject to repurchase and reverse repurchase agreements will be a requirement for registered broker dealers under amended SEC Rule 17a-13.[28] That amendment was available in proposed form for almost a year, and received no adverse comments.[29] In addition, verification of securities subject to repurchase and reverse repurchase agreements is a requirement of Part 450, which applies to depository institutions and to financial institution government securities brokers and dealers by virtue of § 403.5. The Department is not persuaded by the commenter's arguments that this requirement should be modified.

4. *Effective dates.* Two commenters asked that the effective date for identified portions of Part 404 be delayed, citing problems with developing appropriate software and systems to fully comply with these recordkeeping requirements. One commenter stated that it did not become fully aware of the operational implications of the requirements until its pre-membership examination by the NASD. The effective dates requested by the commenters were January 31, 1988 and March 31, 1988. In the absence of a delayed effective date, one commenter asked for a flexible exception policy.

The Department has carefully considered this matter and is persuaded that some delay in the effective date of the recordkeeping requirements applicable to registered government securities brokers and dealers is necessary. For example, it is clear from the comments that the requirement of a securities position ledger represents a departure from current practice and will require additional time to develop. Furthermore, discussions with the NASD have convinced the Department that, while newly registering government securities brokers and dealers are making an effort to meet the recordkeeping requirements of the temporary regulations, problems exist that may not be fully resolved prior to July 25. A delay will allow new registrants to resolve in an orderly and long-lasting fashion problems they may be having in establishing an integrated recordkeeping system.

Therefore, with the exception of the records pertaining to personnel and to lost or stolen securities, the Department will delay the effective date of § 404.2(a), which modifies SEC Rule 17a-3, until October 31, 1987. In addition, because the securities count requirement of § 404.5 is so closely related to the securities ledger requirement of § 404.2, the effective date of that provision will also be delayed until October 31, 1987. Section 404.3, pertaining to record preservation and certain other records, continues to be effective on July 25, 1987. Of course, to the extent that records are not required to be kept until October 31, the preservation of those records is not required until that date.

At this time, the Department is not prepared to delay the effective dates of §§ 404.2 and 404.5 beyond October 31, 1987. A number of the other requirements under these regulations become effective on October 31, 1987. The maintenance of adequate records provides the basis for examiners to determine whether those requirements are being complied with.

Brokers and dealers that are able to comply with the recordkeeping requirements before October 31, 1987 are encouraged to do so. By granting this delay in effective dates, the Department hopes that brokers and dealers will develop integrated recordkeeping systems that will provide for long-term compliance with these requirements.

5. *CFTC regulated entities.* The Chicago Mercantile Exchange commented that CFTC rules 1.27 and 1.31[30] contain extensive recordkeeping and preservation requirements and therefore, there is no need for Part 404 to apply to CFTC regulated entities that are government securities brokers or dealers. The Department notes that it was unclear in the temporary regulations that the Part was meant to apply only to those futures commission merchants that are required to register under section 15C of the Act, and this has been clarified in the final regulations. After discussion with the CFTC, the Department has confirmed that the types of government securities activities that would result in a requirement to register as government securities brokers or dealers are not fully subject to the CFTC regulations cited. Therefore, the Department is not persuaded that the CFTC rules obviate the need for Part 404 compliance by those CFTC regulated entities who will be required to register as government securities brokers or dealers.

6. *Other Modifications.* When the Department proposed Part 404,[31] it noted that many of the proposed modifications to SEC rules 17a-3 and 17a-13 pertaining to repurchase and reverse repurchase agreements had been proposed by the SEC in September 1986[32] but had not yet been adopted.

[28] See Securities Exchange Act Release No. 34-24553, 52 FR 22295 (June 11, 1987).

[29] See Securities Exchange Act Release No. 34-23602, 51 FR 32658 (September 15, 1986).

[30] 17 CFR 1.27, 1.31.

[31] 52 FR 5660 (February 25, 1987).

[32] Securities Exchange Act Release No. 34-23602, 51 FR 32658 (September 15, 1986).

On June 4, 1987, the SEC adopted the proposed amendments to Rules 17a-3 and 17a-13, effective July 25, 1987.[33] Therefore, §§ 404.1, 404.2, and 404.5 of the temporary rules have been modified to reflect the amendments to the SEC rules.

F. Part 405—Reports and Audit

Only one written comment, from the Chicago Mercantile Exchange, was received on this part. That comment requested an exemption from Part 405 for government securities brokers and dealers who are futures commission merchants, on the assertion that the reporting and audit requirements of the CFTC and the related self-regulatory agencies were adequate. As discussed in connection with Part 403, the comment may be based on a misunderstanding arising from an ambiguity in the temporary regulations. In the final regulations, the Department has clarified its intention that only futures commission merchants required to register under section 15C of the Act are subject to the requirements of Part 405. With this limitation, only futures commission merchants who transact business not fully subject to CFTC regulation and not fully examined for under that regulatory system will be subject to the requirements of these regulations. Therefore, the Department has retained the applicability of Part 405 to registered government securities brokers or dealers who are also futures commission merchants.

Several questions have arisen concerning the delayed effective date for reports provided in § 405.1(c). That paragraph has been amended to specify that the reports required by 17 CFR 240.17a-5(a) by virtue of § 405.2—the Form G-405 Report on Finances and Operations of Government Securities Brokers and Dealers—are required starting with the first month and quarter in which a government securities broker or dealer must calculate haircuts under either § 402.1(e) (for government securities interdealer brokers) or § 402.2 (a), (b) and (c) (for all other government securities brokers and dealers). Except as provided by individual exemption, this means that Part I of the Form G-405 will be due, where applicable, starting with October 1987 and Part II or IIA, as appropriate, will be due starting with the quarter ending December 1987.[34] Unaudited quarterly financial reports are required for the quarter ending September 1987.

Other than these changes, the correction of several typographical errors, and changes to §§ 405.2(a)(7) and 405.2(b)(1) to conform to changes made previously in the temporary regulations, Part 405 of the temporary regulations is adopted as final.

G. Part 449—Forms

To accommodate clarifications relating to consolidation of entities for financial responsibility purposes under § 402.2c, and to the revised grace period for net pair-off and give-up receivables and money differences, pages 5 and 6 of Part II and page 4 of Part IIA of Form G-405 (§ 449.5) and the related instructions on pages 13-16A (for Part II) and pages 10-13A (for Part IIA) have been revised. The revised pages are available from the Treasury, the SEC and the NASD.

H. Part 450—Custodial Holdings of Government Securities by Depository Institutions

Part 450 contains the rules relating to the possession or control of customer securities held by depository institutions. The Treasury received only a few requests for clarification or suggested technical changes for any of the rules contained in this Part. The following changes have been made based on those comments.

Section 450.4(a) requires, among other things, that a depository institution maintain customer securities held in an account at a Federal Reserve Bank free of any lien, charge or claim of the Federal Reserve Bank. Since publication of the temporary regulations, the Department has received a number of inquiries from depository institutions about how to comply with this paragraph and has had further discussions with the Federal Reserve Board staff.

Based on those discussions, a new paragraph (a)(3)(ii) has been added in the final regulations to clarify that a depository institution is not in violation of § 450.4(a) if, in certain limited circumstances, a Federal Reserve Bank retains a lien on securities received during the day that may subsequently be determined to be customer securities. This provision has been added to deal with the extraordinary situation, such as massive computer failure or potential failure of the depository institution, in which an extension of credit by a Federal Reserve Bank is necessary to assure the safety and soundness or liquidity of the depository institution and the portion of incoming securities that are pledgeable by the depository institution cannot be promptly ascertained.

This provision will permit the Federal Reserve Bank, in these circumstances, to lend on a secured basis without automatically causing the depository institution to be in violation of the requirements of § 450.4. The provision is conditioned on the depository institution's inability to fully collateralize the extension of credit with securities that are clearly pledgeable, the depository institution's immediate and ongoing efforts to replace any securities subsequently identified as customer securities with pledgeable collateral, and the Reserve Bank's agreement that any customer securities will be the first securities released from the lien in the event of initial overcollateralization or subsequent paydown of the credit extended. This exception is not meant to allow a depository institution to enter into a standing agreement with a Federal Reserve Bank that collateralizes daylight overdrafts or extensions of discount window credit with securities that are customer securities. Because this provision is being published for the first time in the final regulations, the Department would welcome comments on it.

In § 450.4(a)(4)(ii), the phrase "as of the close of business" has been moved to clarify that it is the refusal to segregate as of the close of business that triggers the requirement to notify the dealer's appropriate regulatory agency of the refusal.

In connection with the issues described above in the discussion of Part 403 relating to the possible exclusion from applicability of § 403.5 of certain repurchase transactions, the Treasury recognizes that § 450.4(b) was ambiguous in that it requires a depository institution to keep a copy of a confirmation or safekeeping receipt issued in connection with customer securities, but it does not affirmatively state the requirement to issue either. The discussion of these provisions in the temporary regulations made clear that the Treasury intended to affirmatively impose that requirement. The rule has been amended to impose the requirement with respect to securities other than securities that are the subject of repurchase transactions to which the confirmation requirements of § 403.5 applies. The rule requires the confirmation to include issuer, maturity date, and coupon rate of the securities being confirmed. The confirmation may

[33] Securities Exchange Act Release No. 34-24553, 52 FR 22295 (June 11, 1987).

[34] Self-regulatory organizations may require the reports earlier as part of their procedures to determine whether government securities brokers and dealers will qualify for membership on July 25, 1987 and whether they will have any difficulty remaining qualified when the haircut requirements become effective at the end of October.

be supplied to the customer in any manner that complies with applicable federal banking regulations. In addition, in conformity with the amendment discussed above to §§ 403.4(e) and 403.5(d), the rule permits a foreign customer to waive the right to receive a confirmation. Confirmations involving securities that are the subject of hold-in-custody repurchase transactions will continue to be subject to the confirmation requirements of § 403.5 including the requirement to confirm market value.

III. Executive Order 12291; Regulatory Flexibility Act; Burden on Competition

In the preambles to the proposed and temporary regulations, the Department concluded that the regulations did not constitute a major regulation for purposes of Executive Order 12291 and certified that they would not have a significant economic impact on a substantial number of small entities. Accordingly, the Department concluded that neither a regulatory impact analysis nor a regulatory flexibility analysis is required.

Four comments were received taking issue with the Department's conclusions, from three large dealers and the Public Securities Association. The comments asserted that the regulations relating to hold-in-custody repurchase agreements, particularly the special requirements for agreements of under $1 million, were sufficiently onerous that the commenters would cease to offer some or all hold-in-custody repurchase agreements, thereby causing undesirable effects and impacting the ability of small entities to invest funds. None of the commenters provided any evidence to support their assertions that the commenters' potential business decisions in response to the regulations would have a significant economic impact beyond that required by the statute. However, the Department has concluded, for the reasons stated in the discussion of Part 403 above, that the special requirements for small repurchase agreements are unnecessary and has therefore eliminated them.

When the proposed regulations were issued, the Department received comments from a number of small entities and representatives thereof concerning their potential negative impact. As discussed in the preamble to the temporary regulations, modifications were made between the proposed and temporary regulations to respond to those concerns, particularly in the area of hold-in-custody repurchase agreements.[35] None of these commenters on the proposed regulations commented on the temporary regulations, and no other comments were received from any small entities or their representatives.

On this record, the Department does not believe there is any reason to alter its conclusion that the regulations do not constitute a major regulation and its certification that the regulations will not have a significant economic impact on a substantial number of small entities. As discussed above in connection with Parts 403 and 404, the Department has modified the regulations to remove some of the features cited by the commenters as having the most undesirable economic effects and further has mitigated the operational impact of the temporary regulations by delaying the effective dates of some of the operationally more difficult requirements to January 31, 1988. The discussions about Parts 403 and 404 also indicate why the Department chose to retain the general protections of the temporary regulations for hold-in-custody repurchase investors.

The collection of information requirements contained in the temporary rule were submitted to the Office of Management and Budget pursuant to section 3504(h) of the Paperwork Reduction Act.[36] These requirements of the temporary rule have been adopted with only minor amendments in the final rule. The collection of information requirements of the temporary rule, as amended in the final rule, have been approved by OMB.

List of Subjects

17 CFR Part 400

Administrative practice and procedure, Banks, banking, Brokers, Government securities, Reporting and recordkeeping requirements.

17 CFR Part 401

Banks, banking, Brokers, Government securities.

17 CFR Part 402

Brokers, Government securities.

17 CFR Part 403

Banks, banking, Brokers, Government securities.

17 CFR Part 404

Banks, banking, Brokers, Government securities, Reporting and recordkeeping requirements.

17 CFR Part 405

Brokers, Government securities, Reporting and recordkeeping requirements.

17 CFR Part 499

Banks, banking, Brokers, Government securities, Reporting and recordkeeping requirements.

17 CFR Part 450

Banks, banking, Government securities, Reporting and recordkeeping requirements.

For the reasons set out in the preamble, Chapter IV of Title 17, Code of Federal Regulations, is revised to read as follows:

CHAPTER IV—DEPARTMENT OF THE TREASURY

SUBCHAPTER A—REGULATIONS UNDER SECTION 15C OF THE SECURITIES EXCHANGE ACT OF 1934

Part
400 Rules of General Application
401 Exemptions
402 Financial Responsibility
403 Protection of Customer Securities and Balances
404 Recordkeeping and Preservation of Records
405 Reports and Audit
449 Forms, Section 15C of the Securities Exchange Act of 1934

SUBCHAPTER B—REGULATIONS UNDER TITLE 11 OF THE GOVERNMENT SECURITIES ACT OF 1986

450 Custodial Holdings of Government Securities by Depository Institutions

SUBCHAPTER A—REGULATIONS UNDER SECTION 15C OF THE SECURITIES EXCHANGE ACT OF 1934

PART 400—RULES OF GENERAL APPLICATION

Sec.
400.1 Scope of regulations.
400.2 Office responsible for regulations; filing of requests for exemptions, for interpretations, and of other materials.
400.3 Definitions.
400.4 Information concerning associated persons of financial institutions that are government securities brokers or dealers.
400.5 Amendments to application for registration and to notice of status as a government securities broker or dealer.
400.6 Notice of withdrawal from business as a government securities broker or dealer by a financial institution.

Authority: Sec. 101, Pub. L. 99–571, 100 Stat. 3209 (15 U.S.C. 78o–5).

§ 400.1 Scope of regulations.

(a) Title I of the Government Securities Act of 1986 (Pub. L. 99–571, 100 Stat. 3208) amends the Securities Exchange Act of 1934 (48 Stat. 881–905;

[35] 52 FR 19668–69 (May 26, 1987).

[36] 44 U.S.C. 3504(h).

15 U.S.C. chapter 2B) ("Act") by adding section 15C, authorizing the Secretary of the Treasury to promulgate regulations concerning the financial responsibility, protection of customer securities and balances, recordkeeping and reporting of brokers and dealers in government securities. Those regulations constitute subchapter A of this chapter. Unless otherwise explicitly provided, all regulations in this subchapter apply to all government securities brokers or dealers, including registered brokers or dealers and financial institutions.

(b) Section 15C(a)(1)(A) of the Act (15 U.S.C. 78o–5(a)(1)(A)) requires all government securities brokers and government securities dealers, except those who are brokers or dealers registered pursuant to section 15 or section 15B of the Act or financial institutions, to register with the Securities and Exchange Commission ("Commission"). Regulations concerning registration are at § 240.15Ca2–1 et seq. of this title. The Commission is responsible for the interpretation of the definitions of government securities broker and government securities dealer and of the regulations at § 240.15Ca2–1 et seq.

(c) Section 15C(a)(1)(B)(i) of the Act (15 U.S.C. 78o–5(a)(1)(B)(i)) requires all government securities brokers or dealers that are also registered brokers or dealers to notify the Commission of their status as government securities brokers or dealers. Regulations concerning notice are at § 240.15Ca1–1 of this title.

(d) Section 15C(a)(1)(B)(i) of the Act also requires all government securities brokers or dealers that are financial institutions to notify the appropriate regulatory agency, as defined in section 3(a)(34)(G) of the Act (15 U.S.C. 78c(a)(34)(G)), of their status as government securities brokers or dealers. The form of notice, Form G–FIN, is at § 449.1 of this chapter. Forms are available from the appropriate regulatory agency.

§ 400.2 Office responsible for regulations; filing of requests for exemptions, for interpretations and of other materials.

(a) *Office responsible.* The regulations in this chapter are promulgated by the Assistant Secretary (Domestic Finance) pursuant to a delegation of authority from the Secretary of the Treasury. The office responsible for implementation of the regulations, including interpretations and action on requests for exemption, classification or modification, is the Office of the Commissioner, Bureau of the Public Debt.

(b)(1) *Exemptions and classifications.* Section 15C(a)(4) of the Act (15 U.S.C. 78o–5(a)(4)) authorizes the Secretary to exempt any government securities broker or dealer or class thereof, conditionally or unconditionally, from the requirements of registration or regulations promulgated under section 15C. In addition, section 15C(b)(3) of the Act (15 U.S.C. 78o–5(b)(3)) provides for classification, by the Secretary, of government securities brokers or dealers and authorizes the whole or partial exemption of classes from rules under section 15C or the application of different standards to different classes.

(2) *Interpretations.* Although the appropriate regulatory agencies, as defined in § 400.3, and the self-regulatory organizations, as defined in section 3(a)(26) of the Act (15 U.S.C. 78c(a)(26)), have enforcement responsibility under section 15C of the Act, Treasury is responsible for interpretation of section 15C(b) of the Act (15 U.S.C. 78o–5(b)) and related sections and for interpretation and amendment of the regulations under this chapter (with the exception of Forms G–FIN and G–FINW, §§ 449.1 and 449.2 of this chapter, which are the responsibility of the Board of Governors of the Federal Reserve System ["Board"]).

(c) *Requests for interpretations, exemptions, classifications.* (1) Interpretations under section 15C(b) of the Act (15 U.S.C. 78o–5(b)) and related sections and Treasury regulations thereunder may be provided, at the discretion of the Department, to firms or individuals actually or potentially affected by the Act or regulations, or to their representatives.

(2) Exemptions and classifications under sections 15C (a), (b) and (d) of the Act (15 U.S.C. 78o–5 (a), (b), and (d)) and related sections and Treasury regulations thereunder may be provided at the discretion of the Department and after consultation with the SEC and the Board, to firms or individuals actually or potentially affected by the Act or regulations, or to their representatives.

(3) All requests for exemptions and classifications, and all requests for binding interpretations, shall be in writing, and shall conform to the following procedures.

(i) The names of the company or companies and all other persons involved shall be stated. Letters pertaining to unnamed companies or persons or hypothetical situations will not be answered.

(ii) The letter must contain a concise but complete statement of all material facts, a complete and accurate description of the entire transaction if the request is transactional (even though a request may apply to only a portion of a transaction), and a concise and unambiguous statement of the request, including precise statutory and regulatory citations.

(iii) The letter shall indicate why the writer believes a problem exists or interpretation is needed, the writer's opinion on the matter, and the basis for such opinion.

(iv) If the writer requests confidential treatment of all or a portion of the request or response, this request and the basis therefor shall be included in a separate letter submitted at the same time as the request letter. If confidential treatment of a portion of a letter is requested, a copy of the letter with the portions for which such treatment is requested blocked out shall also be submitted.

(v) An original and two copies of each request letter shall be submitted to the Office of the Commissioner, Bureau of the Public Debt, Room 553, 999 E Street NW., Washington, DC 20239. The envelope shall be marked "Government Securities Act Request." The letter shall indicate in the upper right hand corner of the first page the particular sections of the Act and of the regulations at issue.

(4) A written response by the Department to a request filed as stated in paragraph (c)(3) of this section shall be binding, with respect to the requester, on the Department, but shall cease to be binding if the facts are not as stated in the request or, prospectively, if the Department issues a superseding interpretation. In responding to such a request, the Department will, where appropriate, consult with and may obtain the formal concurrence of the appropriate regulatory agencies or their staffs. The Department understands that even if formal concurrence is not received the appropriate regulatory agencies and self-regulatory organizations will give appropriate deference to binding interpretations of the Department. The Department also expects the SEC staff to reflect such interpretations in responding, pursuant to the established procedures of the Commission, to no-action requests concerning rules the SEC enforces.

(5) The Department may decline to issue an interpretation for any reason and, in particular, may require that a requester make inquiry of its appropriate regulatory agency, the Commission or designated examining authority before the Department responds to a request.

(6) The Department will also provide informal oral and written advice, but such advice is not binding on the Department or on any other agency or organization.

(7)(i) Except as provided in paragraph (c)(7)(ii) of this section, every letter or other written communication requesting the Department to provide interpretive legal advice under the Act or to grant, deny or modify an exemption, classification or modification of regulations, together with any written response thereto, shall be made available upon request for inspection and copying by any person 30 days after the response has been sent or given to the person requesting it.

(ii) Any person submitting a letter or communication may also submit therewith a request that it be accorded confidential treatment for a specified period of time, not exceeding 90 days after the expiration of such 30 days, together with a statement setting forth the considerations upon which the request for such treatment is made. If the Department determines that the request for confidential treatment should be denied, the requester will be given 30 days to withdraw the request.

(d) *Effect of Commission interpretations.* Interpretations of the Commission and its staff (including no-action positions) and of the designated examining authorities, of any Commission regulation expressly adopted by reference in these regulations shall be of the same effect as if the regulation being interpreted were solely the Commission's regulation. However, in the event the Treasury has issued a formal interpretation on the subject, the Treasury understands that the Commission will give that interpretation appropriate deference, particularly with respect to both subsequent no-action positions and the continued validity of prior no-action positions.

§ 400.3 Definitions.

Unless otherwise explicitly provided, in this subchapter and for the purposes of these regulations:

(a) "Act" means the Securities Exchange Act of 1934 (48 Stat. 881, 15 U.S.C. chapter 2B, as amended);

(b) "Appropriate regulatory agency" has the meaning set out in section 3(a)(34)(G) of the Act (15 U.S.C. 78c(a)(34)(G)), except that the appropriate regulatory agency for an entity insured by the Federal Savings and Loan Insurance Corporation is in all cases the Federal Home Loan Bank Board, and, with respect to a financial institution for which an appropriate regulatory agency is not explicitly designated, the appropriate regulatory agency is the SEC;

(c) "Associated person" means a person other than a person whose functions are solely clerical or ministerial:

(1) Directly engaged in any of the following activities in either a supervisory or non-supervisory capacity:

(i) Underwriting, trading or sales of government securities;

(ii) Financial advisory or consultant services for issuers in connection with the issuance of government securities;

(iii) Research or investment advice, other than general economic information or advice, with respect to government securities in connection with the activities described in paragraphs (c)(1)(i) and (c)(1)(ii) of this section;

(iv) Activities other than those specifically mentioned which involve communication, directly or indirectly, with public investors in government securities in connection with the activities described in paragraphs (c)(1)(i) and (c)(1)(ii) of this section; or

(2) Directly engaged in the following activities in a supervisory capacity:

(i) Processing and clearance activities with respect to government securities;

(ii) Maintenance of records involving any of the activities described in paragraph (c)(1) of this section;

Provided, however,

(3) That in the case of a financial institution,

(i) Persons whose government securities functions: (A) Consist solely of carrying out the financial institution's activities in a fiduciary capacity and (B) are subject to examination by the appropriate regulatory agency for compliance with requirements applicable to activities by the financial institution in a fiduciary capacity, shall not be considered "associated persons";

(ii) Persons whose sole government securities activities are, without exercising any investment discretion and solely at the direction of customers, to receive and/or transmit customer orders to purchase or sell government securities, but who do not give investment advice or receive transaction-based compensation shall not be considered "associated persons"; and

(iii) Directors and senior officers of the financial institution who may from time to time set broad policy guidelines affecting the financial institution as a whole that are not directly related to the conduct of the financial institution's government securities business are not considered to be "directly engaged" in the activities described in this paragraph (c);

(d) "Board" means the Board of Governors of the Federal Reserve System;

(e) "Branch or agency of a foreign bank" means a Federal branch or Federal agency of a foreign bank or a State branch or State agency of a foreign bank as such terms are used in the International Banking Act of 1978, Pub. L. 95–369, 92 Stat. 607;

(f) "CFTC" means the Commodity Futures Trading Commission;

(g) "Commission" or "SEC" means the Securities and Exchange Commission;

(h) "Designated examining authority" and "Examining Authority" mean (1) in the case of a registered government securities broker or dealer that belongs to only one self-regulatory organization, such self-regulatory organization, and (2) in the case of a registered government securities broker or dealer that belongs to more than one self-regulatory organization, the self-regulatory organization designated by the Commission pursuant to section 17(d) of the Act (15 U.S.C. 78q(d)) as the entity with responsibility for examining such registered government securities broker or dealer;

(i) "Fiduciary capacity" includes trustee, executor, administrator, registrar, transfer agent, guardian, assignee, receiver, managing agent, and any other similar capacity involving the sole or shared exercise of discretion by a financial institution having fiduciary powers that is supervised by a federal or state financial institution regulatory agency;

(j) "Financial institution" has the meaning set out in section 3(a)(46) of the Act (15 U.S.C. 78c(a)(46)), and such term explicitly does not include a subsidiary or affiliate of an institution described in such section unless such subsidiary or affiliate is itself described in such section;

(k) "Government securities broker" has the meaning set out in section 3(a)(43) of the Act (15 U.S.C. 78c(a)(43)), and explicitly includes not only registered government securities brokers, but also registered brokers and financial institutions;

(l) "Government securities dealer" has the meaning set out in section 3(a)(44) of the Act (15 U.S.C. 78c(a)(44)), and explicitly includes not only registered government securities dealers, but also registered dealers and financial institutions;

(m) "Government securities" has the meaning set out in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42));

(n) "Registered broker or dealer" means a broker or dealer registered pursuant to section 15 or section 15B of the Act (15 U.S.C. 78o, 78o–4)) but does not include a municipal securities dealer that is a bank or a separately

identifiable department or division of a bank;

(o) "Registered government securities broker or dealer" means a government securities broker or dealer registered pursuant to section 15C(a)(1)(A) of the Act (15 U.S.C. 78o-5(a)(1)(A));

(p) "Secretary" means the Secretary of the Treasury; and

(q) "Treasury" or "Department" means the Department of the Treasury, including in particular the Bureau of the Public Debt.

§ 400.4 Information concerning associated persons of financial institutions that are government securities brokers or dealers.

(a) Every associated person of a financial institution that is a government securities broker or dealer that is not exempt pursuant to Part 401 of this chapter shall file with such financial institution a completed Form G-FIN-4 (§ 449.4 of this chapter) unless such person has on file with such financial institution a completed and current Form U-4 (promulgated by a self-regulatory organization) or Form MSD-4 (as required for associated persons of bank municipal securities dealers).

(b) To the extent any information furnished by an associated person pursuant to paragraph (a) of this section (including information on a Form U-4 or Form MSD-4) is or becomes materially inaccurate or incomplete, such associated person shall promptly furnish in writing to such financial institution, in a form acceptable to the appropriate regulatory agency for such financia] institution, a statement correcting such information.

(c) For the purpose of verifying the information furnished by an associated person pursuant to paragraph (a) of this rule, every government securities broker or dealer that is a financial institution shall make inquiry of all other employers of such associated person during the immediately preceding three years concerning the accuracy and completeness of such information.

(d) Every government securities broker or dealer that is a financial institution not exempt from this section pursuant to Part 401 of this chapter shall:

(1) Promptly obtain and, within 10 days thereafter, file with the appropriate regulatory agency, in a form acceptable to such appropriate regulatory agency, the information required by paragraph (a) of this section (which shall consist of all Forms G-FIN-4 filed and a list of all associated persons who have filed Forms MSD-4 or U-4 with the financial institution since the last such filing, designating whether the associated person is serving in a supervisory or non-supervisory capacity) and by paragraph (b) of this section; and

(2) File with the appropriate regulatory agency within 30 days after the termination of the status of an individual as an associated person a Form G-FIN-5 (§ 449.4 of this chapter), unless—

(i) The financial institution is required to and has filed a Form U-5 or Form MSD-5 with respect to such person; or

(ii) The financial institution notifies the appropriate regulatory agency that the individual will remain in the financial institution's employment and the financial institution will continue to update the information about such individual as provided in paragraph (b) of this section and will file a Form G-FIN-5 within 30 days after the termination of such individual's employment with the financial institution.

(e) Every notice and form filed pursuant to this section shall constitute a "report" within the meaning of sections 15, 15C and 32(a) of the Act (15 U.S.C. 78o, 78o-5, 78ff(a)).

(Approved by the Office of Management and Budget under control number 1505-0100)

§ 400.5 Amendments to application for registration and to notice of status as a government securities broker or dealer.

(a) (1) If the information contained in any application for registration as a government securities broker or dealer (other than the statements required by § 240.15Ca2-2 of this title) or in any amendment thereto, becomes inaccurate for any reason, the registered government securities broker or dealer shall file within 30 days thereafter an amendment on Form BD (§ 249.501 of this title) correcting such information, in accordance with the instructions provided therein.

(2) If the information contained in any notice of status as a government securities broker or dealer filed by a registered broker or dealer, or in any amendment thereto, becomes inaccurate for any reason, the registered broker or dealer shall file within 30 days an amendment on Form BD (§ 249.501 of this title) correcting such information, in accordance with the instructions provided therein.

(b) If the information contained in any notice of status as a government securities broker or dealer filed by a financial institution, or any amendment thereto, becomes inaccurate for any reason, the financial institution shall file within 30 days an amendment on Form G-FIN (§ 449.1 of this chapter) correcting such information, in accordance with the instructions provided therein.

(c) Every amendment filed pursuant to this section shall constitute a "report" within the meaning of sections 15, 15C and 32(a) of the Act (15 U.S.C. 78o, 78o-5, 78ff(a)).

(Approved by the Office of Management and Budget under control number 1505-0100)

§ 400.6 Notice of withdrawal from business as a government securities broker or dealer by a financial institution.

(a) Whenever a financial institution that is a government securities broker or dealer that is not exempt from the notice requirements of section 15C(a)(1)(B)(i) of the Act (15 U.S.C. 78o-5(a)(1)(B)(i)) and of § 400.5 pursuant to Part 401 of this chapter, ceases to act as a government securities broker or dealer, it shall file with the appropriate regulatory agency notice of such cessation on Form G-FINW (§ 449.2 of this chapter) in accordance with the instructions contained therein.

(b) Except as provided in paragraph (c) of this section, a notice that a financial institution has ceased to act as a government securities broker or dealer shall become effective for all purposes on the 60th day after the filing thereof with the appropriate regulatory agency or within such shorter period of time as the appropriate regulatory agency determines.

(c) If the notice described in paragraph (a) of this section is filed with the appropriate regulatory agency any time after the date of the issuance of a notice or order by the appropriate regulatory agency instituting proceedings pursuant to section 15C(c)(2)(A) of the Act (15 U.S.C. 78o-5(c)(2)(A)) to censure, suspend, limit, or bar from acting as a government securities broker or government securities dealer the entity filing such notice, or if the appropriate regulatory agency has instituted any action against the entity filing such notice pursuant to section 15C(2)(B) of the Act (15 U.S.C. § 78o-5(c)(2)(B)), the notice shall become effective pursuant to paragraph (b) of this section at such time and upon such terms and conditions as the appropriate regulatory agency deems necessary or appropriate in the public interest for the protection of investors.

(d) Every notice filed pursuant to this section shall constitute a "report" within the meaning of sections 15, 15C and 32(a) of the Act (15 U.S.C. 78o, 78o-5, 78ff(a)).

(Approved by the Office of Management and Budget under control number 1505-0100)

PART 401—EXEMPTIONS

Sec.
401.1 Exemption for organizations handling transactions in United States Savings Bonds.
401.2 Exemption for depository institutions that submit tenders for the account of customers for purchase on original issue of United States Treasury securities.
401.3 Exemption for financial institutions that are engaged in limited government securities brokerage activities.
401.4 Exemption for financial institutions engaged in limited government securities dealer activities.
401.5 Exemption for corporate credit unions transacting limited government securities business with other credit unions.
401.6 Exemption for branches and agencies of foreign banks that deal solely with non-United States citizens resident offshore.
401.7 Temporary exemption for certain government securities brokers and dealers terminating business on or before October 31, 1987.
401.8 Temporary exemption for government securities brokers and dealers that are futures commission merchants registered with the CFTC.

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3209 (15 U.S.C. 78o-5(a)(4)).

§ 401.1 Exemption for organizations handling transactions in United States Savings Bonds.

An organization that handles United States Savings Bond transactions, including a qualified issuing or paying agent or an organization that accommodates customers or employees by forwarding requested transactions to qualified issuing or paying agents or the Treasury and whose transactions in government securities are limited to these transactions and such other activities that are exempted by the regulations under this subchapter, shall be exempt from the provisions of section 15C (a), (b) and (d) of the Act (15 U.S.C. 78o-5 (a), (b), (d)) and the regulations of this subchapter. For the purposes of this section, the term "United States Savings Bond" means any savings-type security offered by the Treasury, including all series of United States Savings Bonds, United States Savings Notes and United States Savings Stamps.

§ 401.2 Exemption for depository institutions that submit tenders for the account of customers for purchase on original issue of United States Treasury securities.

(a) Subject to the requirements of paragraph (b) of this section, a depository institution that submits tenders or subscriptions for purchase on original issue of United States Treasury securities for the account of customers on a fully disclosed basis, whose transactions in government securities are limited to such transactions and such other activities as have been exempted by regulation under this subchapter shall be exempt from the provisions of section 15C (a), (b) and (d) of the Act (15 U.S.C. 78o-5 (a), (b), (d)) and the regulations of this subchapter.

(b) A depository institution that relies on the exemption contained in paragraph (a) of this section is required to comply with the regulations of Part 450 of this chapter concerning custodial holdings of government securities.

(c) For the purposes of this section, "depository institution" has the meaning stated in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)(i)-(vi)) and also includes a foreign bank, an agency or branch of a foreign bank and a commercial lending company owned or controlled by a foreign bank (as such terms are used in the International Banking Act of 1978, Pub. L. 95-369, 92 Stat. 607).

§ 401.3 Exemption for financial institutions that are engaged in limited government securities brokerage activities.

(a)(1) Subject to the requirements of paragraph (b) of this section, a financial institution shall be exempt from the provisions of sections 15C (a), (b), and (d) of the Act (15 U.S.C. 78o-5 (a), (b), (d)) and the regulations of this subchapter, unless it acts as a government securities broker by:

(i) Holding itself out as a government securities broker or interdealer broker; or

(ii) Actively soliciting purchases or sales of government securities on an agency basis;

(2) Notwithstanding the provisions of paragraph (a)(1) of this section, a financial institution shall not be regarded as acting as a government securities broker within the meaning of this section if it:

(i) Effects fewer than 500 government securities brokerage transactions (other than transactions described in §§ 401.1 or 401.2) per year; or

(ii) Effects all such transactions (other than transactions described in §§ 401.1 or 401.2) pursuant to a contractual or other arrangement with one or more government securities brokers or dealers each of which has registered or filed notice pursuant to section 15C(a)(1) of the Act (15 U.S.C. 78o-5(a)(1)) (each referred to as the "transacting government securities broker or dealer") under which the transacting government securities broker or dealer will offer securities services on or off the premises of the financial institution, provided that:

(A) The transacting government securities broker or dealer is clearly identified to customers as the person performing the securities services;

(B) Financial institution employees perform only clerical and ministerial or order-taking functions in connection with government securities transactions unless such employees are associated persons (as defined in § 400.3(c) of this chapter) or registered representatives of the transacting government securities broker or dealer;

(C) Financial institution employees do not receive compensation for government securities activities other than clerical or ministerial functions unless such employees are associated persons (as defined in § 400.3(c) of this chapter) or registered representatives of the transacting government securities broker or dealer; and

(D) Such services are provided on a fully disclosed basis by the transacting government securities broker or dealer, i.e., the transacting government securities broker or dealer receives and maintains all required information concerning each customer, its trading and account.

(b)(1) A financial institution that relies on the exemption contained in paragraph (a) of this section is required to comply with the regulations of part 450 of this chapter concerning custodial holdings of government securities for customers.

(2) A branch or agency of a foreign bank that relies on the exemption contained in paragraph (a) of this section is in addition required to comply with § 403.5(e) of this chapter.

(c) For the purposes of this section "financial institution" includes an insured credit union, as defined in 12 U.S.C. 1752(7).

§ 401.4 Exemption for financial institutions engaged in limited government securities dealer activities.

(a) Subject to the requirements of paragraph (b) of this section, a financial institution shall be exempt from the provisions of Sections 15C (a), (b), and (d) of the Act (15 U.S.C. 78o-5 (a), (b), (d)) and the regulations of this subchapter if its government securities dealer activities are limited to one or more of the following activities:

(1) Sales or purchases in a fiduciary capacity;

(2) The sale and subsequent repurchase and the purchase and subsequent resale of government securities pursuant to a repurchase or reverse repurchase agreement; and

(3) Such other activities as have been exempted by regulation under this subchapter.

(b)(1) A financial institution that relies on the exemption contained in paragraph (a) of this section is required to comply with:

(i) The regulations of part 450 of this chapter concerning custodial holdings of government securities for customers; and

(ii) Section 403.5(d) of this chapter concerning certain repurchase transactions with customers.

(2) A branch or agency of a foreign bank that relies on the exemption contained in paragraph (a) of this section is in addition required to comply with § 403.5(e) of this chapter.

(c) For the purposes of this section "financial institution" includes an insured credit union, as defined in 12 U.S.C. 1752(7).

§ 401.5 Exemption for corporate credit unions transacting limited government securities business with other credit unions.

(a)(1) Subject to the requirements of paragraph (b) of this section, a corporate credit union shall be exempt from the provisions of section 15C (a), (b) and (d) of the Act (15 U.S.C. 78o–5 (a), (b), (d)) and the regulations thereunder if its government securities dealer activities are limited to the sale and subsequent repurchase and the purchase and subsequent resale, each pursuant to a repurchase or reverse repurchase agreement, of government securities to other credit unions and such other activities as have been exempted by regulation under this part.

(2) For the purposes of this section, "corporate credit union" means a credit union whose membership consists primarily of other credit unions and that is (i) a federal credit union as defined in 12 U.S.C. 1752(1), (ii) an insured credit union as defined in 12 U.S.C. 1752(7), or (iii) a member of the National Credit Union Administration Central Liquidity Facility.

(b) A credit union that relies on the exemption contained in paragraph (a) of this section is required to comply with:

(1) The regulations of part 450 of this chapter concerning custodial holdings of government securities; and

(2) Section 403.5(d) concerning certain repurchase transactions with customers.

§ 401.6 Exemption for branches and agencies of foreign banks that deal solely with non-United States citizens resident offshore.

(a) Subject to the requirements of paragraph (b) of this section, a branch or agency of a foreign bank shall be exempt from the provisions of section 15C (a), (b), and (d) of the Act (15 U.S.C. 78o–5 (a), (b), (d)) and the regulations of this subchapter, if all the customers with or on behalf of whom it engages in government securities transactions are limited to foreign governments, agencies of foreign governments and other persons and entities who are not citizens of the United States and who reside or, in the case of a corporation, partnership or other entity, have their principal place of business, outside of the United States.

(b) A branch or agency that relies on the exemption contained in paragraph (a) of this section is required to comply with the regulations of part 450 of this chapter concerning custodial holdings of government securities.

§ 401.7 Temporary exemption for certain government securities brokers and dealers terminating business on or before October 31, 1987.

During the period ending October 31, 1987, a government securities broker or dealer shall be exempt from the provisions of section 15C (a), (b), and (d) of the Act (15 U.S.C. 78o–5(a), (b), (d)) and the regulations of this subchapter if:

(a) Its government securities broker or dealer activities are limited to the performance of contractual obligations entered into prior to July 25, 1987;

(b) It is the subsidiary or affiliate of a government securities broker or dealer that has registered or given notice pursuant to section 15C(a)(1) of the Act (15 U.S.C. 78o–5(a)(1)); and

(c) It ceases all government securities broker or dealer activities on or before October 31, 1987.

§ 401.8 Temporary exemption for government securities brokers and dealers that are futures commission merchants registered with the CFTC.

During the period ending October 31, 1987, a government securities broker or dealer that is a futures commission merchant shall be exempt from the provisions of section 15C (a), (b), and (d) of the Act (15 U.S.C. 78o–5 (a), (b), (d)) and the regulations of this subchapter if:

(a) It is registered with the Commodity Futures Trading Commission under section 4f of the Commodity Exchange Act (7 U.S.C. 6f) and the regulations thereunder; and

(b) It is not currently the subject of any disciplinary action by any federal or state entity regulating persons dealing in securities or commodities.

PART 402—FINANCIAL RESPONSIBILITY

Sec.
402.1 Application of part to registered brokers and dealers and financial institutions; special rules for futures commission merchants and government securities interdealer brokers; effective date.
402.2 Capital requirements for registered government securities brokers and dealers.
402.2a Appendix A—Calculation of market risk haircut for purposes of § 402.2(g)(2).
402.2b [Reserved]
402.2c Appendix C—Consolidated calculation of liquid capital and total haircuts for certain subsidiaries and affiliates.
402.2d Appendix D—Modification of § 240.15c3–1d of this title, relating to satisfactory subordination agreements, for purposes of § 402.2.

Authority: Sec. 101, Pub. L. 99–571, 100 Stat. 3209 (15 U.S.C. 78o–5(b)(1)(A), (b)(2)).

§ 402.1 Application of part to registered brokers and dealers and financial institutions; special rules for futures commission merchants and government securities interdealer brokers; effective date.

(a) *Application of part.* This part applies to all government securities brokers and dealers, except as otherwise provided herein.

(b) *Registered brokers or dealers.* This part does not apply to a registered broker or dealer that is subject to § 240.15c3–1 of this title (SEC Rule 15c3–1).

(c) *Financial institutions.* This part does not apply to a government securities broker or dealer that is a financial institution and that is:

(1) Subject to the rules and regulations of its appropriate regulatory agency concerning capital requirements, or

(2) A branch or agency of a foreign bank subject to regulation, supervision, and examination by state or federal authorities having regulatory or supervisory authority over commercial bank and trust companies.

(d) *Futures commission merchants.* A futures commission merchant subject to § 1.17 of this title that is a government securities broker or dealer but is not a registered broker or dealer shall not be subject to the limitations of § 402.2 but rather to the capital requirement of § 1.17 or § 240.15c3–1 of this title, whichever is greater.

(e) *Government securities interdealer broker.* (1) A government securities interdealer broker, as defined in paragraph (e)(2) of this section, may, with the prior written consent of the Secretary, elect not to be subject to the limitations of § 402.2 but rather to be

subject to the requirements of § 240.15c3–1 of this title (SEC Rule 15c3–1) except paragraph (c)(2)(ix) thereof, and paragraphs (e) (3), (4), (5), (6), (7) and (8) of this section by filing such election in writing with its designated examining authority. A government securities interdealer broker may not revoke such election without the written consent of its designated examining authority.

(2)(i) "Government securities interdealer broker" means an entity engaged exclusively in business as a broker that effects, on an initially fully disclosed or identified group basis, transactions in government securities for counterparties that are government securities brokers or dealers who have registered or given notice pursuant to section 15C(a)(1) of the Act (15 U.S.C. 78o–5(a)(1)), and that promptly transmits all funds and delivers all securities received in connection with its activities as a government securities interdealer broker and does not otherwise hold funds or securities for or owe money or securities to its counterparties and, except as provided in paragraph (e)(2)(ii) of this section, does not have or maintain any government securities in its proprietary or other accounts. For the purpose of this paragraph (e)(2)(i), "identified group basis" means that a counterparty has consented to the identity of the specific group of entities from which the other counterparty is chosen.

(ii) A government securities interdealer broker may have or maintain government securities in its proprietary or other accounts only as a result of:

(A) Engaging in overnight reverse repurchase or securities borrowed transactions solely for the purpose of facilitating the process of clearing government securities transactions;

(B) Engaging in overnight repurchase or securities loaned transactions solely for the purpose of reducing its financing expense in connection with the clearance of government securities transactions;

(C) Subordinated loans subject to satisfactory subordination agreements pursuant to § 240.15c3–1(d) of this title;

(D) Collateral or depository requirements of a clearing corporation or association with which it participates in the clearance of government securities transactions; or

(E) The investment of its excess cash. The maturities of any government securities held or maintained under paragraphs (e)(2)(ii) (C), (D), or (E) of this section may not exceed one year.

(3) In order to qualify to operate under this paragraph (e), a government securities interdealer broker shall at all times have and maintain net capital, as defined in § 240.15c3–1(c)(2) of this title with the modifications of this paragraph (e), of not less than $1,000,000.

(4) For purposes of this paragraph (e), a government securities interdealer broker need not deduct loans to commercial banks for one business day of immediately available funds (commonly referred to as "sales of federal funds") held by the government securities interdealer broker in connection with the clearance of securities on the day the loan is made.

(5) For purposes of this paragraph (e), a government securities interdealer broker need not deduct net pair-off receivables and money differences until the close of business of the third business day following the day the funds are due and give-up receivables outstanding no more than 30 days from the billing date, which shall be no later than the last day of the month in which they arise, as otherwise would be required under § 240.15c3–1(c)(2)(iv)(B) of this title.

(6) For purposes of this paragraph (e), a government securities interdealer broker shall deduct from net worth ¼ of 1 percent of the contract value of each government securities failed-to-deliver contract which is outstanding 5 business days or longer. Such deduction shall be increased by any excess of the contract price of the failed-to-deliver contract over the market value of the underlying security.

(7) For purposes of this paragraph (e), a government securities interdealer broker may exclude from its aggregate indebtedness computation indebtedness adequately collateralized by government securities outstanding for not more than one business day and offset by government securities failed to deliver of the same issue and quantity. In no event may a government securities interdealer broker exclude any overnight bank loan attributable to the same government securities failed-to-deliver contract for more than one business day. A government securities interdealer broker need not deduct from net worth the amount by which the market value of securities failed to receive outstanding longer than thirty (30) calendar days exceeds the contract value of those failed to receive as required by § 240.15c3–1(c)(2)(iv)(E) of this title.

(8)(i) For purposes of this paragraph (e), a government securities interdealer broker shall deduct from net worth 5 percent of its net exposure to each counterparty.

(ii) *Net exposure.* For purposes of this paragraph (e), net exposure shall equal:

(A) The sum of the dollar amount of funds, debt instruments, other securities, and other inventory at risk, in the first instance, to the government securities interdealer broker in the event of the counterparty's default,

(B) Reduced, but not to less than zero, by the sum of:

(*1*) The dollar amount of funds, debt instruments, other securities, and other inventory at risk, in the first instance, to the counterparty in the event of the government securities interdealer broker's default;

(*2*) The deductions taken from net worth for unsecured receivables, repurchase and reverse repurchase deficits, aged fails to deliver, and aged fails to receive arising from transactions with the counterparty;

(*3*) Demand deposits in the case where the counterparty is a commercial bank;

(*4*) Loans for one business day of immediately available funds (commonly referred to as "sales of federal funds") held by the government securities interdealer broker in connection with the clearance of securities on the day the loan is made in the case where the counterparty is a commercial bank;

(*5*) Custodial holdings of securities in the case where the counterparty is a clearing bank or clearing broker of the government securities interdealer broker; and

(*6*) Exposure to a counterparty due to holding marketable instruments subject to market risk haircuts under Appendix A to this section (§ 402.2a) for which the counterparty is the obligor.

(9) On the application of the government securities interdealer broker, the designated examining authority may extend the periods of time in this paragraph (e) if it determines that the extension is warranted because of exceptional circumstances and that the government securities interdealer broker is acting in good faith.

(f) *Effective date.* This part shall be effective July 25, 1987, *provided however,* that until the last business day in October 1987, registered government securities brokers and dealers need not comply with § 402.2 (a), (b), and (c) as long as:

(1) A registered government securities broker or dealer that acts solely as an introducing broker within the meaning of § 240.15c3–1(a)(2) of this title has and maintains liquid capital, as defined in § 402.2(d), in an amount of not less than $5,000; and

(2) Any other registered government securities broker or dealer has and maintains liquid capital, as defined in

§ 402.2(d), in an amount of not less than $50,000.

§ 402.2 Capital requirements for registered government securities brokers and dealers.

(a) *General rule.* No government securities broker or dealer shall permit its liquid capital to be below an amount equal to 120 percent of total haircuts as defined in paragraph (g) of this section.

(b) *Minimum liquid capital.* Notwithstanding the provisions of paragraph (a) of this section, a government securities broker or dealer shall have and maintain liquid capital in an amount not less than $25,000, after deducting total haircuts as defined in paragraph (g) of this section.

(c) *Minimum liquid capital for introducing brokers.* Notwithstanding the provisions of paragraphs (a) and (b) of this section, a government securities broker or dealer that acts solely as an introducing broker within the meaning of § 240.15c3–1(a)(2) of this title, shall maintain liquid capital in an amount not less than $5,000, after deducting total haircuts as defined in paragraph (g) of this section.

(d) *Liquid capital.* "Liquid capital" means net capital as defined in § 240.15c3–1(c)(2) of this title with the following modifications:

(1) The percentages used to calculate the deductions for failed to deliver contracts required by § 240.15c3–1(c)(2)(ix) of this title when the underlying instrument is a Treasury market risk instrument as defined in paragraph (e) of this section are the appropriate net position haircut factors specified in paragraph (f)(2) of this section;

(2) The percentages used to calculate deductions required by § 240.15c3–1(c)(2)(iv)(B) of this title for securities that are Treasury market risk instruments are the appropriate net position haircut factors specified in paragraph (f)(2) of this section;

(3) The deduction required by § 240.15c3–1(c)(2)(iv)(F)(*3*)(*i*) of this title relating to repurchase agreement deficits shall be determined without reference to § 240.15c3–1(c)(2)(iv)(F)(*3*)(*i*)(*B*) or § 240.15c3–1(c)(2)(iv)(F)(*3*)(*i*)(*C*);

(4) The deductions from net worth required by §§ 240.15c3–1 (c)(2)(vi) and (c)(2)(viii) of this title and the adjustments to net worth set forth in § 240.15c3–1a and § 240.15c3–1b of this title (Appendices A and B to SEC Rule 15c3–1) are omitted;

(5) Net pair-off receivables and money differences need not be deducted as otherwise would be required under § 240.15c3–1(c)(2)(iv)(B) of this title until the close of business of the third business day following the day the funds are due;

(6) Give-up receivables outstanding no more than 30 days from the billing date, which shall be no later than the last day of the month in which they arise, need not be deducted as otherwise would be required under § 240.15c3–1(c)(2)(iv)(B) of this title;

(7) Loans to commercial banks for one business day of immediately available funds (commonly referred to as "sales of federal funds") held by the government securities broker or dealer in connection with the clearance of securities on the day the loan is made need not be deducted; and

(8) In determining net worth, all long and short positions in unlisted options that are Treasury market risk instruments shall be evaluated in the manner set forth in § 240.15c3–1(c)(2)(i)(B)(*1*) and not in the manner set forth in § 240.15c3–1(c)(2)(i)(B)(*2*) of this title.

(e) *Treasury market risk instruments.* (1) For purposes of this part, the term "Treasury market risk instrument" means the following dollar-denominated securities, debt instruments, and derivative instruments:

(i) Government securities, except equity securities and those mortgage-backed securities described in paragraph (e)(2) of this section;

(ii) Zero-coupon receipts or certificates based on marketable Treasury notes or bonds;

(iii) Marketable certificates of deposit of no more than one year to maturity;

(iv) Bankers acceptances;

(v) Commercial paper of no more than one year to maturity rated in one of the three highest categories by at least two nationally recognized statistical rating organizations;

(vi) Futures, forwards, and listed options on Treasury market risk instruments described in paragraphs (e)(1)(i)–(v) of this section or on time deposits whose changes in yield are closely correlated with the Treasury market risk instruments described in paragraph (e)(1)(iii) of this section, settled on a cash or delivery basis;

(vii) Options on those futures contracts described in paragraph (e)(1)(vi) of this section, settled on a cash or delivery basis; and

(viii) Unlisted options on marketable Treasury bills, notes or bonds.

(2) "Treasury market risk instrument" does not include mortgage-backed securities that do not pass through to each security holder on a pro rata basis a distribution based on the monthly payments and prepayments of principal and interest on the underlying pool of mortgage collateral less fees and expenses.

(f)(1) *Haircut categories.* For purposes of this part, the applicable categories within which non-zero-coupon and zero-coupon Treasury market risk instruments are classified are:

Category	Term or type for non-zero-coupon instruments	Term for zero-coupon instruments
A	Less than 45 days	Less than 45 days.
B	At least 45 days but less than 135 days	At least 45 days but less than 135 days.
C	At least 135 days but less than 9 months	At least 135 days but less than 9 months.
D	At least 9 months but less than 1 year, 6 months	At least 9 months but less than 1 year, 6 months.
E	At least 1 year, 6 months but less than 3 years, 6 months	At least 1 year, 6 months but less than 3 years.
F	At least 3 years, 6 months but less than 7 years, 6 months	At least 3 years but less than 5 years, 6 months.
G	At least 7 years, 6 months but less than 15 years	At least 5 years, 6 months but less than 9 years.
H	15 years and over	At least 9 years but less than 12 years.
I		At least 12 years but less than 21 years
J		21 years and over.
MB	All fixed rate mortgage-backed securities that are Treasury market risk instruments	
AR	All adjustable rate mortgage-backed securities that are Treasury market risk instruments.	

(2) *Haircut factors.* For purposes of this part, the applicable net position and offset haircut factors to be used in the calculation of the Treasury market risk haircut are as follows:

Category	Haircut factors	
	Net position haircuts (percent)	Offsets (percent)
A	None	None
B	0.12	0.02
C	0.20	0.03
D	0.45	0.07
E	1.10	0.22
F	2.20	0.44
G	3.30	0.50
H	4.50	0.90
I	7.75	1.55
J	11.25	3.38
MB	3.30	0.66
AR	1.10	0.22

(3) *Category pair hedging disallowance haircut factors.* For purposes of this part, the applicable category pair hedging disallowance haircut factors to be used in the calculation of the Treasury market risk haircut are as follows:

Category	Percent disallowed								
	C	D	E	F	G	H	I	J	MB
B	30	40							
C		20	30						
D			20	30	40				
E				20	30	40			
F					20	30	40		30
G						20	30		30
H							20	40	40
I								40	

(g) *Total haircuts.* "Total haircuts" equals the sum of the credit risk haircut and the market risk haircut.

(1) *Credit risk haircut.* The "credit risk haircut" equals the sum of the total counterparty exposure haircut, the total concentration of credit haircut and the credit volatility haircut.

(i) *Net credit exposure.* For purposes of this part, net credit exposure shall equal:

(A) The sum of the dollar amount of funds, debt instruments, other securities, and other inventory at risk to the government securities broker or dealer in the event of the counterparty's default and the market value of purchased unlisted options written by the counterparty that are Treasury market risk instruments,

(B) Reduced, but not to less than zero, by the sum of:

(*1*) The dollar amount of funds, debt instruments, other securities, and other inventory at risk to the counterparty in the event of the government securities broker's or dealer's default and the market value of unlisted options written by the government securities broker or dealer and held by the counterparty that are Treasury market risk instruments;

(*2*) The deductions taken from net worth for unsecured receivables, repurchase and reverse repurchase agreement deficits, aged fails to deliver, and aged fails to receive arising from transactions with the counterparty;

(*3*) Demand deposits in the case where the counterparty is a commercial bank;

(*4*) Loans for one business day of immediately available funds (commonly referred to as "sales of federal funds") held by the government securities broker or dealer in connection with the clearance of securities on the day the loan is made in the case where the counterparty is a commercial bank;

(*5*) Custodial holdings of securities in the case where the counterparty is a clearing bank or clearing broker of the government securities broker or dealer; and

(*6*) Exposure to a counterparty due to holding marketable instruments subject to market risk haircuts under Appendix A to this section (§ 402.2a) for which the counterparty is the obligor.

(ii) *Total counterparty exposure haircut.* The "total counterparty exposure haircut" equals the sum of the counterparty exposure haircuts taken for all counterparties except a Federal Reserve Bank, of the government securities broker or dealer. The "counterparty exposure haircut" equals the product of a counterparty exposure haircut factor of 5 percent and the net credit exposure to a single counterparty not in excess of 15 percent of the government securities broker's or dealer's liquid capital.

(iii) *Total concentration of credit haircut.* The "total concentration of credit haircut" equals the sum of the concentration of credit haircuts taken for all counterparties of the government securities broker or dealer. The "concentration of credit haircut" equals the product of a concentration of credit haircut factor of 25 percent and the amount by which the net credit exposure to a single counterparty is in excess of 15 percent of the government securities broker's or dealer's liquid capital.

(iv) *Credit volatility haircut.* The "credit volatility haircut" equals the product of a credit volatility haircut factor of 0.15 percent and the dollar amount of the larger of the gross long position or gross short position in those Treasury market risk instruments described in paragraphs (e)(1) (iii), (iv) and (v) of this section that have a term to maturity greater than 44 days, including futures and forwards thereon, settled on a cash or delivery basis.

(2) *Market risk haircut.* The "market risk haircut" equals the sum of the Treasury market risk haircut and the other securities haircut, calculated in accordance with the provisions of Appendix A of this section, § 402.2a.

(h) *Debt-equity requirements.* No government securities broker or dealer shall permit the total of outstanding principal amounts of its satisfactory subordination agreements as defined in § 240.15c3–1d of this title (Appendix D to SEC Rule 15c3–1) modified as

provided in Appendix D to this section, § 402.2d, to exceed the allowable levels set forth in § 240.15c3–1(d) of this title.

(i) *Limitation on withdrawal of equity capital.* No equity capital of the government securities broker or dealer or a subsidiary or affiliate consolidated pursuant to Appendix C to this section, § 402.2c, may be withdrawn by action of a stockholder or partner, or by redemption or purchase 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 § 240.15c3–1d of this title, Appendix D to SEC Rule 15c3–1, modified as provided in Appendix D to this section, § 402.2d) under satisfactory subordination agreements which are scheduled to occur within six months following such withdrawal, advance or loan, either:

(1) The ratio of liquid capital to total haircuts, determined as provided in § 402.2, would be less than 150 percent; or

(2) Liquid capital minus total haircuts would be less than 120 percent of the minimum capital required by § 402.2(b) or § 402.2(c) as applicable; or

(3) In the case of any government securities broker or dealer included in such consolidation, the total outstanding principal amounts of satisfactory subordination agreements of the government securities broker or dealer (other than such agreements which qualify as equity under § 240.15c3–1(d) of this title) would exceed 70% of the debt-equity total as defined in such § 240.15c3–1(d).

The term equity capital includes capital contributions by partners, par or stated value of capital stock, paid-in capital in excess of par, retained earnings or other capital accounts. The term equity capital does not include securities accounts of partners and balances in limited partners' capital accounts in excess of their stated capital contributions. This provision shall not preclude a government securities broker or dealer from making required tax payments or preclude the payment to partners of reasonable compensation.

(j) *Modification of appendices to § 240.15c3–1 of this Title.* For purposes of this section, Appendix C to this section (§ 402.2c) is substituted for Appendix C to Rule 15c3–1 (§ 240.15c3–1c of this title), and Appendix D to Rule 15c3–1 (§ 240.15c3–1d of this title), relating to Satisfactory Subordination Agreements, is modified as provided in Appendix D to this section (§ 402.2d).

§ 402.2a Appendix A—Calculation of market risk haircut for purposes of § 402.2(g)(2).

The market risk haircut is the sum of the Treasury market risk haircut and the other securities haircut, calculated as follows.

(a) *Treasury market risk haircut.* The "Treasury market risk haircut" equals the sum of the total governments offset portion haircut, the total futures and options offset haircut, the total hedging disallowance haircut, and the residual net position haircut, calculated with respect to financings and positions in Treasury market risk instruments, except to the extent that a permissible election is made pursuant to paragraph (b)(1) of this section to include qualified positions in the calculation of the other securities haircut.

(1) *Total governments offset portion haircut.* The "total governments offset portion haircut" equals the sum of the governments offset portion haircuts calculated for each category in § 402.2(f)(1). The "governments offset portion haircuts" equal, for each category in § 402.2(f)(1), the product of the offset haircut factor for that category set out in § 402.2(f)(2) and the smaller of the absolute values of the gross long immediate position or gross short immediate position for that category. Schedules B and C in paragraph (c) of this section can be used to make this calculation.

(i)(A) The "gross long immediate position" for purposes of this part equals, for each category except categories MB and AR in § 402.2(f)(1), the sum of the market values of each long immediate position in Treasury market risk instruments with a term to maturity (or, in the case of a floating rate note, the time to the next scheduled interest rate adjustment or the term to maturity, whichever is less) corresponding to such category, the contract values of each reverse repurchase agreement with a term to maturity or time to the next scheduled interest rate adjustment, whichever is less, corresponding to that category, and the values of the cash collateral of each security borrowing with a term to maturity or time to next scheduled interest rate adjustment, whichever is less, corresponding to such category.

(B) In the case of category MB, the "gross long immediate position" equals the sum of the market values of all long immediate positions in fixed rate mortgage-backed securities which are Treasury market risk instruments.

(C) In the case of category AR, the "gross long immediate position" equals the sum of the market values of all long immediate positions in adjustable rate mortgage-backed securities which are Treasury market risk instruments.

(ii)(A) The "gross short immediate position" for purposes of this section equals, for each category except categories MB and AR in § 402.2(f)(1), the sum of the market values of each short immediate position in Treasury market risk instruments with a term to maturity (or, in the case of a floating rate note, the time to the next scheduled interest rate adjustment or the term to maturity, whichever is less) corresponding to such category, and the values of funds received from each financing transaction (including repurchase agreements, securities lending secured by cash collateral, and term financings, but excluding subordinated debt which meets the requirements of § 240.15c3–1d of this title modified as provided in § 402.2d) with a term to maturity or time to the next scheduled interest rate adjustment, whichever is less, corresponding to that category.

(B) In the case of category MB, the "gross short immediate position" equals the sum of the market values of all short immediate positions in fixed rate mortgage-backed securities which are Treasury market risk instruments.

(C) In the case of category AR, the "gross short immediate position" equals the sum of the market values of all short immediate positions in adjustable rate mortgage-backed securities which are Treasury market risk instruments.

(iii) The term "long immediate position" in a Treasury market risk instrument means, for purposes of this part:

(A) The net long position in a Treasury market risk instrument as of the trade date, except when the settlement date, in the case of a Treasury market risk instrument except a mortgage-backed security, is scheduled more than five business days in the future, and, in the case of a mortgage-backed security, more than thirty calendar days in the future;

(B) The net long when-issued position in a marketable U.S. Treasury security between announcement and issue date; and

(C) The net long when-issued position in a government agency or a government sponsored agency debt security between release date and issue date.

(iv) The term "short immediate position" on a Treasury market risk instrument means, for purposes of this part:

(A) The net short position in a Treasury market risk instrument as of the trade date, except when the settlement date, in the case of a Treasury market risk instrument except a mortgage-backed security, is scheduled more than five business days in the future, and, in the case of a mortgage-backed security, more than thirty calendar days in the future;

(B) The net short when-issued position in a marketable U.S. Treasury security between announcement and issue date; and

(C) The net short when-issued position in a government agency or a government sponsored agency debt security between release date and issue date.

(2) *Net immediate position interim haircut.* The "net immediate position interim haircut" equals, for each category in § 402.2(f)(1), the product of the net position haircut factor for that category and the sum of the gross long immediate position and the gross short immediate position for that category. For purposes of this part, a gross long immediate position shall be a positive number and a gross short immediate position shall be a negative number. Schedules B and C in paragraph (c) of this section can be used to make this calculation.

(3) *Total futures and options offset haircut.* The "total futures and options offset haircut" equals the sum of the futures and options offset haircuts calculated for each category in § 402.2(f)(1). The "futures and options offset haircut" equals, for each category in § 402.2(f)(1), the product of a futures and options offset factor of 20 percent and the smaller of the absolute values of the positive and negative aggregate interim haircuts for that category. Schedule D in paragraph (c) of this section can be used to make this calculation.

(i) *Positive aggregate interim haircut.* The "positive aggregate interim haircut" equals, for each category in § 402.2(f)(1), the sum of the positive net immediate position interim haircut (see paragraph (a)(2) of this section), the gross long futures and forward interim haircut, and the positive gross options interim haircut for that category. Schedule D in paragraph (c) of this section can be used to make this calculation.

(A) *Gross long futures and forward interim haircut.* The "gross long futures and forward interim haircut" equals, for each category in § 402.2(f)(1), the sum of the interim haircuts on each long futures position and long forward position placed, in the case of a futures or forward contract on Treasury market risk instruments except mortgage-backed securities, in the category corresponding to the sum of the term to maturity of the contract and the term to maturity of the underlying instrument at the time of the maturity of the contract or, in the case of a futures or forward contract on Treasury market risk mortgage-backed securities, the category corresponding to the type of Treasury market risk mortgage-backed security.

(*1*) For purposes of this part, the "interim haircut on each long futures position and each long forward position" is the product of the net position haircut factor for the category corresponding to, in the case of a futures or forward contract on Treasury market risk instruments except mortgage-backed securities, the maturity of the underlying instrument at the time of the maturity of the contract or, in the case of a futures or forward contract on Treasury market risk mortgage-backed securities, the type of Treasury market risk mortgage-backed security and the value of the long futures position or long forward position evaluated at the current market price for such contract.

(*2*) For purposes of this part, the gross long futures and forward interim haircut shall be a positive number.

(B) *Positive gross options interim haircut.* The "positive gross options interim haircut" equals, for each category in § 402.2(f)(1), the sum of the interim haircuts on each purchased call and sold put placed in the category in which the underlying instrument would be placed.

(*1*) For purposes of this part, the "interim haircut on each purchased call and sold put" equals the lesser of the market value of the option or, (*i*) in the case of an option on a cash instrument, the product of the net position haircut factor for the category to which the underlying cash instrument corresponds and the market value of the underlying cash instrument or, (*ii*) in the case of an option on a futures contract, the interim haircut on the underlying futures contract.

(*2*) For purposes of this part, the positive gross options interim haircut is a positive number.

(ii) *Negative aggregate interim haircut.* The "negative aggregate interim haircut" equals, for each category in § 402.2(f)(1), the sum of the negative net immediate position interim haircut (see paragraph (a)(2) of this section), the gross short futures and forward interim haircut, and the negative gross options interim haircut for that category. Schedule D in paragraph (c) of this section can be used to make this calculation.

(A) *Gross short futures and forward interim haircut.* The "gross short futures and forward interim haircut" equals, for each category in § 402.2(f)(1), the sum of the interim haircuts on each short futures position and short forward position placed, in the case of a futures or forward contract on Treasury market risk instruments except mortgage-backed securities, in the category corresponding to the sum of the term to maturity of the contract and the term to maturity of the underlying instrument at the time of the maturity of the contract or, in the case of a futures or forward contract on Treasury market risk mortgage-backed securities, in the category corresponding to the type of Treasury market risk mortgage-backed security.

(*1*) For purposes of this part, the "interim haircut on each short futures position and each short forward position" is the product of the net position haircut factor for the category corresponding to, in the case of a futures or forward contract on Treasury market risk instruments except mortgage-backed securities, the maturity of the underlying instrument at the time of the maturity of the contract or, in the case of a futures or forward contract on Treasury market risk mortgage-backed securities, the type of Treasury market risk mortgage-backed security and the value of the short futures position or short forward position evaluated at the current market price for such contract.

(*2*) For purposes of this part, the gross short futures and forward interim haircut is a negative number.

(B) *Negative gross options interim haircut.* The "negative gross options interim haircut" equals, for each category in § 402.2(f)(1), the sum of the interim haircuts on each sold call and purchased put placed in the category in which the underlying instrument would be placed.

(*1*) For purposes of this part, the "interim haircut on each sold call and purchased put" equals the lesser of the market value of the option or, (*i*) in the case of an option on a cash instrument, the product of the net position haircut factor for the category to which the underlying cash instrument corresponds and the market value of the underlying cash instrument or, (*ii*) in the case of an option on a futures contract, the interim haircut on the underlying futures contract.

(*2*) For purposes of this part, the negative gross options interim haircut is a negative number.

(4) *Total hedging disallowance haircut.* The "total hedging disallowance haircut" equals the sum of the hedging disallowance haircuts calculated pursuant to each netting of qualified

netting interim haircuts. The "hedging disallowance haircut" equals the absolute value of the product of the applicable category pair hedging disallowance haircut factor specified in § 402.2(f)(3) and the smaller in absolute value of any two qualified netting interim haircuts, netted in accordance with the provisions of this paragraph. Schedule E in paragraph (c) of this section can be used to make this calculation.

(i) *Qualified netting interim haircut.* The term "qualified netting interim haircut" means a residual position interim haircut or a net residual position interim haircut.

(A) *Residual position interim haircut.* The "residual position interim haircut" equals, for each category in § 402.2(f)(1), the sum of the positive aggregate interim haircut and the negative aggregate interim haircut corresponding to the category, calculated in accordance with the provisions of paragraph (a)(3) of this section.

(B)(*1*) *Net residual position interim haircut.* The "net residual position interim haircut" equals, for any two categories between which netting is permitted, the sum of (*i*) the residual position interim haircuts calculated for those categories, in the case of the category of the larger in absolute value of the two residual position interim haircuts being netted, and (*ii*) zero, in the case of the category of the smaller in absolute value of the two residual position interim haircuts being netted.

(*2*) For the purposes of this paragraph (a)(4), netting is permitted only between categories for which a category pair hedging disallowance haircut factor has been specified in paragraph § 402.2(f)(3).

(ii) Net residual position interim haircuts shall be substituted for the residual position interim haircuts in the respective categories in which they have been placed and shall be considered as if they were residual position interim haircuts. New net residual position interim haircuts may continue to be calculated until for each category pair for which netting is permitted at least one of the two qualified netting interim haircuts is zero or both qualified netting interim haircuts are of the same sign.

(5) *Residual net position haircut.* The "residual net position haircut" equals the sum of the absolute values of all qualified netting interim haircuts remaining in each category after the completion of the calculation of permissible nettings described in paragraph (a)(4) of this section. Schedule E in paragraph (c) of this section can be used to make this calculation.

(b) *Other securities haircut.* The "other securities haircut" equals the sum of all deductions specified in § 240.15c3–1 (c)(2)(vi) and (c)(2)(viii) of this title and §§ 240.15c3–1a and 240.15c3–1b of this title for long and short positions in securities, futures contracts, forward contracts, options, and other inventory which are not Treasury market risk instruments as defined in § 402.2(e).

(1) A registered government securities broker or dealer may elect to exclude from its calculation of the Treasury market risk haircut and include in its calculation of the other securities haircut long and short positions in Treasury market risk instruments if such positions form part of a hedge against long and short positions in securities, futures contracts, forward contracts, or options which are not Treasury market risk instruments. Only the portion of the total position in a Treasury market risk instrument that forms part of such hedge may be excluded from the calculation of the Treasury market risk haircut and included in the calculation of the other securities haircut.

(2) For purposes of this paragraph (b), a gross long or short position in Treasury market risk instruments shall be considered part of a hedge if the inclusion of such position in the calculation of the other securities haircut would serve to reduce said haircut.

(3) For purposes of this paragraph (b) as it relates to § 240.15c3–1(c)(2)(vi)(M) ("undue concentration"), references to "10 percent of the "net capital'" shall be understood to refer to 10 percent of the liquid capital and references to "Appendix (D) (17 CFR 240.15c3–1d)" shall be understood to refer to such section as modified by § 402.2d.

(c) *Schedules.* This paragraph sets forth schedules which may be used by government securities brokers or dealers in the calculation of total haircuts as required by this Part 402. The appropriate regulatory agency or designated examining authority may specify other substantially similar forms required to be used by government securities brokers or dealers in the calculation of such haircuts.

Schedule A.—Liquid Capital Requirement, Summary Computation

[In thousands of dollars]

1. Liquid capital [1]	———
2. Haircuts on security and financing positions including contractual commitments:	
a. Total governments offset portion haircut (Schedule C)	———
b. Total futures and options offset haircut (Schedule D)	———
c. Total hedging disallowance haircut (Schedule E)	———
d. Residual net position haircut (Schedule E)	———
e. Other securities haircut (use SEC factors)	———
3. Haircuts on credit exposure:	
a. Total counterparty exposure haircut	———
b. Total concentration of credit haircut	———
c. Credit volatility haircut	———
4. Total haircuts (sum of lines 2 a through e, 3 a, b, and c)	———
5. Capital-to-risk ratio (line 1 divided by line 4)	———

[1] Identical to the amount reported on line 3640 of the Report on Finances and Operations of Government Securities Brokers and Dealers, Form G–405.

BILLING CODE 4810–25–M

Schedule B

Calculation of Net Immediate Positions in Securities and Financings

	Maturity Category 1/	Financings Long 2/ (+)	Financings Short 2/ (-)	Securities Positions Long (+)	Securities Positions Short (-)	Total Securities and Financing Positions (+)	Total Securities and Financing Positions (-)	Offset Portions (+)	Net Immediate Positions (+/-)	
A	0-45 days									A
B	45-135 days									B
C	135 days-9 months									C
D	9-18 months									D
E	1.5-3.5 years (1.5-3 years)									E
F	3.5-7.5 years (3-5.5 years)									F
G	7.5-15 years (5.5-9 years)									G
H	15-30 years (9-12 years)									H
I	(12-21 years)									I
J	(21 years and over)									J
MB	mortgage-backed									MB
AR	adjustable rate mortgage-backed									AR
	Column Number	1	2	3	4	5 (1+3)	6 (2+4)	7# (Note 1)	8# (5+6)	

Carry forward to Schedule C.

Note 1: The offset portion (Column 7) is the smaller of Columns 5 and 6.

1/ The categories are designated in Sec. 402.2(f)(1). A category contains all securities with maturities greater than or equal to the lower of the designated maturities, but less than the higher. Maturity designations in parentheses refer to maturities of zero-coupon instruments to be placed in that category. In categories A, B, C, and D, zero-coupon instruments are to be treated in the same manner as all other instruments. A half year (.5) is always considered to be 6 months.

2/ Long financings are financings which provide securities to a broker or dealer; short financings are those which provide funds.

Schedule C

Governments Offset Portion and Net Immediate Position Interim Haircuts Calculation

	Maturity Category 1/	Governments Offset Portion			Net Immediate Position		
		$ Amounts (+)	Factors	Haircuts (+)	$ Amounts (+/-)	Factors	Interim Haircuts (+/-)
A	0-45 days		None			None	
B	45-135 days		0.0002			0.0012	
C	135 days-9 months		0.0003			0.0020	
D	9-18 months		0.0007			0.0045	
E	1.5-3.5 years (1.5-3 years)		0.0022			0.0110	
F	3.5-7.5 years (3-5.5 years)		0.0044			0.0220	
G	7.5-15 years (5.5-9 years)		0.0050			0.0330	
H	15-30 years (9-12 years)		0.0090			0.0450	
I	(12-21 years)		0.0155			0.0775	
J	(21 years and over)		0.0338			0.1125	
MB	mortgage-backed		0.0066			0.0330	
AR	adjustable rate mortgage-backed		0.0022			0.0110	

Total Governments Offset Portion Haircut $_____

Column Number	7 (Note 1)	9	10# (7x9)	8 (Note 1)	11	12## (8x11)

Carry to Schedule A, line 2a

Carry forward to Schedule D (or Schedule E, if no forwards, futures, or options).

Note 1: From Schedule B.

1/ The categories are designated in Sec. 402.2(f)(1). A category contains all securities with maturities greater than or equal to the lower of the designated maturities, but less than the higher. Maturity designations in parentheses refer to maturities of zero-coupon instruments to be placed in the category. In categories A, B, C, and D, zero-coupon instruments are to be treated in the same manner as all other instruments. A half year (.5) is always considered to be 6 months.

Schedule D

Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts

(In thousands of dollars)

Maturity Category 1/	Net Immediate Position Interim Haircuts (+/-)	Gross Interim Haircuts: Futures & Forward (+)	Futures & Forward (-)	Options (+)	Options (-)	Aggregate Interim Haircuts (+)	Aggregate Interim Haircuts (-)	Futures & Options Offset Portions 2/ (+)	Residual Position Interim Haircuts (+/-)
B 45-135 days									B
C 135 days-9 months									C
D 9-18 months									D
E 1.5-3.5 years (1.5-3 years)									E
F 3.5-7.5 years (3-5.5 years)									F
G 7.5-15 years (5.5-9 years)									G
H 15-30 years (9-12 years)									H
I (12-21 years)									I
J (21 years and over)									J
MB mortgage-backed									MB
AR adjustable rate mortgage-backed									AR
Column Number	12 (Note 1)	13	14	15	16	17	18	19 (Note 2)	20## (17+18)

Total Futures and Options Offset Portion: $ _____

Factor: x20%

Total Futures and Options Offset Haircut: $ _____ #

\# Carry to Schedule A, line 2b.

\## Carry forward to Schedule E.

Note 1: From Schedule C.

Note 2: Column 19 is the smaller of columns 17 and 18.

1/ The categories are designated in Sec. 402.2(f)(1). A category contains all securities with maturities greater than or equal to the lower of the designated maturities, but less than the higher. Maturity designations in parentheses refer to maturities of zero-coupon instruments to be placed in the category. In categories A, B, C, and D, zero-coupon instruments are to be treated in the same manner as all other instruments. A half year is always considered to be 6 months.

2/ The total futures and options haircut is calculated from the total of column 19.

Schedule E

Calculation of Hedging Disallowance Haircuts when Netting Haircuts Across Categories 1/

(In thousands of dollars)

Maturity Category 2/	Residual Position Interim Haircuts (+/-)	20% Disallowance: Hedging Disallowance Haircuts (+)	20% Disallowance: Net Residual Position Interim Haircuts (+/-)	30% Disallowance: Hedging Disallowance Haircuts (+)	30% Disallowance: Net Residual Position Interim Haircuts (+/-)	40% Disallowance: Hedging Disallowance Haircuts (+)	40% Disallowance: Net Residual Position Interim Haircuts (+/-)	Hedging Disallowance Haircuts (+)	Qualified Netting Interim Haircuts (+)	
B 45-135 days										B
C 135 days-9 months										C
D 9-18 months										D
E 1.5-3.5 years (1.5-3 years)										E
F 3.5-7.5 years (3-5.5 years)										F
G 7.5-15 years (5.5-9 years)										G
H 15-30 years (9-12 years)										H
I (12-21 years)										I
J (21 years and over)										J
MB mortgage-backed										MB
AR adjustable rate mortgage-backed										AR

Total Hedging Disallowance Haircut:$_____

Residual Net Position Haircut:$_____

Column Number	20 (Note 1)	21	22 (Note 2)	23	24 (Note 2)	25	26 (Note 2)	27# (Note 3)	28##

\# Column 27 carries forward to Schedule A, line 2c.

\## Column 28 total carries forward to Schedule A, line 2d.

Note 1: From Schedule D (or Schedule C, if no forwards, futures, or options).

Note 2: Net of two offsetting haircuts of paired maturity categories.

Note 3: For every entry in column 20 there should be an entry in either column 27 or 28 (but never both).

1/ See Sec 402.2(f)(3) for category pair hedging disallowance haircut factors.

2/ The categories are designated in Sec. 402.2(f)(1). A category contains all securities with maturities greater than or equal to the lower of the designated maturities, but less than the higher. Maturity designations in parentheses refer to maturities of zero-coupon instruments to be placed in the category. In categories A, B, C, and D, zero-coupon instruments are to be treated in the same manner as all other instruments. A half year (.5) is always considered to be 6 months.

BILLING CODE 4810-25-C

Instructions to Schedules A through E

Schedules A through E may be used by government securities brokers or dealers subject to 17 CFR 402 to determine the firm's capital-to-risk ratio. Section 402.2 provides that a government securities broker or dealer must meet the applicable minimum dollar liquid capital requirement and that the firm's ratio of liquid capital to risk (total haircuts) must be at least 1.2:1; liquid capital must exceed risk by at least 20 percent. Total haircuts is the risk measure used in the ratio; it is made up of measures of market risk and measures of credit risk. The market risk of a government securities broker's or dealer's positions is accounted for through the Treasury market risk haircut and the other securities haircut. Credit risk is accounted for in the counterparty exposure, concentration of credit, and credit volatility haircuts and in the computation of liquid capital through the various deductions and charges.

Only positions in Treasury market risk instruments and financings may be used in the calculation of the Treasury market risk haircut. Treasury market risk instruments and financings are described in 17 CFR 402.2 and in the instructions to the schedule where they are to be first entered. All other types of financial instruments are to be included in the calculation of the other securities haircut. Calculation of the other securities haircut is based on the SEC's Rule 15c3–1 (17 CFR 240.15c3–1).

Treasury market risk instruments may be excluded from the calculation of the Treasury market risk haircut if they are included in the calculation of the other securities haircut as part of a hedge against long and short positions in securities, futures contracts, forward contracts, or options that are not Treasury market risk instruments. Only the portion of the total position in a Treasury market risk instrument that forms part of such a hedge may be excluded, and the result of this transfer of the Treasury market risk instruments must be a reduction in the other securities haircut.

The categories for classifying Treasury market risk instruments are designated in 17 CFR 402.2(f)(1). The categories, which are designated by a maturity range, contain all securities with remaining terms to maturity greater than or equal to the lower end of the range but less than the higher. A half year is always considered to be 6 months. In categories A through D, zero-coupon instruments are to be treated in the same manner as all other instruments. In categories E through J, the maturity designations in parentheses give the maturities of the zero-coupon instruments to be placed in that category. All mortgage-backed securities that are Treasury market risk instruments are to be placed in category MB or category AR, depending on whether they are backed by conventional or adjustable-rate mortgages.

All haircuts may be calculated to the nearest hundred dollars, unless such rounding would materially affect the liquid capital calculation.

Appendix A to the Preamble published with the temporary regulations for 17 CFR Part 402 (52 FR 19669, May 26, 1987) contains an example of the capital calculation. It may also be used as an aid in completing these schedules.

Schedule A—Liquid Capital Requirement Summary Computation

Schedule A is used to determine the capital-to-risk ratio by comparing liquid capital to total haircuts. Schedule A will be the last schedule completed as many of the haircuts entered on Schedule A are calculated on Schedules B through E.

Line 1—Enter liquid capital, which is identical to the amount reported on line 3640 of the Report on Finances and Operations of Government Securities Brokers and Dealers, Form G–405.

Line 2—Haircuts on "Security and Financing Positions" including contractual commitments:

a. Enter the Total Governments Offset Portion Haircut from column 10 of Schedule C.

b. Enter the Total Futures and Options Offset Haircut from column 19 of Schedule D.

c. Enter the Total Hedging Disallowance Haircut as calculated in Schedule E, column 27.

d. Enter the Residual Net Position Haircut as given in column 28 of Schedule E.

e. Enter the other securities haircut as determined by applying the SEC haircut factors to securities, futures contracts, forward contracts, options and other inventory that are not Treasury market risk instruments as defined in 17 CFR 402.2(e). The other securities haircut is the sum of all applicable deductions as specified in 17 CFR 240.15c3–1 (c)(2)(vi) and (c)(2)(viii) and in 17 CFR 240.15c3–1a and 240.15c3–1b. Any position(s) in Treasury market risk instruments that have been excluded from the calculation of the Treasury market risk haircut because they are part of a hedge with these other instruments are to be included in the calculation of this haircut.

Line 3—Haircuts on credit exposure:

a. Enter the total counterparty exposure haircut which is the sum of the counterparty exposure haircut with each counterparty, except a Federal Reserve Bank. A counterparty exposure haircut is equal to 5 percent of the net credit exposure to a single counterparty which is not in excess of 15 percent of the government securities broker's or dealer's liquid capital. If the net credit exposure to a counterparty does exceed 15 percent of liquid capital, the excess will be used in calculating the total concentration of credit haircut on line 3b.

Net credit exposure equals the difference between the government securities broker's or dealer's credit exposure to a single counterparty and that counterparty's credit exposure to the government securities broker or dealer. The government securities broker's or dealer's credit exposure to a counterparty is equal to the sum of the dollar amount of funds, debt instruments, other securities, and other inventory at risk to the government securities broker or dealer in the event of the counterparty's default and the market value of purchased unlisted options that are Treasury market risk instruments and were written by the counterparty. It does not include, however, (1) the deduction taken from net worth for unsecured receivables, repurchase and reverse repurchase agreement deficits, aged fails to deliver, and aged fails to receive arising from transactions with the counterparty; (2) demand deposits in the case where the counterparty is a commercial bank; (3) loans of immediately available funds (commonly referred to as "sales of federal funds") held by the government securities broker or dealer in connection with the clearance of securities on the day the loan is made in the case where the counterparty is a commercial bank; (4) custodial holdings of securities in the case where the counterparty is a clearing bank or clearing broker of the government securities broker or dealer; or (5) credit exposure to the counterparty due to holding marketable instruments for which the counterparty is the obligor.

The counterparty's credit exposure to the government securities broker or dealer equals the dollar amount of funds, debt instruments, other securities, and other inventory at risk to the counterparty in the event of the government security broker's or dealer's default and any unlisted options written by the government securities broker or dealer and held by the counterparty.

b. Enter the total concentration of credit haircut which is the sum of all

concentration of credit haircuts applied in cases where the net credit exposure (as defined above) to a single counterparty is in excess of 15 percent of the government securities broker's or dealer's liquid capital. The concentration of credit haircut is 25 percent of the amount of net credit exposure in excess of 15 percent of the government securities broker's or dealer's liquid capital.

c. Enter the credit volatility haircut which equals a factor of 0.15 percent applied to the larger of the gross long or gross short position in money market instruments qualifying as Treasury market risk instruments which mature in 45 days or more, and in futures and forwards on these instruments that are settled on a cash or delivery basis. Money market instruments qualifying as Treasury market risk instruments are (1) certificates of deposit with no more than one year to maturity, (2) bankers acceptances, and (3) commercial paper which has no more than one year to maturity and is rated in one of the three highest categories by at least two nationally recognized statistical rating organizations.

Line 4—Enter total haircuts which is the sum of lines 2 a through e, and 3 a, b, and c.

Line 5—Enter the capital-to-risk ratio which is found by dividing line 1, "Liquid capital," by line 4, "Total haircuts." The capital-to-risk ratio must be at least equal to 1.2:1.

Schedule B—Calculation of Net Immediate Position in Securities and Financings

Schedule B is used to calculate the net immediate position in and offset portion of securities and financings. The results are then carried over to Schedule C for initial haircut calculations. Futures, forwards, and options which are Treasury market risk instruments are to be entered on Schedule D.

Positions in and financings on debt instruments other than mortgage-backed or adjustable rate mortgage-backed securities should be placed in the category corresponding to their remaining term to maturity. In the case of a floating rate note, however, the note should be placed in the category corresponding to the time to the next scheduled interest rate adjustment or remaining term to maturity, whichever is less.

Column 1—Under "Financings-Long" report in the appropriate category the contract value of reverse repurchase agreements and the value(s) of cash collateral on security borrowings. Financings so reported should be placed in the category corresponding to the remaining term to maturity or time to the next scheduled interest rate adjustment, whichever is less.

Column 2—Under "Financings-Short" report in the appropriate category as a negative number the values of funds received from financing transactions. Include repurchase agreements, securities lending secured by cash collateral, and term financings, but exclude subordinated debt which meets the requirements of 17 CFR 240.15c3-1d as modified by 17 CFR 402.2d. Financings so reported should be placed in the category corresponding to the remaining term to maturity or time to the next scheduled interest rate adjustment, whichever is less.

Columns 3 and 4—Report in the appropriate column by maturity or type of mortgage-backed security under "Securities Positions" the sum of the market values of immediate positions in Treasury market risk instruments. The net position in each individual Treasury market risk instrument is to be appropriately reported as a long (+) or short (−) position in summation with all other positions of the same category (long/short). Short positions are assigned a negative value. Treasury market risk instruments are defined in 17 CFR 402.2(e). Those to be reported in Schedule B are:

(1) Government securities as defined in 17 CFR 400.3(m) except equity securities and mortgage-backed securities which do not pass through to the security holder on a pro rata basis a distribution based on the monthly payments and prepayments of principal and interest on the underlying pool of mortgage collateral less fees and expenses;

(2) Zero-coupon receipts or certificates based on marketable Treasury notes or bonds;

(3) Marketable certificates of deposit of no more than one year to maturity;

(4) Bankers acceptances; and

(5) Commercial paper of no more than one year to maturity rated in one of the three highest categories by at least two nationally recognized statistical rating organizations.

Report all positions as of the trade date. If the settlement date is scheduled for more that five business days in the future (or, in the case of a mortgage-backed security, more than thirty calendar days in the future), then report the position as a forward contract on Schedule D. Also, under "Securities Positions" in the appropriate column and category, report any when-issued position in a marketable Treasury security between announcement and issue date and any when-issued position in a government agency or a government sponsored agency debt security between release date and issue date.

Exclude positions in Treasury market risk instruments which form part of a hedge against long and short positions in securities, futures contracts, forward contracts, or options that are not Treasury market risk instruments and are to be included in the calculation of the other securities haircut. Only that portion of the total position in a Treasury market risk instrument that forms part of such a hedge may be excluded, and the inclusion of the Treasury market risk instruments must reduce the other securities haircut.

Column 5—Under "Total Securities and Financing Positions (+)" report in the appropriate category the sum of the long financings (column 1) and long securities positions (column 3).

Column 6—Under "Total Securities and Financing Positions (−)" report in the appropriate category the sum of the short financings (column 2) and short securities positions (column 4).

Column 7—Under "Offset Portions" report in the appropriate category the lesser of the absolute values of the positive (column 5) or negative (column 6) total securities and financing positions.

Column 8—Under "Net Immediate Positions" report in the appropriate category the sum, or net value, of the positive (column 5) and negative (column 6) total securities and financing positions.

Columns 7, "Offset Portions," and 8, "Net Immediate Positions," are to be carried to Schedule C.

Schedule C—Governments Offset Portion and Net Immediate Position Interim Haircuts Calculation

Schedule C is used to calculate the total governments offset portion haircut and net immediate position interim haircuts by applying offset and net position haircut factors to the offset portions and net immediate positions in Treasury market risk instruments and financings. The total governments offset portion haircut is then carried to Schedule A, and the net immediate position interim haircuts are carried to Schedule D or E.

Column 7—Transfer to column 7, "Governments Offset Portion—$ Amounts," column seven from Schedule B, "Offset Portions."

Column 9—These are the governments offset portion haircut factors given at 17 CFR 402.2(f)(2). They may be updated from time to time.

Column 10—Under "Governments Offset Portion—Haircuts" report in the appropriate category the product of the

corresponding values in column 7, "$ Amounts," and in column 9, "Factors."

To determine the total governments offset portion haircut, sum the values under "Governments Offset Portion—Haircuts" in column 10, and enter this number in the appropriate space. Carry this value to Schedule A, line 2a, converting, if necessary, to thousands of dollars.

Column 8—Transfer to column 8, "Net Immediate Positions—$ Amounts," column eight from Schedule B, "Net Immediate Positions."

Column 11—These are the net immediate position haircut factors given at 17 CFR 402.2(f)(2). They may be updated from time to time.

Column 12—Under "Net Immediate Positions—Interim Haircuts" place in the appropriate category the product of the corresponding values in column 8, "$ Amounts," and in column 11, "Factors." A haircut on a short position remains negative.

Carry column 12 to Schedule D, or, if there are no futures, forwards, or options positions, to Schedule E.

Schedule D—Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts

Schedule D is used to enter haircuts on futures, forwards and options positions and to calculate the total futures and options offset haircut and the residual position interim haircuts as needed for Schedules A and E respectively. If there are no futures and options positions, it is not necessary to fill out Schedule D.

Report on Schedule D futures, forwards, and options which are Treasury market risk instruments as defined in 17 CFR 402.2(e). These futures, forwards, and listed option contracts may be based on any of the Treasury market risk instruments described in the instructions to columns 3 and 4 on Schedule B or on time deposits whose changes in yield are closely correlated with certificates of deposit which are Treasury market risk instruments. Options on Treasury market risk futures contracts and unlisted options on marketable Treasury bills, notes, and bonds are also to be included. Futures contracts may settle on a cash or delivery basis. Any of these contracts which are being included as part of a hedge in the calculation of the other securities haircut must be excluded from Schedule D.

Report as a forward contract any position for which the time between trade date and settlement date is more than five business days (30 calendar days for a mortgage-backed security). Any when-issued position in a marketable Treasury security established between announcement and issue date and any when-issued position in a government agency or a government sponsored agency debt security established between release date and issue date is reported in the appropriate category on Schedule B under "Securities Positions."

Column 12—Transfer to column 12, "Net Immediate Position Interim Haircuts," column 12 from Schedule C, "Net Immediate Positions—Interim Haircuts," converting, if necessary, to thousands of dollars.

Columns 13 and 14—Under "Gross Interim Haircuts—Futures and Forward" enter in the appropriate category the sum of the interim haircuts on the futures or forward positions belonging to that category. The interim haircut on a futures or forward position equals the product of the value of the position evaluated at the current market price for such contract and the net position haircut factor that corresponds to either the term to maturity of the underlying instrument or, for mortgage-backed securities, the type of security. The term to maturity of the underlying instrument is the term to maturity of the deliverable security at the time of the maturity of the futures or forward contract. The haircut on a futures or forward position on a non-mortgaged-backed instrument is to be entered in the category corresponding to the sum of the remaining time to maturity of the futures or forward contract and the maturity of the underlying instrument. Haircuts on futures and forwards on mortgage-backed securities are to be entered in the appropriate mortgage-backed securities category. The interim haircuts on long futures and forwards are positive (column 13), and on short futures and forwards, negative (column 14).

Columns 15 and 16—Under "Gross Interim Haircuts—Options" enter, in the category in which the instrument directly underlying the contract would be entered, the lesser of (1) the market value of the option or (2) the net immediate position interim haircut on the underlying cash instrument or gross futures interim haircut on the underlying futures contract. Note that in the case of an option on a futures contract the category in which the option contract is to be entered is the sum of the remaining time to maturity of the futures or forward contract and the maturity of the instrument underlying the futures or forward contract. The haircut factor used to determine the gross futures interim haircut is that factor corresponding to the term to maturity of the deliverable security at the time of the maturity of the futures or forward contract. Gross option haircuts on purchased calls and sold puts are positive, those on sold calls and purchased puts are negative.

Column 17—Under "Aggregate Interim Haircuts (+)" enter in the appropriate category, the sum of any positive net immediate position interim haircut (column 12) and the positive gross option (column 15) and gross futures and forward (column 13) interim haircuts for that category.

Column 18—Under "Aggregate Interim Haircuts (−)" enter in the appropriate category, the sum of any negative net immediate position interim haircut (column 12) and the negative gross option (column 16) and gross futures and forward (column 14) interim haircuts for that category.

Column 19—Under "Futures and Options Offset Portions" enter, in the appropriate category, the lesser of the absolute values of the positive and negative aggregate interim haircuts (columns 17 and 18) for that category.

The total futures and options offset portion is the sum of the values in column 19 under "Futures and Options Offset Portions."

The total futures and options offset haircut is the total futures and options offset portion multiplied by a factor of 20 percent and is carried to line 2b, Schedule A.

Column 20—Enter in the appropriate category under "Residual Position Interim Haircuts" the sum, or net value, of the positive and negative aggregate interim haircuts. Carry this to column 20 on Schedule E.

Schedule E—Calculation of Hedging Disallowance Haircuts When Netting Haircuts Across Categories

Schedule E is used to calculate the hedging disallowance and residual net position haircuts which are then carried to Schedule A. The purpose of Schedule E is to hedge positions in different categories in order to reduce total haircuts. Netting the residual position interim haircuts reflects the risk reduction inherent in hedges between positions in different categories where the price volatility is reasonably well correlated.

Section 402.2(f)(3) of the rule specifies the hedging disallowance haircut factors for the category pairs. Netting of residual position interim haircuts is permitted only between any two categories for which a hedging disallowance haircut factor is specified. Hedging disallowance haircuts are similar to offset haircuts in that they are

applied to the smaller of the two residual position interim haircuts and represent the portion of the hedge being "disallowed." A hedging disallowance haircut is determined each time two residual position interim haircuts are netted.

There are three levels of permissible netting corresponding to the three hedging disallowance haircut factors: The 20 percent, 30 percent, and 40 percent levels. It is not necessary to net all possible pairs at any one level. A greater reduction in total haircuts can sometimes be obtained by choosing not to net a pair at one level (e.g., the 20 percent level) so that one element of the pair can be netted against a third category at another level (e.g., the 30 percent level).

Column 20—Transfer column 20, "Residual Position Interim Haircuts," from Schedule D. If there are no futures or options positions, transfer instead column 12, "Net Immediate Positions—Interim Haircuts," from Schedule C.

Column 21—Use the matrix at 17 CFR 402.2(f)(3) to determine the categories from which the residual position interim haircuts may be paired at the 20 percent level. For each pair multiply the smaller of the absolute values of the two residual position interim haircuts by the hedging disallowance haircut factor of 20 percent, and, in the category of the smaller, enter the resulting hedging disallowance haircut.

Column 22—For each pair being netted at this level, enter under "Net Residual Position Interim Haircuts" (1) the sum, or net value, of the two residual position interim haircuts (and/or net residual position interim haircuts) in the category of the larger (in absolute value) of the two interim haircuts that were netted, and (2) a zero in the category of the smaller.

These net residual position interim haircuts replace the residual position interim haircuts (or net residual position interim haircuts) from which they were derived. Net residual position interim haircuts can in turn be used in any other allowable netting exactly as residual position interim haircuts would be. If further netting of that category at the same level is permissible and possible, it will be necessary to replace the net residual position interim haircut involved with a new (and smaller) net residual position interim haircut in column 22.

Since the net residual position interim haircut in any category containing a hedging disallowance haircut is zero, further netting with any such category is impossible.

After all netting has been completed for category pairs with a 20 percent hedging disallowance haircut factor, move on to column 23.

Column 23—Use the matrix at 17 CFR 402.2(f)(3) to determine the categories from which the residual position interim haircuts and/or net residual position interim haircuts may be paired at the 30 percent level. In each category, the newest (and smallest) net residual position interim haircut determined by netting at the 20 percent level replaces the old value and must be used in hedging in that category at higher levels. For each pair being netted, multiply the smaller of the absolute values of the two (net) residual position interim haircuts by the hedging disallowance haircut factor of 30 percent, and in the category of the smaller, enter the resulting hedging disallowance haircut.

Column 24—For each pair being netted at this level, enter under "Net Residual Position Interim Haircuts" (1) the sum, or net value, of the two residual position interim haircuts and/or net residual position interim haircuts in the category of the larger (in absolute value) of the two interim haircuts that were netted, and (2) a zero in the category of the smaller.

These net residual position interim haircuts replace the residual position interim haircuts (or net residual position interim haircuts) from which they were derived. Net residual position interim haircuts can in turn be used in any other allowable netting exactly as residual position interim haircuts would be. If further netting of that category at the same level is permissible and possible, it will be necessary to replace the net residual position interim haircut involved with a new (and smaller) net residual position interim haircut.

After all netting has been completed for category pairs with a 30 percent hedging disallowance haircut factor, continue to column 25.

Column 25—Use the matrix at 17 CFR 402.2(f)(3) to determine the categories from which the residual position interim haircuts and/or net residual position interim haircuts may be paired at the 40 percent level. In each category, any new net residual position interim haircut determined by netting at the 20 or 30 percent level replaces the old value and must be used in hedging with that category at the 40 percent level. For each pair being netted, multiply the smaller of the absolute values of the two (net) residual position interim haircuts by the hedging disallowance haircut factor of 40 percent and, in the category of the smaller, enter the resulting hedging disallowance haircut.

Column 26—For each pair being netted at this level, enter under "Net Residual Position Interim Haircuts" (1) the sum, or net value, of the two (net) residual position interim haircuts in the category of the larger (in absolute value) of the two interim haircuts that were netted, and (2) a zero in the category of the smaller. If further netting of that category at the same level is permissible and possible, it will be necessary to replace the net residual position interim haircut involved with a new (and smaller) net residual position interim haircut.

Column 27—When all possible (net) residual position interim haircuts have been netted, enter under "Hedging Disallowance Haircuts" all hedging disallowance haircuts calculated in the netting procedures, each in its appropriate category.

Enter under "Total Hedging Disallowance Haircut" the sum of all the hedging disallowance haircuts entered in column 27. Carry to Schedule A, line 2c.

Column 28—Under "Qualified Netting Interim Haircuts" enter in the appropriate category the absolute value of the haircut given under "Net Residual Position Interim Haircut" at the highest hedging disallowance factor used for that category (columns 26, 24, or 22). This value will also be the smallest of the net residual position interim haircuts in that category. If the position in a given category was not used in hedging then enter the absolute value of the residual position interim haircut from column 20.

Sum the qualified netting interim haircuts, enter this value under "Residual Net Position Haircut," and carry to Schedule A, line 2d.

§ 402.2b [Reserved]

§ 402.2c Appendix C—Consolidated computations of liquid capital and total haircuts for certain subsidiaries and affiliates.

(a) *Consolidation.* (1) A government securities broker or dealer (the "parent broker or dealer"), in computing its liquid capital and total haircuts pursuant to § 402.2:

(i) Shall consolidate in a single computation of liquid capital the assets and liabilities of any subsidiary or affiliate for which the parent broker or dealer guarantees, endorses, or assumes directly or indirectly the obligations or liabilities if the parent broker or dealer has obtained the opinion of counsel described in paragraph (b) of this section with respect to such subsidiary or affiliate;

(ii) May not consolidate in a single computation of liquid capital the assets and liabilities of any subsidiary or affiliate for which the parent broker or

dealer guarantees, endorses, or assumes directly or indirectly the obligations or liabilities if the parent broker or dealer has not obtained the opinion of counsel described in paragraph (b) of this section with respect to such subsidiary or affiliate, but in that event, the parent broker or dealer shall compute its total haircuts by adding the total haircuts of each such subsidiary or affiliate computed in accordance with the provisions of § 402.2 to the haircuts of the parent broker or dealer computed separately in accordance with the provisions of § 402.2; and

(iii) May consolidate in its computation of liquid capital the assets and liabilities of any majority owned and controlled subsidiary or affiliate for which the parent broker or dealer does not guarantee, endorse or assume directly or indirectly the obligations or liabilities if the parent broker or dealer has obtained the opinion of counsel described in paragraph (b) of this section with respect to such subsidiary or affiliate.

(2) With respect to any subsidiary or affiliate whose assets and liabilities are consolidated in the parent broker's or dealer's computation of liquid capital according to the provisions of paragraph (a)(1)(i) or (a)(1)(iii) of this section, the parent broker or dealer shall compute its haircuts in accordance with the provisions of § 402.2 as if the consolidated entity were one firm, or, in the alternative, shall add the total haircuts of each consolidated subsidiary or affiliate computed in accordance with the provisions of § 402.2 to the haircuts of the parent broker or dealer computed separately in accordance with the provisions of § 402.2.

(b) *Required counsel opinion.* The opinion of counsel referred to in paragraph (a) of this section shall demonstrate to the satisfaction of the Commission, through the Designated Examining Authority, that net asset values, or the portion thereof related to the parent broker's or dealer's ownership interest in a majority owned and controlled subsidiary or affiliate, may be caused by the parent broker or dealer or an appointed trustee to be distributed to the parent broker or dealer within 30 calendar days. Such opinion shall also set forth the actions necessary to cause such a distribution to be made, identify the parties having the authority to take such actions, identify and describe the rights of other parties or classes of parties, including but not limited to customers, general creditors, subordinated lenders, minority shareholder employees, litigants and governmental or regulatory authorities, who may delay or prevent such a distribution and such other assurances as the Commission or the Designated Examining Authority by rule or interpretation may require. Such opinion shall be current and periodically renewed in connection with the parent broker's or dealer's annual audit pursuant to § 240.17a-5 of this title, as made applicable to government securities brokers or dealers by § 405.2 of this chapter, or upon any material change in circumstances.

(c) *Principles of consolidation.* The following minimum and non-exclusive requirements shall govern the consolidation of a subsidiary or affiliate in the computation of total liquid capital and total haircuts of a government securities broker or dealer pursuant to this section:

(1) The total liquid capital of the government securities broker or dealer shall be reduced by the estimated amount of any taxes reasonably anticipated to be incurred upon distribution of the assets of the subsidiary or affiliate.

(2) Liabilities of a consolidated subsidiary or affiliate that are subordinated to the claims of present and future creditors pursuant to a satisfactory subordination agreement shall not be added to consolidated net worth unless such subordination extends also to the claims of present or future creditors of the parent broker or dealer and all consolidated subsidiaries.

(3) Subordinated liabilities of a consolidated subsidiary or affiliate that are consolidated in accordance with paragraph (c)(2) of this section may not be prepaid, repaid or accelerated if any of the entities included in such consolidation would otherwise be unable to comply with the provision of § 240.15c3-1d of this title, as modified by § 402.2d.

(4) Each government securities broker or dealer included within the consolidation shall at all times be in compliance with the liquid capital or net capital requirement to which it is subject.

(d) *Certain Precluded Acts.* Even if consolidation is not required or allowed under paragraph (a) of this section, no parent broker or dealer 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 parent broker's or dealer's computation of liquid capital.

§ 402.2d Appendix D—Modification of § 240.15c3-1d of this title, relating to satisfactory subordination agreements, for purposes of § 402.2.

Section 240.15c3-1d of this title shall apply to government securities brokers and dealers subject to the requirements of § 402.2 with the following modifications.

(a) References to "broker or dealer" include government securities brokers and dealers.

(b) References to "17 CFR 240.15c3-1" mean § 402.2.

(c) Section 240.15c3-1d(a)(2)(iii) is modified to read as follows:

"(iii) The term "Collateral Value" of any securities pledged to secure a secured demand note shall mean the market value of such securities after giving effect to the haircuts specified in § 402.2a of this title.".

(d) References to "17 CFR 240.15c3-1d" mean that section as modified by this section.

(e) Section 240.15c3-1d(b)(6)(iii) is modified to read as follows:

"(iii) The secured demand note agreement may also provide that, in lieu of the procedures specified in the provisions required by paragraph (b)(6)(ii) of this section, the lender, with the prior written consent of the government securities broker or dealer and the Examining Authority for such broker or dealer, may reduce the unpaid principal amount of the secured demand note. After giving effect to such reduction, the liquid capital, as defined in § 402.2(d) of this title, of the government securities broker or dealer may not be less than 150% of the government securities broker's or dealer's total haircuts, as defined in § 402.2(g) of this title. No single secured demand note shall be permitted to be reduced by more than 15% of its original principal amount and after such reduction no excess collateral may be withdrawn. No Examining Authority shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, liquid capital after deducting total haircuts would be less than 120% of the minimum dollar amount required by § 402.2(b) or § 402.2(c) of this title as applicable.".

(f) Section 240.15c3-1d(b)(7) is modified to read as follows:

"(7) A government securities broker or dealer 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. This restriction shall not apply to temporary subordination agreements which comply with the provisions of paragraph (c)(5) 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 maturities 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 of such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the government securities broker or dealer, the liquid capital, as defined in § 402.2(d) of this title, of the government securities broker or dealer would be less than 150% of the government securities broker's or dealer's total haircuts, as defined in § 402.2(g) of this title. Notwithstanding the above, no Prepayment shall occur without the prior written approval of the Examining Authority for such government securities broker or dealer.".

(g) Section 240.15c3–1d(b)(8) is modified to read as follows:

"(i) The Payment Obligation of the government securities broker or dealer 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 such broker or dealer under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such Payment Obligation), either the liquid capital, as defined in § 402.2(d) of this title, of the government securities broker or dealer would be less than 150% of the government securities broker's or dealer's total haircuts, as defined in § 402.2(g) of this title, or the government securities broker's or dealer's liquid capital after deducting total haircuts would be less than 120% of the minimum dollar amount required by § 402.2(b) or § 402.2(c) of this title, as applicable. The subordination agreement may provide that if the Payment Obligation of the government securities broker or dealer thereunder does not mature and is suspended as a result of the requirement of this paragraph (b)(8) for a period of not less than six months, the government securities broker or dealer shall thereupon 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 17 CFR 240.15c3–1 and 240.15c3–1d.".

(h) Section 240.15c3–1d(b)(10)(ii)(B) is modified to read as follows:

"(B) The liquid capital, as defined in § 402.2(d) of this title, of the government securities broker or dealer being less than 120% of total haircuts, as defined in § 402.2(g) of this title, throughout a period of 15 consecutive business days, commencing on the day the broker or dealer first determines and notifies the Examining Authority for the government securities broker or dealer, or the Examining Authority or the Commission first determines and notifies the government securities broker or dealer of such fact;".

(i) Section 240.15c3–1d(c)(2) is modified to read as follows:

"(2) *Notice of Maturity or Accelerated Maturity.* Every government securities broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to all Payments of Payment Obligations 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 broker or dealer, the liquid capital, as defined in § 402.2(d) of this title, of such government securities broker or dealer, would be less than 150% of total haircuts, as defined in § 402.2(g) of this title.".

(j) Section 240.15c3–1d(c)(5)(i) is modified to read as follows:

"(i) For the purpose of enabling a government securities broker or dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the capital requirements of § 402.2 of this title, a government securities broker or dealer 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 such subordination agreement became effective. This temporary relief shall not apply to a government securities broker or dealer if, at such time, it is subject to any of the reporting provisions of § 405.3 of this title, irrespective of its compliance with such provisions or if immediately prior to entering into such subordination agreement, the liquid capital, as defined in § 402.2(d) of this title, of such broker or dealer would be less than 150% of total haircuts, as defined in § 402.2(g) of this title, or the amount of its then outstanding subordination agreements exceeds the limits specified in § 240.15c3–1(d). Such temporary subordination agreement shall be subject to all other provisions of this Appendix D.".

(k) Section 240.15c3–1d(c)(5)(ii)(A) is modified to read as follows:

"(A) 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 of such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the government securities broker or dealer, the liquid capital, as defined in § 402.2(d) of this title, of such broker or dealer, would be less than 180% of total haircuts, as defined in § 402.2(g) of this title.".

PART 403—PROTECTION OF CUSTOMER SECURITIES AND BALANCES

Sec.
403.1 Application of part to registered brokers and dealers.
403.2 Hypothecation of customer securities.
403.3 Use of customers' free credit balances.
403.4 Customer protection—reserves and custody of securities.
403.5 Custody of securities held by financial institutions that are government securities brokers or dealers.
403.6 Compliance with part by futures commission merchants.
403.7 Effective dates.

Authority: Sec. 101, Pub. L. 99–571, 100 Stat. 3209 (15 U.S.C. 78o–5(b)(1)(A), (b)(2)).

§ 403.1 Application of part to registered brokers and dealers.

With respect to their activities in government securities, compliance by registered brokers or dealers with § 240.8c–1 of this title (SEC Rule 8c–1), as modified by § 403.2 (a), (b) and (c), with § 240.15c2–1 of this title (SEC Rule 15c2–1), with § 240.15c3–2 of this title (SEC Rule 15c3–2) as modified by § 403.3, and with § 240.15c3–3 of this title (SEC Rule 15c3–3) as modified by § 403.4(a)–(i) constitutes compliance with this part.

§ 403.2 Hypothecation of customer securities.

Every registered government securities broker or dealer shall comply with the requirements of § 240.8c–1 of this title concerning hypothecation of customer securities with the following modifications:

(a) In § 240.8c–1(a), the words "no government securities broker or dealer" shall be substituted for the words "no member of a national securities exchange, and no broker or dealer who transacts a business in securities through the medium of such member."

(b) Section 240.8c–1(d) is modified to read as follows:

"(d) *Exemption for clearing liens.* The provisions of paragraphs (a)(2), (a)(3) and (f) of this section shall not apply to any lien or claim of a clearing bank, or the clearing corporation (or similar department or association) of a national securities exchange or a registered national securities association, for a loan made to acquire any securities subject to said lien and to be repaid on the same calendar day, which loan is incidental to the clearing of transactions in securities or loans through such bank, corporation, department or association; *provided, however,* that for the purpose of paragraph (a)(3) of this section, 'aggregate indebtedness of all customers in respect of securities carried for their accounts' shall not include indebtedness in respect of any securities subject to any lien or claim exempted by this paragraph."

(c) References to "member, broker or dealer" mean "government securities broker or dealer."

§ 403.3 Use of customers' free credit balances.

Every registered government securities broker or dealer shall comply with the requirement of § 240.15c3–2 of this title concerning the use of customer free credit balances. For purposes of this section, all references to "broker or dealer" in § 240.15c3–2 shall include government securities brokers and dealers.

§ 403.4 Customer protection—reserves and custody of securities.

Every registered government securities broker or dealer shall comply with the requirements of §§ 240.15c3–3 and 240.15c3–3a of this title (SEC Rule 15c3–3 and Exhibit A thereto), with the following modifications:

(a) References to "broker or dealer" include government securities brokers and dealers.

(b) "Fully paid securities," as defined in § 240.15c3–3(a)(3) of this title, includes all securities held by a government securities broker or a government securities dealer for the account of a customer who has made full payment for such securities.

(c) "Margin securities," as defined in § 240.15c3–3(a)(4) of this title, includes any securities for which a customer has not made full payment and for which the customer has received an extension of credit by a government securities broker or government securities dealer for a portion of the purchase price.

(d) "Excess margin securities," as defined in § 240.15c3–3(a)(5) of this title, includes margin securities carried for the account of a customer having a market value in excess of 140 percent of the total of the debit balances in the customer's account or accounts with the broker or dealer.

(e) For purposes of this section, § 240.15c3–3(b) of this title shall include a new paragraph (4) as follows:

"(4)(i) Notwithstanding paragraph (k)(2)(i) of this section, a broker or dealer that retains custody of securities that are the subject of a repurchase agreement between the broker or dealer and a counterparty shall:

"(A) Obtain the repurchase agreement in writing;

"(B) Confirm in writing the specific securities that are the subject of a repurchase transaction pursuant to such agreement at the end of the trading day on which the transaction is initiated and at the end of any other day during which other securities are substituted if the substitution results in a change to issuer, maturity date, par amount or coupon rate as specified in the previous confirmation;

"(C)(*1*) For registered brokers and dealers, advise the counterparty in the repurchase agreement that the Securities Investor Protection Corporation has taken the position that the provisions of the Securities Investor Protection Act of 1970 do not protect the counterparty with respect to the repurchase agreement;

"(*2*) For registered government securities brokers and dealers, advise the counterparty in the repurchase agreement that the Securities Investor Protection Act of 1970 will not provide protection to the counterparty with respect to the repurchase agreement.

"(D) Maintain possession or control of securities that are the subject of the agreement.

"(ii) For purposes of this paragraph (4), securities are in the broker's or dealer's control only if they are in the control of the broker or dealer within the meaning of §§ 240.15c3–3 (c)(1), (c)(3), (c)(5), (c)(6), or § 403.4(f) of this title.

"(iii) A broker or dealer shall not be in violation of the requirement to maintain possession or control pursuant to paragraph (b)(4)(i)(D) during the trading day if:

"(A) In the written repurchase agreement, the counterparty grants the broker or dealer the right to substitute other securities for those subject to the agreement; and

"(B) The provision in the written repurchase agreement governing the right, if any, to substitute is immediately preceded by the following disclosure statement, which must be prominently displayed:

'Required Disclosure

The [seller] is not permitted to substitute other securities for those subject to this agreement and therefore must keep the [buyer's] securities segregated at all times, unless in this agreement the [buyer] grants the [seller] the right to substitute other securities. If the [buyer] grants the right to substitute, this means that the [buyer's] securities will likely be commingled with the [seller's] own securities during the trading day. The [buyer] is advised that, during any trading day that the [buyer's] securities are commingled with the [seller's] securities, they will be subject to liens granted by the [seller] to its clearing bank and may be used by the [seller] for deliveries on other securities transactions. Whenever the securities are commingled, the [seller's] ability to resegregate substitute securities for the [buyer] will be subject to the [seller's] ability to satisfy the clearing lien or to obtain substitute securities.'.

"(iv)(A) A confirmation issued in accordance with paragraph (b)(4)(i)(B) of this section shall specify the issuer, maturity date, coupon rate, par amount and market value of the security and shall further identify a CUSIP or mortgage-backed security pool number, as appropriate, except that a CUSIP or a pool number is not required on the confirmation if it is identified in internal records of the broker or dealer that designate the specific security of the counterparty. For purposes of this paragraph (b)(4)(iv), the market value of any security that is the subject of the repurchase transaction shall be the most recently available bid price plus accrued interest, obtained by any reasonable and consistent methodology.

"(B) A person that is a non-U.S. citizen residing outside of the United States or a foreign corporation, partnership, or trust may waive, but only in writing, the right to receive the confirmation required by paragraph (b)(4)(i)(B) of this section.

"(v) This paragraph (b)(4) shall not apply to a repurchase agreement

between the broker or dealer and another broker or dealer (including a government securities broker or dealer), a registered municipal securities dealer, or a general partner or director or principal officer of the broker or dealer or any person to the extent that his claim is explicitly subordinated to the claims of creditors of the broker or dealer.".

(f)(1) Securities under the control of a broker or dealer, as described in § 240.15c3-3(c) of this title, shall include securities maintained by a broker or dealer in an account at a depository institution, as defined in section 19(b)(A)(i)-(vi) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)(i)-(vi)), which depository institution has a book-entry securities account at a Federal Reserve Bank through which it provides clearing services ("clearing bank"), provided the securities are maintained in a Segregated Account of the government securities broker or dealer. For purposes of this paragraph (f)(1) and paragraph (h) of this section, a Segregated Account is an account (other than a clearing account) of the government securities broker or dealer maintained on the books of a clearing bank pursuant to a written clearing agreement with such clearing bank which provides that:

(i) Such account is established for the purpose of segregating securities of counterparties or customers of such broker or dealer from proprietary securities of the broker or dealer;

(ii) The broker or dealer is entitled to direct the disposition of the securities; and

(iii) The clearing bank does not have, and will not assert, any claim or lien against such securities nor will the clearing bank grant any third party, including any Federal Reserve Bank, any interest in such securities so long as they are maintained in the segregated account.

(2) For purposes of this section, § 240.15c3-3(c)(2) of this title is redesignated as paragraph (c)(2)(i) and new paragraph (c)(2)(ii) is added to read as follows:

"(ii) Are carried for the account of any customer by a government securities broker or dealer in an account designated exclusively for customers of the government securities broker or dealer with a registered broker or dealer or another registered government securities broker or dealer (the "carrying broker or dealer") in compliance with instructions of the registered government securities broker or dealer to the carrying broker or dealer that the securities are to be maintained free of any charge, lien or claim of any kind in favor of the carrying broker or dealer or any persons claiming through such carrying broker or dealer; or".

(g) For purposes of this section, the operation of § 240.15c3-3(d)(2) is suspended until further notice with respect to mortgage-backed securities.

(h) In addition to the notification required by § 240.15c3-3(i) of this title, whenever any government securities broker or dealer instructs its clearing bank to place securities in a Segregated Account (as defined in paragraph (f)(1) of this section), and the clearing bank refuses to do so as of the close of business on that day, the broker or dealer shall, in accordance with § 240.17a-11(f) of this title, give telegraphic notice of the notification by the clearing bank within 24 hours and within 48 hours of the telegraphic notice, file a report stating what steps are being taken to correct the situation.

(i) For purposes of this section, § 240.15c3-3(l) of this title is modified to read as follows:

"(l) *Delivery or disposition of securities.* Nothing stated in this section shall be construed as affecting the absolute right of a customer of a government securities broker or dealer, unless otherwise agreed in writing, in the normal course of business operations following demand made on the broker or dealer, to receive the physical delivery of certificates if the securities are issued in certificated form, or to direct a transfer of or otherwise to exercise control over any securities if they are:

"(1) Fully-paid securities to which the customer is entitled;

"(2) Margin securities upon full payment by such customer to the broker or dealer of the customer's indebtedness to the broker or dealer; or

"(3) Excess margin securities not reasonably required to collateralize such customer's indebtedness to the broker or dealer.".

(j) Except with respect to a government securities interdealer broker subject to the financial responsibility requirements of § 402.1(e) and a registered government securities broker or dealer that is a futures commission merchant registered with the CFTC, § 240.15c3-3(e)(3) is modified for purposes of this section to read as follows:

"(3) Computations necessary to determine the amount required to be deposited as specified in paragraph (e)(1) of this section shall be made weekly, as of the close of the last business day of the week, and the deposit so computed shall be made no later than 1 hour after the opening of banking business on the second following business day; provided, however, a government securities broker or dealer registered pursuant to section 15C(a)(1)(A) of the Act (15 U.S.C. 78o-5 (a)(1)(A)) which has a ratio of liquid capital to total haircuts (calculated in accordance with Part 402 of this chapter) of 1.8 or greater and which carries aggregate customer funds (as defined in paragraph (a)(10) of this section), as computed at the last required computation pursuant to this section, not exceeding $1 million, may in the alternative make the computation monthly, as of the close of the last business day of the month, and, in such event, shall deposit not less than 105 percent of the amount so computed no later than 1 hour after the opening of banking business on the second following business day. If a registered government securities broker or dealer, computing on a monthly basis, has, at the time of any required computation, a ratio of liquid capital to total haircuts of less than 1.8, such broker or dealer shall thereafter compute weekly as aforesaid until four successive weekly computations are made, none of which were made at a time when its ratio of liquid capital to total haircuts was less than 1.8. Computations in addition to the computation required in this paragraph (3), may be made as of the close of any other business day, and the deposits so computed shall be made no later than 1 hour after the opening of banking business on the second following business day. The registered government securities broker or dealer shall make and maintain a record of each such computation made pursuant to this paragraph (3) or otherwise and preserve such record in accordance with § 240.17a-4.".

(k) Except with respect to a government securities interdealer broker subject to the financial responsibility requirements of § 402.1(e) and a registered government securities broker or dealer that is a futures commission merchant registered with the CFTC, Note E(5) of § 240.15c3-3a of this title is modified for purposes of this section to read as follows:

"(5) Debit balances in margin accounts (other than omnibus accounts) shall be reduced by the amount by which any single customer's debit balance exceeds 25% (to the extent such amount is greater than $50,000) of the government securities broker's or dealer's liquid capital unless such broker or dealer can demonstrate that

the debit balance is directly related to credit items in the Reserve Formula. Related accounts (*e.g.*, the separate accounts of an individual, accounts under common control or subject to cross guarantees) shall be deemed to be a single customer's accounts for purposes of this provision.".

§ 403.5 Custody of securities held by financial institutions that are government securities brokers or dealers.

(a) A government securities broker or dealer that is a financial institution shall:

(1) Comply with Part 450 with respect to all government securities held for the account of customers of the financial institution in its capacity as a fiduciary or custodian (unless otherwise exempt pursuant to § 450.3); and

(2) Comply with Part 450 and with paragraphs (b), (c) and (d) of this section with respect to all fully paid and excess margin government securities held for customers of the financial institution in its capacity as government securities broker or dealer, and government securities that are the subject of a repurchase agreement between the financial institution and certain counterparties as described in paragraph (d) of this section.

(b) A financial institution shall not be in violation of the possession or control requirements of paragraphs (c) and (d) of this section if, solely as the result of normal business operations, temporary lags occur between the time when a security is first required to be in the financial institution's possession or control and the time when it is actually placed in possession or control, provided that the financial institution takes timely steps in good faith to establish prompt possession or control. In the event that a financial institution has accepted funds from a customer for the purchase of securities and the financial institution does not initiate the purchase of the specified securities by the close of the next business day after receipt of such customer's funds, the financial institution shall immediately deposit or redeposit the funds in an account belonging to such customer and send the customer notice of such deposit or redeposit.

(c)(1) On each business day a financial institution shall determine the quantity and issue of such securities, if any, that are required to be but are not in the financial institution's possession or control. As appropriate to bring such securities into possession or control, the financial institution shall:

(i) Promptly obtain the release of any lien, charge, or other encumbrance against such securities;

(ii) Promptly obtain the return of any securities loaned;

(iii) Take prompt steps to obtain possession or control of securities failed to receive for more than 30 days, except in the case of mortgage-backed securities; or

(iv) Take prompt steps to buy in securities as necessary to the extent any shortage of securities in possession or control cannot be resolved as required by any of the above procedures.

(2) The financial institution shall prepare and maintain a current and detailed description of the procedures and internal controls that it utilizes to comply with the possession or control requirements of this paragraph (c), which shall be made available upon request to its appropriate regulatory agency.

(3) Nothing stated in this section shall be construed as affecting the absolute right of a customer of a government securities broker or dealer, unless otherwise agreed in writing, in the normal course of business operations following demand made on the broker or dealer, to receive the physical delivery of certificates if the securities are issued in certificated form, or to direct a transfer of or otherwise to exercise control over any securities if they are:

(i) Fully-paid securities to which the customer is entitled;

(ii) Margin securities upon full payment by such customer to the broker or dealer of the customer's indebtedness to the broker or dealer; or

(iii) Excess margin securities not reasonably required to collateralize such customer's indebtedness to the broker or dealer.

(d)(1) If a financial institution retains custody of securities, other than in safekeeping as defined in paragraph (f)(3) of this section, that are the subject of a repurchase transaction, or if a financial institution retains custody of such securities, whether or not in safekeeping, and retains the right to substitute other securities for such securities, the financial institution shall:

(i) Obtain the repurchase agreement in writing;

(ii) Confirm in writing the specific securities that are the subject of a repurchase transaction pursuant to such agreement at the end of the day of initiation of the transaction and at the end of any other day during which other securities are substituted if the substitution results in a change to issuer, maturity date, par amount or coupon rate specified in the previous confirmation;

(iii) Advise the counterparty in the repurchase agreement that the funds held by the financial institution pursuant to a repurchase transaction are not a deposit and therefore are not insured by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation or the National Credit Union Share Insurance Fund, as applicable;

(iv) If the counterparty agrees to grant the financial institution the right to substitute securities, include in the written repurchase agreement the provision by which the financial institution retains the right to substitute securities;

(v) If the counterparty agrees to grant the financial institution the right to substitute securities, include in the written repurchase agreement the following disclosure statement, which must be prominently displayed in the written repurchase agreement immediately preceding the provision governing the right to substitution:

"Required Disclosure

The [seller] is not permitted to substitute other securities for those subject to this agreement and therefore must keep the [buyer's] securities segregated at all times, unless in this agreement the [buyer] grants the [seller] the right to substitute other securities. If the [buyer] grants the right to substitute, this means that the [buyer's] securities will likely be commingled with the [seller's] own securities during the trading day. The [buyer] is advised that, during any trading day that the [buyer's] securities are commingled with the [seller's] securities, they may be subject to liens granted by the [seller] to third parties and may be used by the [seller] for deliveries on other securities transactions. Whenever the securities are commingled, the [seller's] ability to resegregate substitute securities for the [buyer] will be subject to the [seller's] ability to satisfy any lien or to obtain substitute securities."; and

(vi) Maintain possession or control of securities that are the subject of the agreement in accordance with § 450.4(a) of this chapter, except when exercising its right of substitution in accordance with the provisions of the agreement and paragraph (d)(1)(iv) of this section.

(2)(i) A confirmation issued in accordance with paragraph (d)(1)(ii) of this section shall specify the issuer, maturity date, coupon rate, par amount and market value of the security and shall further identify a CUSIP or mortgage-backed security pool number, as appropriate, except that a CUSIP or a pool number is not required on the confirmation if it is identified in internal records of the broker or dealer that designate the specific security of the counterparty. For purposes of this paragraph (d)(2), the market value of any security that is the subject of the repurchase transaction shall be the most

recently available bid price plus accrued interest, obtained by any reasonable and consistent methodology.

(ii) A person that is a non-U.S. citizen residing outside of the United States or a foreign corporation, partnership, or trust may waive, but only in writing, the right to receive the confirmation required by paragraph (d)(1)(ii) of this section.

(3) This paragraph (d) shall not apply to a repurchase agreement between the financial institution and a broker or dealer (including a government securities broker or dealer), a registered municipal securities dealer, or a director or principal officer of the financial institution or any person to the extent that his claim is explicitly subordinated to the claims of creditors of the financial institution.

(e)(1) A government securities broker or dealer that is a branch or agency of a foreign bank shall keep on deposit with an insured bank (as that term is defined in 12 U.S.C. 1813(h)) an amount equal to the amount that would be required to be set aside pursuant to § 240.15c3–3(e)(1) of this title with respect to government securities of customers of such branch or agency that are citizens or residents of the United States. The amount required to be deposited pursuant to this § 403.5(e)(1) may be reduced by the amount of assets pledged or deposited by the branch or agency pursuant to regulations promulgated by a Federal or State banking regulatory agency that are attributable to liabilities to customers which are included both in the calculation of the required pledge or deposit of assets and in the calculation of the amount to be set aside pursuant to § 240.15c3–3(e)(1) of this title.

(2) The amount deposited in accordance with this section shall be pledged to the appropriate regulatory agency of the branch or agency making the deposit for the exclusive benefit of the customers to whom the credit balances are owed.

(3) For purposes of making the calculation pursuant to § 240.15c3–3(e)(1) of this title, the terms "free credit balances," "other credit balances" and "credit balances" shall not include any funds placed in deposits or accounts enumerated at 12 CFR 204.2.

(4) For purposes of making the calculation pursuant to § 240.15c3–3(e)(1) of this title, the formula set forth at § 240.15c3–3a of this title shall be modified as follows:

(i) For purposes of this section, references to "securities account," "cash account," "margin account", or other customer accounts for purposes of this section shall not include any deposits or accounts enumerated at 12 CFR 204.2;

(ii) References to "security or "securities shall mean U.S. government securities;

(iii) References to net capital shall be inapplicable;

(iv) Item 2 is modified to read as follows:

"2. Monies borrowed by the branch or agency collateralized by securities carried for the account of customers. (See Note B.)";

(v) Item 4 is modified to read as follows:

"4. Customers' securities failed to receive only with respect to transactions for which payment has been received by and is under the control of the branch or agency. (See Note D.)";

(vi) Note B is modified to read as follows:

"Note B. Item 2 shall include the principal amount of Restricted Letters of Credit obtained by members of Options Clearing Corporation which are collateralized by customers' securities. Item 2 shall not include bank loans to customers in the ordinary course collateralized by the customers' U.S. government securities."; and

(vii) Note C is modified to read as follows:

"Note C. Item 3 shall include in addition to monies payable against customers' securities loaned the amount by which the market value of securities loaned exceeds the collateral value received from the lending of such securities. Item 3 shall exclude cash collateral received pursuant to a written securities lending agreement that complies fully with the supervisory guidelines of its appropriate regulatory agency that expressly govern securities lending practices.".

(f)(1) For purposes of this section, the terms "fully paid securities," "margin securities," and "excess margin securities" shall have the meanings described in § 403.4 (b), (c) and (d).

(2) For purposes of this section, the term "customer" shall include any person from whom or on whose behalf a financial institution that is a government securities broker or dealer has received or acquired or holds securities for the account of that person or funds resulting from transactions in securities for or with such person or that represent principal, interest, or other proceeds of such securities. The term shall not include a broker or dealer that is registered pursuant to section 15, 15B or 15C (a)(1)(A) of the Act (15 U.S.C. 78o, 78o–4, 78o–5(a)(1)(A)) or that has filed notice of its status as a government securities broker or dealer pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 78o–5(a)(1)(B)) except with respect to securities maintained by such broker or dealer in a Segregated Account as defined in § 403.4(f)(1) and with respect to securities otherwise identified by such broker or dealer as customer securities for purposes of maintaining possession or control of such securities as required by this part. The term "customer" shall not include a director or principal officer of the financial institution or any other person to the extent that that person has a claim for property or funds, which by contract, agreement or understanding, or by operation of law, is part of the capital of the financial institution or is subordinated to the claims of creditors of the financial institution.

(3) For purposes of paragraph (d)(1) of this section, securities will be deemed to be in safekeeping if the employees responsible for the safekeeping of the securities:

(i) Have no direct involvement in the purchase and sale of securities, including the transfer of interests in securities pursuant to repurchase transactions;

(ii) Are not subject to the control of any employees that have responsibility for the purchase and sale of securities, including the transfer of interests in securities pursuant to repurchase transactions; and

(iii) Have the affirmative responsibility for maintaining the books and records of customer securities transferred into their possession or control, including government securities held in book-entry form, that provide the basis for the securities count required by § 450.4(d) of this chapter.

(g) The appropriate regulatory agency of a financial institution that is a government securities broker or dealer may extend the period specified in paragraph (c)(1)(iii) of this section on application of the financial institution for one or more limited periods commensurate with the circumstances, provided the appropriate regulatory agency is satisfied that the financial institution is acting in good faith in making the application and that exceptional circumstances warrant such action. Each appropriate regulatory agency shall make and preserve for a period of not less than three years a record of each extension granted pursuant to this paragraph, which shall contain a summary of the justification for the granting of the extension.

§ 403.6 Compliance with part by futures commission merchants.

A registered government securities broker or dealer that is also a futures commission merchant registered with the CFTC shall comply with the provisions of this Part with respect to all customer funds and securities except

those that are incidental to the broker's or dealer's futures-related business, as defined in § 240.3a43–1(b) of this title. For purposes of the preceding sentence, the term "customer" shall have the meaning set forth in § 240.15c3–3(a)(1) of this title.

§ 403.7 Effective dates.

(a) *General.* Except as provided in paragraphs (b) through (e) of this section, this Part shall be effective on the last business day in October 1987.

(b) *Confirmations.* The requirement of §§ 403.4(e) and 403.5(d) to describe the specific securities that are the subject of a repurchase transaction, including the market value of such securities, on a confirmation at the initiation of a repurchase transaction or on substitution of other securities shall be effective January 31, 1988.

(c) *Written repurchase agreements.* The requirement to obtain a repurchase agreement in writing with the provisions described in §§ 403.4(c) and 403.5(d) shall be effective October 31, 1987 in the case of new customers of a government securities broker or dealer and shall be effective January 31, 1988 in the case of existing customers of a government securities broker or dealer. For purposes of this paragraph, an "existing customer" of a government securities broker or dealer is any counterparty with whom the government securities broker or dealer has entered into a repurchase transaction on or after January 1, 1986, but before July 25, 1987. For purposes of this paragraph, a "new customer" of a government securities broker or dealer is any counterparty other than an existing customer.

(d) *Disclosures.* (1) Before a written repurchase agreement has been entered into in accordance with paragraph (c) of this section, a government securities broker or dealer that is subject to § 403.4(e) shall furnish the counterparty with a separate interim disclosure document containing: (i) The disclosure referred to in § 403.4(e) concerning the Securities Investor Protection Act of 1970, and (ii) if applicable, the following disclosure:

"Required Disclosure

Unless the [buyer] and the [seller] have agreed to the contrary, the [buyer's] securities are likely to be commingled with the [seller's] own securities during the trading day. The [buyer] is advised that, during any trading day that the [buyer's] securities are commingled with the [seller's] securities, they will be subject to liens granted by the [seller] to its clearing bank and may be used by the [seller] for deliveries on other securities transactions. Whenever the securities are commingled, the [seller's] ability to resegregate substitute securities for the [buyer] will be subject to the [seller's] ability to satisfy the clearing lien or to obtain substitute securities.".

(2) Before a written repurchase agreement has been entered into in accordance with paragraph (c) of this section, a financial institution that is subject to § 403.5(d) shall furnish the counterparty with a separate interim disclosure document containing: (i) The disclosure referred to in § 403.5(d) concerning the inapplicability of deposit insurance, and (ii) if applicable, the following disclosure:

"Required Disclosure

Unless the [buyer] and the [seller] have agreed to the contrary, the [buyer's] securities are likely to be commingled with the [seller's] own securities during the trading day. The [buyer] is advised that, during any trading day that the [buyer's] securities are commingled with the [seller's] securities, they will be subject to liens granted by the [seller] to third parties and may be used by the [seller] for deliveries on other securities transactions. Whenever the securities are commingled, the [seller's] ability to resegregate substitute securities for the [buyer] will be subject to the [seller's] ability to satisfy any lien or to obtain substitute securities.".

(3) In the case of hold-in-custody repurchase transactions initiated before August 31, 1987 and terminating on or after August 31, 1987, the disclosure document described in this paragraph (d) must be mailed to the counterparties involved on or before August 31, 1987. In the case of a hold-in-custody repurchase transaction initiated on or after August 31, the disclosure document described in this paragraph (d) must be provided to the counterparty involved no later than the day on which the first hold-in-custody repurchase transaction is initiated on or after August 31, 1987, unless the disclosure has already been provided to the counterparty in accordance with the preceding sentence.

(e) *Existing term repurchase transactions.* Notwithstanding paragraphs (b), (c) and (d) of this section, the requirements of §§ 403.4(e) and 403.5(d), with the exception of the requirements to confirm the substitution of securities subject to a repurchase transaction, shall not be applicable to any repurchase transaction initiated on or before August 31, 1987 that, by its terms, matures on a specific date after August 31, 1987.

PART 404—RECORDKEEPING AND PRESERVATION OF RECORDS

Sec.
404.1 Application of part to registered brokers and dealers.
404.2 Records to be made and kept current by registered government securities brokers and dealers; records of non-resident registered government securities brokers and dealers.
404.3 Records to be preserved by registered government securities brokers and dealers.
404.4 Records to be made and preserved by government securities brokers and dealers that are financial institutions.
404.5 Securities counts by registered government securities brokers and dealers.

Authority: Sec. 101, Pub. L. 99–571, 100 Stat. 3209 (15 U.S.C. 78o–5 (b)(1)(B), (b)(1)(C), (b)(2)).

§ 404.1 Application of part to registered brokers and dealers.

Compliance by a registered broker or dealer with § 240.17a–3 of this title (pertaining to records to be made), § 240.17a–4 of this title (pertaining to preservation of records), § 240.17a–13 of this title (pertaining to quarterly securities counts) and § 240.17a–7 of this title (pertaining to records of non-resident brokers or dealers) shall constitute compliance with this part.

§ 404.2 Records to be made and kept current by registered government securities brokers and dealers; records of non-resident registered government securities brokers and dealers.

(a) Every registered government securities broker or dealer shall comply with the requirements of § 240.17a–3 of this title (SEC Rule 17a–3), with the following modifications:

(1) References to "broker or dealer" and "broker or dealer registered pursuant to Section 15 of the Act" include registered government securities brokers or dealers.

(2) References to §§ 240.17a–3, 240.17a–4, 240.17a–5, and 240.17a–13 mean such sections as modified by this Part and Part 405 of this chapter.

(3) (i) Except in the case of a government securities interdealer broker who is subject to the financial responsibility rules of § 402.1(e) of this chapter and a registered government securities broker or dealer that is a futures commission merchant registered with the CFTC, paragraph 240.17a–3(a)(11) is modified to read as follows:

"(11) A record of the proof of money balances of all ledger accounts in the form of trial balances, and a record of the computation of liquid capital and total haircuts, as of the trial date,

determined as provided in § 402.2 of this title; *provided however*, that such computation need not be made by any registered government securities broker or dealer unconditionally exempt from Part 402 of this title. Such trial balances and computations shall be prepared currently at least once a month.".

(ii) For a government securities interdealer broker who is subject to the financial responsibility rules of § 402.1(e) of this chapter, references to § 240.15c3-1 include modifications contained in § 402.1(e) of this chapter.

(4) Paragraph 240.17a-3(b)(1) is modified to read as follows:

"(1) This section shall not be deemed to require a government securities broker or dealer registered pursuant to Section 15C(a)(1)(A) of the Act (15 U.S.C. 78o-5(a)(1)(A)) to make or keep such records of transactions cleared for such government securities broker or dealer as are customarily made and kept by a clearing broker or dealer pursuant to the requirements of §§ 240.17a-3 and 240.17a-4: *Provided*, that the clearing broker or dealer has and maintains net capital of not less than $25,000 (or, in the case of a clearing broker or dealer that is a registered government securities broker or dealer, liquid capital less total haircuts, determined as provided in § 402.2 of this title, of not less than $50,000) and is otherwise in compliance with § 240.15c3-1, § 402.2 of this title, or the capital rules of the exchange of which such clearing broker or dealer is a member if the members of such exchange are exempt from § 240.15c3-1 by paragraph (b)(2) thereof.".

(5) The undertaking in § 240.17a-3(b)(2) is modified to read as follows:

"The undersigned hereby undertakes to maintain and preserve on behalf of [registered government securities broker or dealer] the books and records required to be maintained by [registered government securities broker or dealer] pursuant to 17 CFR 404.2 and 404.3 and Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 and to permit examination of such books and records at any time or from time to time during business hours by examiners or other representatives of the Securities and Exchange Commission, and to furnish to said Commission at its principal office in Washington, D.C., or at any regional office of said Commission specified in a demand made by or on behalf of said Commission for copies of books and records, true, correct, complete, and current copies of any or all, or any part, of such books and records. This undertaking shall be binding upon the undersigned, and the successors and assigns of the undersigned.".

(6) Section 240.17a-3(c) is modified to read as follows:

"(c) This section shall not be deemed to require a government securities broker or dealer to make or keep such records as are required by paragraph (a) reflecting the sale and redemption of United States Savings Bonds, United States Savings Notes and United States Savings Stamps.".

(b) (1) Every non-resident government securities broker or dealer registered or applying for registration pursuant to section 15C of the Act shall comply with § 240.17a-7 of this title, *provided that* in such section references to "broker or dealer" shall include government securities brokers or dealers.

(2) The term "non-resident government securities broker or dealer" means: (i) In the case of an individual, one who resides in or has his principal place of business in any place not subject to the jurisdiction of the United States; (ii) in the case of a corporation, one incorporated in or having its principal place of business in any place not subject to the jurisdiction of the United States; and (iii) in the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not subject to the jurisdiction of the United States.

(c) *Effective date.* Paragraph (a) of this section shall be effective on October 31, 1987, *except that* registered government securities brokers and dealers are required to maintain the records specified in § 240.17a-3(a) (12), (13), (14) and (15) beginning July 25, 1987.

(Approved by the Office of Management and Budget under control number 1505-0100)

§ 404.3 Records to be preserved by registered government securities brokers and dealers.

(a) Every registered government securities broker or dealer, except a government securities interdealer broker subject to the financial responsibility rules of § 402.1(e) and a registered government securities broker or dealer that is also a futures commission merchant registered with the CFTC, shall comply with the requirements of § 240.17a-4 of this title (SEC Rule 17a-4), with the following modifications:

(1) References to "broker or dealer" and "broker and dealer registered pursuant to Section 15 of the Act" include registered government securities brokers or dealers.

(2) References to §§ 240.17a-3, .17a-4, and .17a-5 mean such sections as modified by this part and Part 405 of this chapter.

(3) References to § 240.15c3-1, relating to net capital, and "Computation for Net Capital" thereunder mean § 402.2 of this chapter and the computation of the ratio of liquid capital to total haircuts required thereunder.

(4) References to § 240.15c3-3, relating to possession or control of customer securities and balances, mean § 403.4 of this chapter.

(5) References to Form X-17A-5 mean Form G-405 (§ 449.5 of this chapter).

(6) The computation described in § 240.17a-4(b)(8)(x) is not required.

(b) A government securities interdealer broker subject to the financial responsibility rules of § 402.1(e) and a registered government securities broker or dealer that is also a futures commission merchant registered with the CFTC, shall comply with the requirements of § 240.17a-4 of this title (SEC Rule 17a-4), with the following modifications:

(1) References to "broker or dealer" and "broker and dealer" include registered government securities brokers or dealers.

(2) References to §§ 240.17a-3, 240.17a-4, and 240.17a-5 mean such sections as modified by this part and Part 405 of this chapter.

(3) With respect to a government securities interdealer broker subject to the financial responsibility rules of § 402.1(e) of this chapter, references to § 240.15c3-1, relating to net capital, and "Computation for Net Capital" thereunder include the modifications contained in § 402.1(e) of this chapter.

(4) References to § 240.15c3-3, relating to possession or control of customer securities and balances, mean § 403.4 of this chapter.

(c) This section shall be effective on July 25, 1987.

(Approved by the Office of Management and Budget under control number 1505-0100)

§ 404.4 Records to be made and preserved by government securities brokers and dealers that are financial institutions.

(a) *Records to be made and kept.* Every financial institution that is a government securities broker or dealer and that is not exempt from this part pursuant to Part 401 of this chapter shall comply with the requirements of §§ 404.2 and 404.3 unless such financial institution:

(1) Is subject to 12 CFR Part 12 (relating to national banks), 12 CFR Part 208 (relating to state member banks of the Federal Reserve System) or 12 CFR Part 344 (relating to state banks that are

not members of the Federal Reserve System), or is a United States branch or agency of a foreign bank and complies with 12 CFR Part 12 (for federally licensed branches and agencies of foreign banks) or 12 CFR Part 208 (for uninsured state-licensed branches and agencies of foreign banks) or 12 CFR Part 344 (for insured state licensed branches and agencies of foreign banks), *provided however*, that the records required to be made and kept by those regulations shall be made or kept without regard to the exemptions for transactions in U.S. government or federal agency obligations provided in 12 CFR 12.7(a), 12 CFR 208.8(k)(6)(i), and 12 CFR 344.7(a);

(2) Complies with the recordkeeping requirements of § 450.4(c), (d)(3) and (f) of this chapter; and

(3) Makes and keeps current:

(i)(A) A securities record or ledger reflecting separately for each government security as of the settlement dates all "long" or "short" positions (including government securities that are the subjects of repurchase or reverse repurchase agreements) carried by such financial institution for its own account or for the account of its customers or others (except securities held in a fiduciary capacity) and showing the location of all government securities long and the offsetting position to all government securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried;

(B) A complete and current Form G-FIN-4 (§ 449.3 of this chapter) or Form U-4 (promulgated by a self-regulatory organization) or Form MSD-4 (as required for associated persons of bank municipal securities dealers) for each associated person as defined in § 400.3(c) of this chapter;

(C) A Form G-FIN-5 (§ 449.4 of this chapter) or Form U-5 (promulgated by a self-regulatory organization) or Form MSD-5 (as required for associated persons of bank municipal securities dealers) for each associated person whose association has been terminated as provided in § 400.4(d)(2) of this chapter; and

(D) A complete and current Form G-FIN (§ 449.1 of this chapter) and, if applicable, a Form G-FINW (§ 449.2 of this chapter).

(ii) For purposes of paragraph (a)(3)(i)(A) of this section, "safekeeping" may be shown as a location of any securities long as long as the financial institution complies with the requirements of Part 450 of this chapter with respect to such securities.

(b) *Preservation of records.* (1) The records required by paragraph (a)(3)(i)(A) of this section shall be preserved for not less than six years, the first two years in an easily accessible place.

(2) The records required by paragraphs (a)(3)(i) (B) and (C) of this section shall be preserved for at least three years after the person who is the subject of the record has terminated his employment and any other association with the government securities broker or dealer function of the financial institution.

(3) The records required by paragraph (a)(3)(i)(D) of this section shall be preserved for at least three years after the financial institution has notified the appropriate regulatory agency that it has ceased to function as a government securities broker or dealer.

(c) *Effective date.* This section shall be effective on July 25, 1987, *except that* until October 31, 1987, a financial institution government securities broker or dealer is not required to make and keep current the securities position record required by paragraph (a)(3)(i)(A) of this section.

(Approved by the Office of Management and Budget under control number 1505-0100)

§ 404.5 Securities counts by registered government securities brokers and dealers.

(a) *Securities counts.* Every registered government securities broker or dealer shall comply with the requirements of § 240.17a-13 of this title (Commission Rule 17a-13), with the modification that references to "broker or dealer" and "broker and dealer registered pursuant to Section 15 of the Act" include registered government securities brokers or dealers.

(b) *Effective date.* This section shall be effective on October 31, 1987.

(Approved by the Office of Management and Budget under control number 1505-0100)

PART 405—REPORTS AND AUDIT

Sec.

405.1 Application of part to registered brokers and dealers and to financial institutions; transition rule.
405.2 Reports to be made by registered government securities brokers and dealers.
405.3 Supplemental current financial and operational reports to be made by certain registered government securities brokers and dealers.
405.4 Financial recordkeeping and reporting of currency and foreign transactions by registered government securities brokers and dealers.

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3209 (15 U.S.C. 78o-5(b)(1)(B), (b)(1)(C), (b)(2)).

§ 405.1 Application of part to registered brokers and dealers and to financial institutions; transition rule.

(a) Compliance by registered brokers or dealers with §§ 240.17a-5, 240.17a-8, and 240.17a-11 of this title (Commission Rules 17a-5, 17a-8 and 17a-11) constitutes compliance with this part.

(b) A government securities broker or dealer that is a financial institution and is subject to financial reporting rules of its appropriate regulatory agency is exempt from the provisions of §§ 405.2 and 405.3.

(c) This part shall be effective July 25, 1987, *provided however*,

(1) That registered government securities brokers or dealers shall first be required to file the reports required by § 240.17a-5(a), by virtue of § 405.2, for the month and the quarter during which they were first required to comply with Part 402 of this chapter other than the interim liquid capital requirements of § 402.1(f); but that

(2) For any quarter ending prior to the quarter during which they were first required to comply with Part 402 of this chapter other than the interim liquid capital requirements of § 402.1(f), registered government securities brokers or dealers shall file with the designated examining authority for such registered broker or dealer, within 17 business days after the close of the quarter, an unaudited balance sheet (with appropriate notes) for such quarter, prepared in accordance with generally accepted accounting principles.

§ 405.2 Reports to be made by registered government securities brokers and dealers.

(a) Every registered government securities broker or dealer, except a government securities interdealer broker subject to the financial responsibility requirements of § 402.1(e) of this chapter and a government securities broker or dealer that is also a futures commission merchant registered with the CFTC, shall comply with the requirements of § 240.17a-5 of this title (SEC Rule 17a-5), with the following modifications:

(1) References to "broker or dealer" include registered government securities brokers and dealers.

(2) References to "rules of the Commission" or words of similar import include, where appropriate, the regulations contained in this subchapter.

(3) References to Form X-17A-5 mean Form G-405 (§ 449.5 of this chapter).

(4) For the purposes of § 240.17a-5(a)(4) of this title, the Commission may, on the terms and conditions stated in

that subparagraph, declare effective a plan with respect to Form G-405, in which case, that plan shall be treated the same as a plan approved with respect to Form X-17A-5.

(5) References to "net capital" mean "liquid capital" as defined in § 402.2(d) of this chapter.

(6) References to § 240.15c3-1, relating to net capital, mean § 402.2 of this chapter.

(7) Paragraph 240.17a-5(c)(2)(ii) is modified to read as follows:

"(ii) A footnote containing a statement of the registered government securities broker's or dealer's liquid capital, total haircuts, and ratio of liquid capital to total haircuts, determined in accordance with § 402.2 of this title. Such statement shall include summary financial statements of subsidiaries consolidated pursuant to § 402.2c of this title, where material, and the effect thereof on the liquid capital, total haircuts and ratio of liquid capital to total haircuts of the registered government securities broker or dealer.".

(8) References to § 240.15c3-3 and the exhibits thereto, relating to possession or control of customer securities and reserve requirements, mean § 403.4 of this chapter.

(9) The reference to § 240.15b1-2 of this title, relating to financial statements to be filed upon registration, means § 240.15Ca2-2.

(10) The supplemental report described in § 240.17a-5(e)(4) of this title, concerning the Securities Investor Protection Act, is not required.

(11) The statement described in § 240.17a-5(f)(2) of this title shall be headed "Notice Pursuant to Section 405.2," and shall be filed within 30 days following the effective date of registration as a government securities broker or dealer.

(12) References in § 240.17a-5(h)(2) of this title to § 240.17a-11 mean § 405.3(a) of this chapter.

(b) A government securities interdealer broker subject to the financial responsibility requirements of § 402.1(e) of this chapter shall comply with the requirements of § 240.17a-5 of this title (SEC Rule 17a-5), with the following modifications:

(1) References to "broker or dealer" include government securities interdealer brokers;

(2) References to "rules of the Commission" or words of similar import include, where appropriate, the regulations contained in this subchapter.

(3) References to "net capital" mean net capital calculated as provided in § 402.1(e) of this chapter.

(4) References to § 240.15c3-1, relating to net capital, include the modifications contained in § 402.1(e) of this chapter.

(5) References to § 240.15c3-3 and the exhibits thereto, relating to possession or control of customer securities and reserve requirements, mean § 403.4 of this chapter.

(6) The reference to § 240.15b1-2 of this title, relating to financial statements to be filed upon registration, means § 240.15Ca2-2.

(7) The supplemental report described in § 240.17a-5(e)(4) of this title, concerning the Securities Investor Protection Act, is not required.

(8) The statement described in § 240.17a-5(f)(2) of this title shall be headed "Notice Pursuant to Section 405.2" and shall be filed within 30 days following the effective date of registration as a government securities broker.

(9) References in § 240.17a-5(h)(2) of this title to § 240.17a-11 mean § 405.3(b) of this chapter.

(c) A registered government securities broker or dealer that is also a futures commission merchant registered with the CFTC shall comply with the requirements of § 240.17a-5 of this title (SEC Rule 17a-5), with the following modifications:

(1) References to "broker or dealer" include registered government securities brokers and dealers.

(2) References to "rules of the Commission" or words of similar import include, where appropriate, the regulations contained in this subchapter.

(3) References to § 240.15c3-3 and the exhibits thereto, relating to possession or control of customer securities and reserve requirements, mean § 403.4 of this chapter.

(4) The reference to § 240.15b1-2 of this title, relating to financial statements to be filed upon registration, means § 240.15Ca2-2.

(5) The supplemental report described in § 240.17a-5(e)(4) of this title, concerning the Securities Investor Protection Act, is not required.

(6) The statement described in § 240.17a-5(f)(2) of this title shall be headed "Notice Pursuant to § 405.2," and shall be filed within 30 days following the effective date of registration as a government securities broker or dealer.

(7) References in § 240.17a-5(h)(2) of this title to § 240.17a-11 mean § 405.3(c) of this chapter.

(Approved by the Office of Management and Budget under control number 1505-0100)

§ 405.3 Supplemental current financial and operational reports to be made by certain registered government securities brokers and dealers.

(a) Every registered government securities broker or dealer, other than a government securities interdealer broker that is subject to the financial responsibility requirements of § 402.1(e) and a government securities broker or dealer that is also a futures commission merchant registered with the CFTC, shall comply with the requirements of § 240.17a-11 of this title (SEC Rule 17a-11), with the following modifications:

(1) References to "broker or dealer" include registered government securities brokers and dealers.

(2) References to § 240.15c3-1, relating to net capital, mean § 402.2 of this chapter.

(3) References to "net capital" mean "liquid capital" as defined in § 402.2 of this chapter.

(4) References to § 240.15c3-1d, relating to subordination agreements, mean that section as modified by § 402.2d of this chapter.

(5) References to Form X-17A-5 mean Form G-405 (§ 449.5 of this chapter).

(6) References to § 240.17a-5, relating to reports and audit, mean § 405.2(a) of this chapter.

(7) Section 240.17a-11(b)(1), for the purposes of this section, is modified to read as follows:

"(1) If a computation made by a registered government securities broker or dealer pursuant to the requirements of § 402.2 of this title shows, at any point during the month, that his liquid capital is less than 150 percent of total haircuts, determined in accordance with § 402.2 of this title, such person shall file a report on Part II or Part IIA of Form G-405 (§ 449.5 of this title) as determined in accordance with the standards set forth in § 240.17a-5(a)(2) (ii) and (iii), within 15 calendar days after the end of each month thereafter until 3 successive months shall have elapsed during which liquid capital does not fall below 150 percent of total haircuts.".

(8) References to § 240.17a-3, relating to records, mean § 404.2 of this chapter.

(b) A government securities interdealer broker that is subject to the financial responsibility requirements of § 402.1(e) of this chapter shall comply with the requirements of § 240.17a-11 of this title (SEC Rule 17a-11), with the following modifications:

(1) References to "broker or dealer" include government securities interdealer brokers;

(2) References to § 240.15c3–1, relating to net capital, include the modifications contained in § 402.1(e) of this chapter.

(3) References to "net capital" mean net capital calculated as provided in § 402.1(e) of this chapter.

(4) References to § 240.17a–5, relating to reports and audit, mean § 405.2(b) of this chapter.

(5) References to § 240.17a–3, relating to records, mean § 404.2 of this chapter.

(c) A registered government securities broker or dealer that is also a futures commission merchant registered with the CFTC shall comply with the requirements of § 240.17a–11 of this title (SEC Rule 17a–11), with the following modifications:

(1) References to "broker or dealer" include government securities brokers and dealers.

(2) References to § 240.15c3–1, relating to net capital, mean either § 240.15c3–1 or § 1.17 of this title, depending on which computation results in the higher net capital requirement.

(3) References to "net capital" mean the higher of net capital calculated under § 240.15c3–1 or § 1.17 of this title.

(4) References to § 240.17a–5, relating to reports and audit, mean § 405.2(c) of this chapter.

(5) A new paragraph § 240.17a–5(b)(5) is added, to read as follows:

"(5) If a computation made by a government securities broker or dealer that is not a registered broker or dealer but that is also a futures commission merchant registered with the Commodity Futures Trading Commission shows that:

"(i) The adjusted net capital of such entity is less than the greater of:

"(A) 150 percent of the appropriate minimum dollar amount required by § 1.17(a)(1)(i);

"(B) 6 percent of the following amount: The customer funds required to be segregated pursuant to section 4d(2) of the Commodity Exchange Act and § 1.17 of this title, less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, provided, however, the deduction for each option customer shall be limited to the amount of customer funds in such option customer's account; or

"(ii) At any point during the month, aggregate indebtedness is in excess of 1200 percent of net capital or total net capital is less than 120 percent of the minimum net capital required, then such person shall file a report on Part II or Part IIA of Form X–17A–5 (§ 249.617 of this chapter) as determined in accordance with the standards set forth in § 240.17a–5(a)(2) (ii) and (iii), within 15 calendar days after the end of each month thereafter until three successive months have elapsed during which none of the conditions described in this paragraph (b)(5) shall have occurred.".

(Approved by the Office of Management and Budget under control number 1505–0100)

§ 405.4 Financial recordkeeping and reporting of currency and foreign transactions by registered government securities brokers and dealers.

Every registered government securities broker or dealer who is subject to the requirements of the Currency and Foreign Transactions Reporting Act of 1970 shall comply with the reporting, recordkeeping and record retention requirements of 31 CFR Part 103. Where 31 CFR Part 103 and § 404.3 of this chapter require the same records to be preserved for different periods of time, such records or reports shall be preserved for the longer period of time.

PART 449—FORMS, SECTION 15C OF THE SECURITIES EXCHANGE ACT OF 1934

Sec.

449.1 Form G–FIN, notification by financial institutions of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934.
449.2 Form G–FINW, notification by financial institutions of cessation of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.6 of this chapter.
449.3 Form G–FIN–4, notification by persons associated with financial institutions that are government securities brokers and dealers pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.
449.4 Form G–FIN–5, notification of termination of association with a financial institution that is a government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.
449.5 Form G–405, information required of registered government securities brokers and dealers pursuant to section 15C of the Securities Exchange Act of 1934 and §§ 405.2 and 405.3 of this chapter.

Authority: Sec. 101, Pub. L. 99–571, 100 Stat. 3208 (15 U.S.C. 78o–5(a), (b)(1)(B), (b)(2)).

§ 449.1 Form G–FIN, notification by financial institutions of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934.

This form is to be used by financial institutions that are government securities brokers or dealers not exempt under Part 401 of this chapter to notify their appropriate regulatory agency of their status. The form is promulgated by the Board of Governors of the Federal Reserve System and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.2 Form G–FINW, notification by financial institutions of cessation of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.6 of this chapter.

This form is to be used by financial institutions that are government securities brokers or dealers to notify their appropriate regulatory agency that they have ceased to function as a government securities broker or dealer. The form is promulgated by the Board of Governors of the Federal Reserve System and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.3 Form G–FIN–4, notification by persons associated with financial institutions that are government securities brokers and dealers pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.

This form is to be used by associated persons of financial institutions that are government securities brokers or dealers to provide certain information to the financial institution and the appropriate regulatory agency concerning employment, residence, and statutory disqualification. The form is promulgated by the Department of the Treasury and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.4 Form G–FIN–5, notification of termination of association with a financial institution that is a government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.

This form is to be used by financial institutions that are government securities brokers or dealers to notify the appropriate regulatory agency of the fact that an associated person is no longer associated with the government securities broker or dealer function of the financial institution. The form is promulgated by the Department of the Treasury and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance

Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.5 Form G-405, information required of registered government securities brokers and dealers pursuant to section 15C of the Securities Exchange Act of 1934 and §§ 405.2 and 405.3 of this chapter.

This form is to be used by registered government securities brokers and dealers to make the monthly, quarterly and annual financial reports required by Part 405 of this chapter. The form is promulgated by the Department of the Treasury and is available from the SEC and the designated examining authorities.

Subchapter B—Regulations Under Title II of the Government Securities Act of 1986

PART 450—CUSTODIAL HOLDINGS OF GOVERNMENT SECURITIES BY DEPOSITORY INSTITUTIONS

Sec.
450.1 Scope of regulations; office responsible.
450.2 Definitions.
450.3 Exemption for holdings subject to fiduciary standards.
450.4 Custodial holdings of government securities.
450.5 Effective date.

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3208 (15 U.S.C. 78o-5(b)(1)(A), (b)(2), (b)(3)(B)); Sec. 201, Pub. L. 99-571, 100 Stat. 3222-23 (31 U.S.C. 3121, 9110).

§ 450.1 Scope of regulations; office responsible.

(a) This part applies to depository institutions that hold government securities as fiduciary, custodian, or otherwise for the account of a customer, and that are not government securities brokers or dealers, as defined in sections 3(a)(43) and 3(a)(44) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(43)-(44)). Depository institutions exempt under Part 401 of this chapter from the requirements of Subchapter A of this chapter must comply with this part. Certain depository institutions that are government securities brokers or dealers must also comply with this part, as well as with additional requirements set forth in § 403.5.

(b) The regulations in this subchapter are promulgated by the Assistant Secretary (Domestic Finance) pursuant to a delegation of authority from the Secretary of the Treasury. The office responsible for the regulations is the Office of the Commissioner, Bureau of the Public Debt.

§ 450.2 Definitions.

For purposes of this subchapter:

(a) "Appropriate regulatory agency" has the meaning set out in section 3(a)(34)(G) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(34)(G)), except that the appropriate regulatory agency for—

(1) An institution insured by the Federal Savings and Loan Insurance Corporation is the Federal Home Loan Bank Board;

(2) A federal credit union as defined in 12 U.S.C. 1752(1) and an insured credit union as defined in 12 U.S.C. 1752(7) is the National Credit Union Administration; and

(3) Any depository institution for whom an appropriate regulatory agency is not explicitly specified by either section 3(a)(34)(G) or this paragraph, is the SEC;

(b) "Customer" includes, but is not limited to, the counterparty to a transaction pursuant to a repurchase agreement for whom the depository institution retains possession of the security sold subject to repurchase, but does not include a broker or dealer that is registered pursuant to section 15, 15B or 15C(a)(1)(A) of the Act (15 U.S.C. 78o, 78o-4, 78o-5(a)(l)(A)) or that has filed notice of its status as a government securities broker or dealer pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 78o-5(a)(1)(B)) except as provided in § 450.4.

(c) "Depository institution" has the meaning stated in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A) (i)-(vi)) and also includes a foreign bank, an agency or branch of a foreign bank and a commercial lending company owned or controlled by a foreign bank (as such terms are defined in the International Banking Act of 1978, Pub. L. 95-369, 92 Stat. 607);

(d) "Fiduciary capacity" includes trustee, executor, administrator, registrar, transfer agent, guardian, assignee, receiver, managing agent, and any other similar capacity involving the sole or shared exercise of discretion by a depository institution having fiduciary powers that is supervised by a federal or state financial institution regulatory agency; and

(e) "Government securities" means those obligations described in subparagraphs (A), (B), or (C) of section 3(a)(42) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(42)(A)-(C)).

§ 450.3 Exemption for holdings subject to fiduciary standards.

(a) The Secretary has determined that the rules and standards of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation governing the holding of government securities in a fiduciary capacity by depository institutions subject thereto are adequate. Accordingly, such depository institutions are exempt from this part with respect to their holdings of government securities in a fiduciary capacity and their holdings of government securities in a custodial capacity provided that (1) such institution has adopted policies and procedures that would apply to such custodial holdings all the requirements imposed by its appropriate regulatory agency that are applicable to government securities held in a fiduciary capacity, and (2) such custodial holdings are subject to examination by the appropriate regulatory agency for compliance with such fiduciary requirements.

(b) The Secretary expects that each appropriate regulatory agency will notify the Department if it materially revises its rules and standards governing the holding of government securities in a fiduciary capacity.

§ 450.4 Custodial holdings of government securities.

Depository institutions that are subject to this Part shall observe the following requirements with respect to their holdings of government securities for customer accounts:

(a)(1) Except as otherwise provided in this section, a depository institution shall maintain possession or control of all government securities held for the account of customers by segregating such securities from the assets of the depository institution and keeping them free of any lien, charge or claim of any third party granted or created by such depository institution.

(2)(i) Where customer securities are maintained by a depository institution at another depository institution, including but not limited to a correspondent bank or a trust company ("custodian institution"), the depository institution shall be in compliance with paragraph (a)(1) of this section if:

(A) The depository institution notifies the custodian institution that such securities are customer securities;

(B) The custodian institution maintains such securities in an account that is designated for customers of the depository institution and that does not contain proprietary securities of the depository institution; and

(C) The depository institution instructs the custodian institution to maintain such securities free of any lien, charge, or claim of any kind in favor of such custodian institution or any persons claiming through it.

(ii) To the extent that a custodian institution holds securities that have been identified as customer securities by a depository institution in accordance with paragraph (a)(2)(i) of this section, the custodian institution shall treat such securities as customer securities separate from any other securities held for the account of the depository institution.

(3)(i) Where securities that a depository institution is required, pursuant to this Part 450, to keep free of all liens, charges, or other claims ("customer securities") are maintained by a depository institution at a Federal Reserve Bank, the depository institution shall be in compliance with paragraph (a)(1) of this section if any lien, charge or other claim of such Federal Reserve Bank or any person claiming through it against securities of the depository institution expressly excludes customer securities.

(ii) Notwithstanding paragraph (a)(3)(i) of this section, a depository institution described in that paragraph shall be in compliance with paragraph (a)(1) of this section if a Federal Reserve Bank retains a lien on securities received during the day that are subsequently determined to be customer securities, *provided that*,

(A) On that day, the depository institution:

(*1*) Because of extraordinary circumstances, at the end of that day either requests a discount window advance or is unable to eliminate an overdraft with its Federal Reserve Bank and the Federal Reserve Bank extends credit to the depository institution in order to assure the safety and soundness or liquidity of the depository institution; and

(*2*) After reasonable efforts, is unable to provide the Federal Reserve Bank with an adequate security interest in other collateral that is clearly identifiable as pledgeable by the depository institution sufficient to fully collateralize such extension of credit; and

(B) The depository institution diligently pursues with the Federal Reserve Bank the substitution of other collateral for securities determined to be customer securities; and

(C) The Federal Reserve Bank agrees that to the extent the lien extends to collateral of a value greater than the outstanding balance on the loan, customer securities will be the first collateral released from the lien.

(4)(i) To the extent that a depository institution holds securities that have been identified to such depository institution as customer securities by a government securities broker or dealer, or that the government securities broker or dealer has instructed the depository institution to place in a segregated account, in accordance with Part 403 of subchapter A of this chapter, the depository institution shall treat such securities as customer securities separate from any other securities held for the account of the government securities broker or dealer and shall comply with all of the provisions of this section with respect to such customer securities, except as provided in paragraph (a)(4)(ii) of this section.

(ii) A clearing bank that provides clearing services for a government securities broker or dealer and that maintains a segregated account as described in § 403.4 of this chapter shall not be required to transfer securities to such account upon the instruction of the broker or dealer for whom such account is maintained if the clearing bank determines that such securities continue to be required as collateral for an extension of clearing credit to such dealer. Whenever a clearing bank does not segregate securities as of the close of business upon the instruction of such broker or dealer, it shall send a notification to the appropriate regulatory agency of the broker or dealer for whom such account is maintained. Such securities shall thereafter be segregated pursuant to the instruction of the broker or dealer as soon as they are no longer required by the clearing bank as collateral for the extension of clearing credit.

(5) A depository institution that is subject to Part 403 is not required to maintain possession or control of margin securities as that term is defined in § 403.5(f)(1).

(6) Notwithstanding the requirement of paragraph (a)(1) to maintain possession or control of customer securities, a depository institution may lend such securities to a third party pursuant to the written agreement of the customer, if such loan of securities is carried out in full compliance with supervisory guidelines of its appropriate regulatory agency that expressly govern securities lending practices.

(b)(1) Except as otherwise provided in paragraph (b)(2) of this section, a depository institution shall issue a confirmation or a safekeeping receipt for each security held for a customer in accordance with this section with the exception of securities that are the subject of repurchase transactions which are subject to the requirements of § 403.5(d) of this chapter. The confirmation or safekeeping receipt shall identify the issuer, maturity date, par amount and coupon rate of the security being confirmed. The confirmation may be supplied to the customer in any manner that complies with applicable federal banking regulations.

(2) A depository institution shall not be required to send the confirmation or safekeeping receipt required by paragraph (b)(1) of this section to a customer that is a non-U.S. citizen residing outside the United States or a foreign corporation, partnership, or trust, if such customer expressly waives in writing the right to receive such confirmation or safekeeping receipt.

(c) Records of government securities held for customers shall be maintained and shall be kept separate and distinct from other records of the depository institution. Such records shall:

(1) Provide a system for identifying each customer, and each government security (or the amount of each issue of a government security issued in book-entry form) held for the customer;

(2) Describe the customer's interest in the government security;

(3) Indicate all receipts and deliveries of government securities and all receipts and disbursements of cash by the depository institution in connection with such securities;

(4) Include a copy of the safekeeping receipt or a confirmation issued for each government security held; and

(5) Provide an adequate basis for audit of such information.

(d) Counts of government securities held for customers in both definitive and book-entry form shall be conducted at least annually and such counts shall be reconciled with customer account records.

(1) Counts of book-entry securities and of definitive securities held outside the possession of the depository institution shall be made by reconciliation of the records of the depository institution with those of any depository, depository institution, or Federal Reserve Bank on whose books the depository institution has securities accounts.

(2) The depository institution conducting the count shall also verify any such securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to the depository institution's control or direction that are not in its physical possession, where the securities have been in such status for longer than thirty days.

(3) The dates and results of such counts and reconciliations shall be documented with differences noted in a security count difference account not

later than seven business days after the date of each required count and verification as provided in this paragraph (d).

(e) For purposes of this section, a depository institution shall treat a government securities broker or dealer as a customer with respect to securities maintained by such government securities broker or dealer in a Segregated Account as defined in § 403.4(f)(1) of this chapter and with respect to securities otherwise identified to the depository institution as customer securities for purposes of maintaining possession or control of such securities as required by Part 403 of this chapter. The recordkeeping requirements of paragraph (c) of this section require the depository institution to treat such securities as customer securities separate from any other securities held for the account of the government securities broker or dealer, but do not require the depository institution to keep records identifying individual customers of the government securities broker or dealer.

(f) The records required by paragraphs (c) and (d)(3) of this section shall be preserved for not less than six years, the first two years in an easily accessible place.

(Approved by the Office of Management and Budget under control number 1505-0100.)

§ 450.5 Effective date.

This part shall be effective October 31, 1987.

Charles O. Sethness,

Assistant Secretary for Domestic Finance.

[FR Doc. 87-16779 Filed 7-23-87; 8:45 am]

BILLING CODE 4810-25-M

federal register

Friday
July 24, 1987

Part IV

Securities and Exchange Commission

17 CFR Part 240

Implementation of the Government Securities Act of 1986; Adoption of Final Rules

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-24726; File No. S7-5-87]

Implementation of the Government Securities Act of 1986

AGENCY: Securities and Exchange Commission.

ACTION: Adoption of final rules.

SUMMARY: The Commission is adopting previously proposed rules to implement provisions of the Government Securities Act of 1986 that authorize the Commission, after consultation with the Commodity Futures Trading Commission ("CFTC"), to except from the definitions of government securities broker and government securities dealer certain persons directly or indirectly regulated by the CFTC whose government securities activities are incidental to their futures business. The first proposed rule defines as incidental certain transactions for customers by futures commission merchants, primarily as agent, subject to conditions designed to assure that customer funds and securities are safeguarded and that government securities transactions in general are not advertised and in some cases certain other conditions. The second proposed rule defines as incidental certain principal transactions by CFTC-regulated persons, including transactions to effect delivery on futures contracts, certain exchange of futures for physicals transactions, certain investment transactions, certain proprietary hedging and arbitrage transactions, and certain proprietary matched book repurchase transactions.

EFFECTIVE DATE: July 25, 1987.

FOR FURTHER INFORMATION CONTACT: Catherine McGuire, Esq., Senior Counsel to the Director, (202) 272-2790 or Lynne G. Masters, Esq. at (202) 272-2848, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

On October 28, 1986, the Securities Exchange Act of 1934 (the "Exchange Act") was amended by Pub. L. No. 99-571, the Government Securities Act of 1986 (the "Government Securities Act"). The Government Securities Act provides for the regulation of government securities brokers and government securities dealers. The regulatory system to be established under the Government Securities Act is a limited one in that it does not provide generally for regulation that would affect particular transactions in government securities, *e.g.*, margin or suitability regulation.[1] Instead, the Government Securities Act requires the Secretary of the Treasury (the "Treasury") to adopt rules concerning the financial responsibility, protection of securities and funds, recordkeeping, reporting, and audit of government securities brokers and government securities dealers. The Commission is to provide for the registration of government securities brokers and government securities dealers that are not financial institutions or registered broker-dealers. Financial institutions and registered broker-dealers are required to file notice of their government securities broker or government securities dealer status with their appropriate regulatory agency.

Under the Government Securities Act, the terms government securities broker[2] and government securities dealer [3] do not include any person registered with the Commodity Futures Trading Commission ("CFTC"), any contract market designated by the CFTC, such a contract market's affiliated clearing organization,[4] or any floor trader on such a contract market (hereinafter collectively referred to as "CFTC-regulated persons") solely because such person effects transactions in government securities that the Commission, after consultation with the CFTC, has determined to be incidental to such person's futures-related business.

After consulting with the CFTC,[5] the Commission on February 25, 1987, proposed two rules, Rule 3a43-1 and 3a44-1, defining activities it preliminarily believed were incidental to the futures-related business of certain CFTC-regulated persons. (*See* Securities Exchange Act Rel. No. 24135 (February 25, 1987) 52 FR 6340 (March 3, 1987) ("Proposing Release")).

Twenty-five comment letters were received from 25 commenters on the proposed rules.[6] In addition, three letters were received from the CFTC and its staff.[7] As discussed more fully below, numerous comments criticized Rules 3a43-1 and 3a44-1 as too restrictive in their attempt to define those activities that are "incidental transactions." In response to commenters' concerns, the Commission has narrowed the preliminary requirements of the rules and has broadened the types of transactions in government securities and accounts for which such transactions are permitted.

---

[1] Section 15C(b)(1) of the Government Securities Act explicitly requires the Secretary of the Treasury to adopt regulations related to the transfer and control of securities in repurchase transactions.

[2] New section 3(a)(43) of the Exchange Act defines a government securities broker as: any person regularly engaged in the business of effecting transactions in government securities for the account of others, but does not include—

(A) any corporation the securities of which are government securities under subparagraph (B) or (C) of paragraph (42) of this subsection; or

(B) any person registered with the Commodity Futures Trading Commission, any contract market designated by the Commodity Futures Trading Commission, such contract market's affiliated clearing organization, or any floor trader on such contract market, solely because such person effects transactions in government securities that the Commission, after consultation with the Commodity Futures Trading Commission, has determined by rule or order to be incidental to such person's futures-related business.

[3] New section 3(a)(44) of the Exchange Act defines a government securities dealer as: any person engaged in the business of buying and selling government securities for his own account, through a broker or otherwise, but does not include—

(A) any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business;

(B) any corporation the securities of which are government securities under subparagraph (B) or (C) of paragraph (42) of this subsection;

(C) any bank, unless the bank is engaged in the business of buying and selling government securities for its own account other than in a fiduciary capacity, through a broker or otherwise; or

(D) any person registered with the Commodity Futures Trading Commission, any contract market designated by the Commodity Futures Trading Commission, such contract market's affiliated clearing organization, or any floor trader on such contract market, solely because such person effects transactions in government securities that the Commission, after consultation with the Commodity Futures Trading Commission, has determined by rule or order to be incidental to such person's futures-related business.

[4] The CFTC Division of Trading and Markets has advised the Commission's staff that many commodities clearing corporations are not legally controlling, controlled by, or under common control with designated contract markets ("exchanges"). Nevertheless, in this context, the Commission interprets the term "affiliated clearing organization" to include those clearing organizations that have a contractual or customary arrangement to clear futures contracts traded on a particular futures exchange.

[5] The CFTC Division of Trading and Markets reviewed and submitted preliminary comments on each of the proposed exceptions. Letter from Kevin M. Foley, Chief Counsel, Division of Trading and Markets, CFTC, to Richard G. Ketchum, Director, Division of Market Regulation, SEC, dated February 18, 1987.

[6] The letters of comment and Commission staff summary thereof are available for public inspection and copying at the Commission's Public Reference Room. *See* File No. S7-5-87.

[7] Letter from Jean A. Webb, Secretary, CFTC, to Jonathan G. Katz, Secretary, SEC, dated April 3, 1987; *see infra* text following notes 15 and 22; letter from Andrea M. Corcoran, Director, Division of Trading and Markets, CFTC, to Richard G. Ketchum, Director, Division of Market Regulation, SEC, dated May 20, 1987; *see infra* text and accompanying note 10; letter from Andrea M. Corcoran, Director, Division of Trading and Markets, CFTC, to Richard G. Ketchum, dated June 30, 1987 (recommending technical changes to the rules).

Consistent with the Commission's responsibility under the Exchange Act, the rules contain conditions and provide safeguards that the Commission believes are necessary to further the goals of investor protection as intended by the Government Securities Act. As required in sections 3(a)(43) and 3(a)(44), the Commission has continued to consult with the CFTC concerning these rules. In its June 30 letter, the staff of the CFTC indicated that it believed the rules to be generally responsive to CFTC and commenters' concerns.

II. Rule 3a43–1: Customer-related Transactions

A. Preliminary Conditions

Rule 3a43–1 concerns customer-related transactions that, but for the Commission's determination, might cause a futures commission merchant regulated by the CFTC to be considered a government securities broker or government securities dealer. Futures commission merchants take orders for execution on futures exchanges and carry customer accounts. In connection with this business, they may act as agent for futures customers in effecting transactions in government securities or engage as principal in certain combination transactions that involve both futures and government securities.

The legislative history of these exceptions suggests that, in determining whether such customer activity is futures-related, the Commission should assure that the government securities activities of such customers are protected by the regulatory scheme administered by the CFTC.[8] The proposed rule, therefore, contained a requirement that the funds and securities involved in the government securities transactions proposed to be determined to be incidental to the futures-related business be held in a customer segregation account subject to the CFTC's rules at 17 CFR 1.20–1.30.

Several commenters stated that that condition would unfairly restrict investments on behalf of proprietary accounts (e.g. affiliates and other insiders) in government securities and argued that such accounts should be entitled to the same treatment as segregated customer accounts. Other commenters noted that futures commission merchants should be permitted to execute government securities transactions with funds deposited to margin or guarantee foreign futures and options contracts.[9] In addition, commenters including the staff of the Division of Trading and Markets of the CFTC noted that CFTC regulations applicable to segregation of funds associated with "dealer options" are codified at 17 CFR 32.6 rather than in the referenced sections.[10] Finally, the CFTC staff advised that the definition of customer should be revised to include a reference to foreign futures and options on futures customers. The staff further advised that it would be inappropriate to require segregation of funds and securities associated with effecting delivery pursuant to a futures contract. CFTC staff explained that commodities exchange rules permit delivery through a delivery account as well as the segregation account.

The rule has been modified to address the concerns raised by commenters. Accordingly, the definition of customer has been expanded to include proprietary accounts, foreign futures and options on futures customers, and options on physicals customers by defining the term to mean any person for whom the futures commission merchant effects or intends to effect transactions in futures, options on futures, or any other instruments subject to CFTC jurisdiction.[11] The definitions of futures and options on futures contracts have been expanded to include contracts traded on or subject to the rules of any board of trade located outside the United States, its territories, and possessions.[12]

The rule as adopted contains a definition of regulated account that is defined as a customer segregation account subject to CFTC regulations [13] except where CFTC regulations do not permit segregation or require maintenance of a separate regulated account. The rule provides that where CFTC rules require maintenance of a separate regulated account, the term means such an account. The CFTC staff has indicated that it will recommend CFTC consideration of a requirement for such an account for customer funds and securities related to trading of foreign instruments. The regulations applicable to such an account would require segregation of the funds in such an account from proprietary funds, and would not permit comingling such funds with customer funds related to domestically traded instruments. The rule also provides that where CFTC regulations do not permit segregation,[14] the term means any other account subject to CFTC recordkeeping regulations. Proprietary accounts are not permitted to be kept in customer segregation accounts. Nevertheless, these accounts are subject to the general recordkeeping regulations of the CFTC. Finally, the rule excepts from the preliminary condition that requires funds and securities associated with such transactions to be maintained in a regulated account transactions to effect delivery of securities pursuant to a futures contract.

Solicitation

As proposed, Rule 3a43–1 contained a second condition that required that the transactions in government securities be unsolicited. The purpose of that condition was to ensure that the transactions proposed to be excepted were truly incidental to a futures commission merchant's business. Commenters believed that such a prohibition would not permit legitimate recommendations of combination transactions to customers and was likely to have anticompetitive effects. They believed that futures commission merchants should be able to solicit transactions that were otherwise incidental to the futures business. In view of these concerns, the Commission has determined not to impose as a preliminary condition to the availability of the exception a prohibition against solicitation. Accordingly, the rule as adopted permits specified transactions by a futures commission merchant to be solicited.[15]

[8] Report of the Senate Committee on Banking, Housing and Urban Affairs to accompany S. 1416, S. Rep. No. 426, 99th Cong. 2d. Sess. 19 (1986) [hereinafter cited as Senate Report].

[9] CFTC rules do not currently permit such funds to be placed in a customer segregation account. In addition, the definitions of futures and options on futures contracts in the proposed rules referred to contracts traded on a contract market designated by the CFTC, *i.e.*, a U.S. futures exchange.

[10] The CFTC uses the term "dealer options" to distinguish a class of options on physicals authorized to be traded off-exchange from those traded on or subject to the rules of a contract market.

[11] In particular, options on physicals are included in the phrase "other instruments subject to CFTC jurisdiction."

[12] Subject to certain limited exceptions, the domestic offer and sale of foreign options on futures and foreign options on physicals are currently prohibited.

[13] This change addresses the dealer options problem raised by the commenters by deleting the reference to specific CFTC segregation requirements.

[14] The Commission has not adopted the suggestion of some commenters that segregation not be required if it is not required by the CFTC. Where CFTC rules permit segregation, segregation is required unless there is a separate regulated account.

[15] As discussed below, the prohibition on solicitation has been retained for certain transactions relating to the investment of customer margin and excess funds. *See infra* text at n. 30.

Advertising

Proposed Rule 3a43-1 also contained a condition prohibiting a futures commission merchant from advertising that it is in the business of effecting transactions in government securities. That condition was designed to assure further that the enumerated transactions are incidental and to avoid the use of the exceptions to circumvent securities self-regulatory organization authority to regulate government securities advertising. Commenters including the CFTC argues that the prohibition placed futures commission merchants at a competitive disadvantage to futures commission merchants that are also registered as broker-dealers. They believed that futures commission merchants that are not registered broker-dealers would be required to stop advertising the services they offer their customers or incur the additional expense of registering as broker dealers, whereas registered broker-dealer futures commission merchants would only be required to file notice with the Commission of their government securities activities.

The Commission is sympathetic to these concerns and has modified the condition to permit limited advertising. Limiting a futures commission merchant's advertisement of a general government securities business is appropriate in order to assure that the futures commission merchant's government securities transactions are truly incidental to its futures-related business. However, advertising of government securities transactions in connection with futures-related trading would be permitted under the revised rule. This revision is intended to allow futures commission merchants to inform their customers of the types of government securities services they provide in connection with futures trading and investment of excess customer funds. For instance, it would allow futures commission merchants to advertise that they may purchase government securities on behalf of customers so as to permit customers to receive interest on customer segregated funds, that they can execute certain hedging and arbitrage strategies in government securities and futures contracts, and that they effect exchange of futures for physicals transactions involving futures on government securities. However, it would not allow futures commission merchants to advertise their willingness to execute trades in government securities alone.

B. Excepted Transactions

Agency Transactions

The first section of the rule excepts agency transactions relating to delivery pursuant to a futures contract or for risk reduction or arbitrage of existing or contemporaneously created futures positions. One commenter suggested that the Commission clarify what the commenter perceived as a definitional ambiguity with regard to permitted "agency" investments by futures commission merchants. The commenter noted that "[t]he government securities market is virtually exclusively a dealer market. Thus, if a futures commission merchant is instructed by its customer to purchase a U.S. Treasury Bill or other government security, the futures commission merchant will purchase the security in its name as principal. The futures commission merchant will then resell the security to its customer."

As the Treasury Department noted in its discussion of its exemption for agency transactions by financial institutions, it may be appropriate to consider a futures commission merchant acting as principal with a counterparty in the government securities market to be acting as agent vis-a-vis its customer. In the context of this rule, the Commission recognizes as indicia of an agency transaction the key factors identified by the Treasury Department. Specifically, the Treasury Department stated:

> Two major characteristics of [an agency] transaction are that the transacting broker purchases or sells a security on the order of the customer, not from or to its own inventory, and that the customer is charged an explicit transaction-based fee or commission. It should be noted that the counterparty of the transacting broker need not and indeed usually does not know that the transaction is a brokerage rather than a dealer transaction except perhaps by the size of the order.[16]

Thus, where a futures commission merchant acts as agent for a customer, and as part of this relationship purchases a security in the futures commission merchant's own name on behalf of its customer, it will be acting as agent for purposes of this rule.

Delivery Transactions. The first excepted transaction is an agency transaction in government securities to effect delivery pursuant to a futures contract. Currently, three commodities exchanges actively trade contracts on government securities.[17] Futures commission merchants regularly make and take delivery of the securities underlying these contracts at expiration as agent for customers. In addition, futures commission merchants may purchase a government security as agent for a customer for the purpose of making delivery. These activities are integral to the operation of the futures markets. As noted above, the Division of Trading and Markets of the CFTC supported this exception and urged that the preliminary condition requiring segregation not be applicable to this type of transaction. Accordingly, the Commission has made that change and has otherwise adopted this part of the rule as proposed.

Risk Reduction and Arbitrage. The second type of agency transactions excepted by the rule are those for risk reduction or arbitrage of existing or contemporaneously created futures or options on futures positions. In the Proposing Release the Commission proposed to except transactions in government securities for bona fide hedging or arbitrage of futures or options on futures positions. Although the Commission did not define the terms bona fide hedging and arbitrage, the Commission stated that it believed

> these terms comprehend the purchase or sale of government securities to reduce the risk of a futures position or to take advantage of pricing disparities between the government securities and futures contracts for government securities. The Commission acknowledges that bona fide hedging and arbitrage transactions may involve government securities of a different type, maturity, or coupon than the government security that is the subject of the futures contract and that there may be residual basis risk in a hedging or arbitrage position.[18]

The Commission solicited comment on whether a definition was needed.

Two commenters believed that these terms should be expanded to include risk management strategies other than transactions merely intended to reduce the risk of futures or options on futures positions as suggested in the Proposing Release.[19] One commenter suggested

[16] 52 FR 19646 (May 26, 1987).

[17] The Chicago Board of Trade ("CBT") trades Treasury bond futures and options on the those futures, Treasury note futures and options on those futures, and GNMA futures; the Chicago Mercantile Exchange ("Merc") trades Treasury bill futures and options on those futures; the MidAmerica Commodity Exchange also trades Treasury bill futures and Treasury bond futures, but the size of the contracts is one-half the size of the contracts traded on the CBT and the Merc respectively.

[18] Proposing Release at n. 13.

[19] The Commission has declined to adopt this recommendation because such an essentially unbounded provision would undermine the purpose of the exception and would be inconsistent with its interpretation of those terms as stated in the Proposing Release.

that the Commission avoid a definition that would limit the activities of futures commission merchants or refrain from adopting a definition altogether in view of the CFTC's current review of its definition. Another commenter proposed an exception for agency transactions for risk reduction or arbitrage of futures or options on futures positions. One commenter recommended that the Commission clarify that, for purposes of the exception, these activities should relate to existing futures and options on futures positions and not to situations where the futures or options on futures are purchased to hedge an existing government securities position.

Consistent with these comments, the Commission has not adopted a definition of bona fide hedging and arbitrage transactions. The rule as adopted provides an exception for transactions in government securities for the purpose of risk reduction [20] or arbitrage of existing or contemporaneously created futures or options on futures poisitions.[21] The rule would not permit taking of cash positions in anticipation of reducing the risk of futures or options on futures positions to be established in the future. The purposes of these limitations are to assure that transactions in government securities effected by a futures commission merchant on behalf of a customer in reliance upon this exception are directly related to a customer's hedge or arbitrage of a futures or options on futures position and that such agency transactions are truly incidental to the futures commission merchant's futures-related business.

Margin and Excess Customer Funds

The second section of the rule provides exceptions for investment of margin and excess customer funds. As proposed, Rule 3a43–1 excepted agency transactions for the purchase of government securities by a futures commission merchant for deposit as initial margin. As discussed in the Proposing Release, the Division of Trading and Markets of the CFTC submitted a comment letter suggesting that the scope of this exception was too narrow because it did not provide for the investment of other types of margin and excess customer funds on deposit for futures or options on futures trading (collectively "excess customer funds"). Accordingly, the Commission specifically requested comment on the need for such an exception. In particular, the Commission solicited comment on whether to use objective standards that could be formulated either in terms of the number of transactions, dollar amount of compensation received for effecting agency transactions in government securities, or percentage of firm revenues that are derived from effecting agency transactions in government securities, or in terms of the securities, issuers, maturities, or arrangements that are customarily utilized for these purposes.

Commenters including the CFTC uniformly objected to the limitation of the proposed exception to initial margin as too narrow. These comments were not part of a general theme that deemed the rules as too restrictive in listing "incidental transactions". Commenters generally recommended that the Commission abandon the "list" approach and generally grant CFTC-regulated persons greater latitude in their government securities transactions.[22] The CFTC and others observed that transactions in securities for segregated customer accounts are already highly regulated by the CFTC and futures self-regulatory organizations and believed this regulation provides sufficient protection to the customer. The CFTC and other commenters noted that excess customer funds are invested as an accommodation to customers who desire to have their funds invested and to receive interest on those investments.[23] Several commenters including the CFTC believed that granting an exception for transactions only for initial margin would place sole futures commission merchants at a competitive disadvantage to futures commission merchants that are also registered broker-dealers. One commenter suggested that customers funds would be channeled possibly to less desirable investments such as commercial paper, certificates of deposit, and bankers acceptances. The CFTC and other commenters also observed that these services often are provided at cost.

Most commenters argued that the use of objective criteria such as those proposed was unnecessary, and hence they failed to supply any empirical data on the relevance of the criteria suggested by the Commission. Commenters generally agreed, however, that if a standard had to be imposed, they would recommend one based on a percentage of revenues.[24] Some commenters argued against a standard based on a dollar limit or on the number of agency transactions in the belief that such limitation could place futures commission merchants with a large customer base at a competitive disadvantage.

Several commenters observed that futures commission merchants purchase primarily Treasury bills for their customers for the investment of excess customer funds. One commenter suggested a standard that provided for investment of excess funds for a period of up to 91 days; another recommended a similar provision permitting investments in repurchase agreements and transactions in Treasury bills or other Treasury securities maturing within a short term from the date of the investment. Others suggested that a standard based on the short-term nature of the investment was an unreliable measure of whether a transaction was incidental.

Some commenters argued that no restrictions should be placed on the investment of excess customer funds if it was done at cost as an accommodation to that customer. These commenters suggested that firms generally did not seek to recover more than their costs in effecting government securities transactions for their customers.

The Commission continues to believe that an unlimited exception for the

[20] The Commission notes that it will interpret the term "risk reduction transactions" independently from the CFTC definition of "bona fide hedging."

[21] Under this standard, positions resulting from market orders entered simultaneously would be considered contemporaneously created even if market conditions resulted in the cash market order being executed prior to the related futures or option on futures order.

[22] Several commenters argued that all government securities transactions routinely affected by CFTC-regulated persons whose primary business is in the futures industry are incidental to such futures business. Two commenters argued that additional regulation of futures commission merchants and other CFTC-regulated persons is warranted only when their primary business ceases to be futures-related or when their government securities activities deviate from the normal and legitimate business practices in the futures industry. The Commission, they suggested, should make that determination after consultation with the CFTC on a case-by-case basis.

[23] Commenters indicated that these types of transactions are traditionally done on an agency basis, although one commenter who focused on this provision specifically suggested that futures commission merchants be permitted to engage in sales from inventory for initial margin purposes.

[24] One commenter letter suggested establishing a standard of incidental transactions based on revenue derived from any government securities activities that amounted to a percentage of total revenue. Another recommended that the Commission adopt a safe harbor provision to each rule providing that in addition to the types of transactions specified in the rules, a CFTC-regulated person could engage in a limited amount of government securities transactions as long as the revenues derived from the additional transactions compose only a small part (ten percent) of the CFTC-regulated person's total revenue. Other commenters suggested that the limitations advertising and solicitation would eliminate the potential for abuse that might occur with the investment of excess customer funds.

investment of excess customer funds may permit futures commission merchants to engage in a substantial government securities business that cannot fairly be categorized as merely "incidental" to its futures business.[25] In response to the comment letters, however, the Commission has added subparagraph (2) which provides futures commission merchants with greater flexibility to meet the various needs of their customers. Subparagraph (2) provides for agency transactions for the investment of margin and excess customer funds [26] in government securities under conditions designed to ensure that such trading is an accommodation to the futures commission merchant's customers without permitting these accounts effectively to be converted into accounts primarily for the purpose of effecting government securities transactions.[27] Under this section, futures commission merchants may effect agency transactions in government securities provided that these transactions satisfy any one of the three alternatives discussed below.

The first alternative permits futures commission merchants to engage in unlimited agency transactions involving Treasury securities with a maturity of less than 93 days at the time of the transaction.[28] This condition permits purchases and sales of short-term Treasury securities such as Treasury bills. As noted above, several commenters indicated that futures commission merchants customarily invest excess customer funds in Treasury bills. This provision will permit a futures commission merchant to invest as agent excess customer funds temporarily in short-term Treasury securities pending consummation of futures and options transactions without registering as a government securities broker. As noted above, a futures commission merchant will be permitted to solicit these transactions and to advertise these services as available in connection with futures or options on futures accounts.

The second alternative is that the transactions generate no monetary profit for the futures commission merchant in excess of the costs of executing such transactions. This responds to comments of futures commission merchants that these transactions are truly accommodations to customers done at no profit. It permits a futures commission merchant to invest customer funds as agent as an accommodation to its customers provided that the fee charged the customer does not include a commission higher than the cost of executing the transaction.[29] Accordingly, the futures commission merchant may pass on the customer the incremental cost of providing the service to the customer.

The third alternative under the rule is intended to provide futures commission merchants with a safe harbor for government securities transactions relating to excess customer funds based on a percentage of revenues and is primarily designed to permit futures commission merchants to accommodate the various needs of their customers. Because of its breadth, the alternative is available only for unsolicited transactions.[30] The alternative requires that gross income from executing government securities transactions under this alternative (including transactional fees passed through to the customer) cannot exceed 2% of the futures commission merchant's total commission revenues.[31] Commenters generally agreed that if the Commission adopted a general limitation on government securities transactions then an appropriate standard would be one based on a percentage of revenues.[32] The Commission believes a standard of 2% of total commission revenues from unspecified incidental agency transactions for customers will enable futures commission merchants to continue to serve their futures customers' related government securities needs but will prevent futures commission merchants from employing this exception to operate a substantial government securities business without registration.

The Commission expects that the futures commission merchant will retain in its records information to document compliance with the alternatives provided by this section. The courts and the Commission have consistently held that the person claiming an exemption under provisions of the federal securities laws has the burden of proving the exemption is available to it.[33] Accordingly, any CFTC-regulated person who relies on the rule has the burden of establishing that it has satisfied the conditions of the rule.

Exchange of Futures for Physicals Transactions

The third section of the rule provides an exception for exchange of futures for physicals transactions. This exception also is subject to the two preliminary requirements concerning segregation and advertising.[34] This section, containing the only exception for transactions as principal with customers in the Rule 3a43–1, has been adopted essentially as proposed. An exchange of futures for physicals transaction is a type of combination cash and futures transaction that is exempt from the Commodity Exchange Act's requirements for competitive execution on a futures exchange floor. CFTC rules, by reference to contract market rules, permit such off-exchange transactions.[35]

---

[25] The suggestions by some commenters that no firm would accept the pervasive regulation under the Commodity Exchange Act in order to avoid registration as a government securities broker misses the point. The Commission's concern is that an existing futures commission merchant would engage in a substantial government securities business over and above its existing futures business.

[26] This provision applies to margin and excess funds on any investment subject to CFTC jurisdiction, such as options on physicals as well as futures and options on futures.

[27] Because this rule is intended to permit agency transactions, no provision has been made for a futures commission merchant to sell government securities to its customers from its own inventory or to engage in repurchase transactions directly with its customers; *see supra* n. 16.

[28] Once a year Treasury issues a security that has a maturity of 92 days.

[29] The Commission believes that cost recovery for brokerage execution services should be measured by the incremental costs directly attributable to providing that service.

[30] As defined in the rule, "unsolicited transaction" means a transaction that is not recommended to a customer or effected in a discretionary account by the futures commission merchant, an associated person of the futures commission merchant, a business affiliate that is controlled by, controlling, or under common control with the futures commission merchant, or an introducting broker that is guaranteed by the futures commission merchant. As discussed in the Proposing Release, futures commission merchants could generally acquaint customers of their willingness to invest excess customer funds in government securities without any resulting transactions being deemed solicited. Proposing Release at note 9.

[31] Income received in connection with transactions in Treasury securities under subparagraph (b)(2)(i) or in connection with transactions that generate no monetary profit under subparagraph (b)(2)(ii) of the rule would be excluded from the 2% ceiling.

[32] Suggestions for an appropriate standard without the unlimited exception for revenues from short-term securities or futures commission merchant costs ranged from .05% to 10%. The only quantitative information, however, was submitted to Mocatta which indicated that revenues from agency transactions in government securities accounted for less than .05% of its total revenues. *See* Letter from Gary Alan DeWaal, General Counsel, Mocatta Futures Corporation, to Jonathan G. Katz, Secretary, SEC, dated March 27, 1987.

[33] See e.g., SEC v. Netelkos, 592 F. Supp. 906 (S.D.N.Y. 1984).

[34] See supra text at notes 8 through 15.

[35] 17 CFR 1.38, Chicago Mercantile Exchange Rule 538, Chicago Board of Trade Rule 444.01(c).

Generally, these transactions involve one party who simultaneously buys a government security and sells a (or gives up a long) futures contract while the other party to the transaction simultaneously sells a government security and buys a (or receives a long) futures contract, at a price difference mutually agreed upon. Among other uses, these transactions permit the establishment, transfer, or close-out of hedged or arbitrage positions.[36] Because the futures commission merchant is often the counterparty to such a transaction, this type of transaction may be done as principal with a customer and as agent for a customer.

Exemptive Authority

One commenter proposed that the Commission provide that CFTC-regulated entities could apply to the Commission for determination that additional government securities activities are incidental futures-related business. Accordingly, the rule contains a fourth section that authorizes the Commission to exempt as incidental to futures-related business certain transactions of an individual or group of futures commission merchants. The Commission intends to continue to consult with the CFTC in determining what activities are incidental to a futures-related business for purposes of exemptions under the rules.

III. Principal Transactions

A. Preliminary Conditions

Rule 3a44–1 concerns principal activities that, but for the Commission's determination, might cause a person regulated by the CFTC to be considered a government securities dealer. Because Congress intended that the Commission except CFTC-regulated persons only where their government securities activities are closely related to their futures activities, the rule applies only to persons who do not hold themselves out or advertise as government securities dealers.[37] This rule does not apply to transactions with customers other than CFTC-regulated persons except for making or taking delivery of a government security pursuant to a futures contract. The Commission is adopting Rule 3a44–1 essentially as proposed. As discussed below, however, the rule has been modified in some respects in response to issues raised by commenters.

B. Excepted Transactions

Delivery Transactions

The first excepted activity, consistent with proposed Rule 3a43–1(b)(1)(i), is the sale or purchase of government securities for delivery pursuant to a futures contract. As noted above, physical delivery pursuant to a futures contract is integral to the trading of government securities futures contracts, and hence clearly is incidental to the functioning of the futures market.

Exchange of Futures for Physicals Transactions

The second excepted activity is exchange of futures for physicals transactions between CFTC-regulated persons. This exception permits floor brokers, floor traders, and futures commission merchants to engage in such transactions with one another.[38] In response to suggestions of commenters, the rule has been amended to clarify that exchange of futures for physicals transactions as principal may be done with government securities brokers or dealers that have registered or provided notice pursuant to section 15C(a) of the Exchange Act. Thus, for example, the rule permits a futures commission merchant to solicit as principal a trade directly with a CFTC-regulated person or a government securities broker or government securities dealer that has registered with the Commission or filed notice pursuant to section 15C(a) of the Exchange Act in order to permit a combination cash and futures position taken in a customer initiated principal transaction to be offset with a professional transaction.

Transactions in Segregated Funds

The third excepted activity is transactions, including transactions involving repurchase agreements and reverse repurchase agreements, by futures commission merchants for investment of customer segregation funds or by a clearing organization for investment of funds it holds. These transactions are excepted if they are done with a bank[39] or with a government securities broker or government securities dealer that has registered or filed notice with its appropriate regulatory agency. The exception specifically permits transactions with banks as well as with those who will be subject to the Government Securities Act regulations because current CFTC interpretations on the investment of customer funds require some of such investments to be with banks,[40] and the Treasury Department has exempted certain banks from the requirement to file notice as a government securities dealer.[41]

Commenters asserted that the paragraph should be expanded to include futures commission merchants as acceptable counterparties. The Commission has declined to include futures commission merchants within the scope of this exception. As a practical matter, the efficient investment of customer segregated funds requires the services of a person whose business it is to buy and sell government securities rather than a person whose sales and purchases are based on its own cash management and futures trading strategies. Where a futures commission merchant stands ready regularly to engage in government securities transactions for the investment of customer segregated funds of other futures commission merchants, it is engaged in a government securities business and accordingly should be registered as a government securities broker or goverment securities dealer.

Risk Reduction and Arbitrage Transactions

The fourth exception has been revised to refer to risk reduction and arbitrage transactions consistent with and for the reasons set forth above with respect to Rule 3a43–1(b)(1)(iii). Commenters also believed that futures commission merchants should be included as counterparties under the rule because risk reduction and arbitrage transactions would be incidental to both parties' futures business. The rule has been modified accordingly and allows these transactions to be with a CFTC-regulated person as well as a government securities broker or government securities dealer who has registered or filed notice with its appropriate regulatory agency.

[36] A futures commission merchant that engages in a series of transactions with a customer that are structured to result in a purchase or sale of a government security without the establishment, transfer, or close-out of a related futures position would not be eligible for this exception from the definitions of government securities broker and government securities dealer.

[37] A futures commission merchant that runs a matched repurchase agreement book in accordance with the provisions of subparagraph (b)(5) would not be deemed holding itself out as a government securities dealer for purposes of the rule.

[38] A futures commission merchant's transactions with customers as agent or principal are also excepted under rule 3a43–1(b)(2).

[39] The term "bank" is defined in section 3(a)(6) of the Exchange Act.

[40] See e.g., Financial and Segregation Interpretation No. 2—Use of Customer's Funds for the Purchase of Obligations Under Repurchase Agreements, ¶ 7112 CCH Commodity Futures Law Reports (1975).

[41] 17 CFR 401.4, 52 FR 1986 (May 26, 1987).

Certain Repurchase Transactions

The rule contains a fifth exception that provides for repurchase and reverse repurchase agreement transactions between a futures commission merchant acting in a proprietary capacity and another CFTC-regulated person acting in a proprietary capacity with contemporaneous offsetting transactions by the futures commission merchant with certain other regulated entities. This exception was added at the suggestion of a commenter. It permits a futures commission merchant to act as principal in matched book repurchase transactions for investment of excess funds of floor broker and floor trader customers through repurchase and reverse repurchase transactions with regulated government securities dealers, banks, or other CFTC-regulated persons on the other side.[42] The requirement that the futures commission merchant be acting in a proprietary capacity assures that segregated customer funds and clearing funds cannot be used in these transactions except by CFTC-regulated entity customers as to whom those funds are proprietary.

Cash Management

Commenters suggested that the rule be amended to make clear that a futures commission merchant's investment of its own capital in government securities for each management and other trading purposes should be permitted. These comnmenters observed that this activity was cited by Congress as the type of activity that should be expected from government securities regulation. These commenters requested the rule be clarified to permit explicitly this type of activity. Others suggested that the adopting release make it clear that the limitations in the rule are inapplicable to those who are not "regularly engaged in the business."

The legislative history to the Government Securities Act suggests that whether a firm's activities bring it within the definition of a government securities dealer is to be largely determined based on traditional interpretations of the definitions of dealer. The definition of dealer excludes any person who buys and sells securities for his own account but not as part of a regular business.[43] As the legislative history suggests, commodities professionals, as an incidental part of their futures business, may buy and sell government securities for cash management purposes. These transactions generally would not bring such professionals within the definition of government securities dealer because they would not be considered to be "engaged in the business". Accordingly, the Commission does not believe any explicit exemption is necessary for incidental cash management investment activities.

Exemptions

At the suggestions of one commenter, the rule contains a new section that provides the Commission with general authority to exempt other transactions by CFTC-regulated persons that it finds to be incidental to their futures-related business either upon its own motion or upon request. This section parallels the exemptive authority in Rule 3a43–1.

IV. Commodity Pool Operations and Commodity Pools

Although commodity pool operators are excepted from the definition of government securities dealer under Rule 3a44–1, the Commission did not propose to except commodity pool operators from the definition of government securities broker because the Commission understands that commodity pool operators are not separately compensated for effecting transactions for the commodity pools they operate. Therefore, the Commission believes generally that their activities would not come within the traditional interpretation of the term broker.[44] In addition, commodity pool operators, generally, do not directly hold funds and securities or effect transactions with persons who are not government securities brokers or government securities dealers.

One commenter observed, however, that it was unclear whether commodity pool operators "generate income from commissions on government securities transactions effected on behalf of the pools they manage." The comment believed, that "[t]o the extent that government securities transactions engaged in by commodity pool operators would bring them within the definition of 'broker,' a similar exclusion from the definition of government securities broker is appropriate."

Receipt of transaction-related compensation is one of the key factors that distinguishes a broker from an investment adviser. Absent data suggesting that this form of compensation is customary in the futures industry, the Commission believes that this would be a key factor in distinguishing commodity pool operators who are also government securities brokers from those whose activities are incidental to their futures-related business. Accordingly, the Commission has not adopted the commenter's suggestion.

One commenter also suggested that the Commission staff exercise its no-action or interpretive authority to make it clear that commodity pools themselves that actively trade government securities are not required to register as government securities dealers. That commenter suggested that all government securities transactions are executed through regulated government securities broker-dealers or financial institutions. The Commission believes that a separate exception for commodity pools is unnecessary because the activities described above generally do not fall within the traditional interpretation of the definition of dealer.[45]

V. Competition Findings, Effective Date, and Statutory Basis

Section 23(a)(2) of the Exchange Act requires the Commission, in adopting rules under that Act, to consider the anticompetitive effect of such rules, if any, and to balance this effect against the regulatory benefits gained in terms of furthering the purposes of the Exchange Act. The Commission has considered proposed Rules 3a43–1 and 3a44–1 and believes that adopting the rules will not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act. Indeed the Commission believes that by defining a variety of government securities transactions as incidential to a futures-related business, the rules relieve potentially burdensome registration and regulatory requirements for certain CFTC-regulated persons. At the same time, the rules provide for a fair playing field by assuring that CFTC-regulated persons who are competing directly with government securities brokers and government securities dealers must register.

[42] The requirement that transctions with banks and government securities brokers and government securities dealers be contemporaneously offsetting transactions contemplates repurchase transactions on the same day in securities of the same type, coupon, and maturity as are the subject of the transaction with the CFTC-regulated entity. The repurchase obligation in such transactions would be for the same or shorter period as the transaction with the CFTC-regualted person.

[43] *See, e.g.* letter from Robert L.D. Colby, Chief Counsel, Division of Market Regulation, SEC, to Elizabeth J. Tolmach, Esq. Caplan & Drysdale, dated April 2, 1987 (publicly available April 2, 1987); letter from Susan J. Walters, Branch Chief, Division of Market Regulation, SEC to Martin E. Lybecker, Esq., Drinker Biddle & Reath, dated June 26, 1986 (publicly available July 26, 1986).

[44] *See* L. Loss, Securities Regulation, Vol. II, at 1299 (2d. ed. 1961).

[45] See supra letters cited note 43.

Section 553(d) of the Administrative Procedure Act, 5 U.S.C. 553(d) provides that the "required publication or service of a substantive rule shall be made not less than 30 days before its effective date except . . . a substantive rule which grants or recognizes an exemption or relieves a restriction . . . or . . . as otherwise provided by the agency for good cause found and published with the rule." Because Rules 3a43–1 and 3a44–1 except certain CFTC regulated-persons from the definitions of government securities brokers and government securities dealers, they have the effect of removing restrictions in that they relieve such persons from the requirements of registration and regulation under the Exchange Act that would otherwise be imposed by the operation of the Government Securities Act.

The Government Securities Act directs that by July 25, 1987, the Commission shall provide final regulations as are initially required to implement the Government Securities Act. Futures commission merchants that are government securities brokers or dealers are currently operating under a temporary exemption from registration and other requirements that expires October 31, 1987. The Commission believes good cause exists for the rules to become effective July 25, 1987, so that futures commission merchants and other CFTC-regulated persons can determine whether they must register by October 31, 1987. Accordingly, Rules 3a43–1 and 3a44–1 will become effective as final rules on July 25, 1987.

VI. Regulatory Flexibility Act Considerations

The Commission has prepared an Initial Regulatory Flexibility Analysis ("IRFA") and a Final Regulatory Flexibility Analysis ("Analysis") in accordance with 5 U.S.C. 603 and 604 respectively regarding proposed Rules 3a43–1 and 3a44–1. No comments were received on the Commission IRFA although several commenters raised issues involving considerations addressed by the Regulatory Flexibility Act.

The intent of and the possible costs and benefits of each rule proposal is also discussed in the Analysis. The Analysis notes that the objective of the rules is to implement the provisions of the Government Securities Act. The rules except from the definition of government securities broker and government securities dealer certain persons subject to CFTC oversight by defining as incidental to their futures-related business certain activities in government securities. Therefore, the rules reduce cost burdens on small futures commission merchants and other small CFTC-regulated entities. A copy of the Final Regulatory Flexibility Analysis may be obtained by contacting Lynne G. Masters, Esq., Division of Market Regulation, Securities and Exchange Commission, Washington, DC 20549, (202) 272–2848.

VII. Statutory Authority

Pursuant to the Securities Exchange Act of 1934 and particularly sections 3 and 23 thereof, 15 U.S.C. 78c and 78w, the Commission adopts §§ 240.3a43–1 and 3a44–1 of Title 17 of the Code of Federal Regulations, in the manner set forth below.

VIII. List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities, Government securities, Futures commission merchant, Customer funds.

IX. Text of Amendments

In accordance with the foregoing, 17 CFR Part 240 is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 is amended by adding the following citations:

Authority: Sec. 23; 48 Stat. 901, as amended; 15 U.S.C. 78w; * * * Sections 240.3a43–1 and 240.3a44–1 also issued under Sec. 3; 15 U.S.C. 78c; * * *

2. By adding § 240.3a43–1 and § 240.3a44–1 as follows:

§ 240.3a43–1 Customer-related government securities activities incidental to the futures-related business of a futures commission merchant registered with the Commodity Futures Trading Commission.

(a) A futures commission merchant registered with the Commodity Futures Trading Commission ("CFTC") is not a government securities broker or government securities dealer solely because such futures commission merchant effects transactions in government securities that are defined in paragraph (b) of this section as incidental to such person's futures-related business.

(b) Provided that the futures commission merchant maintains in a regulated account all funds and securities associated with such government securities transactions (except funds and securities associated with transactions under paragraph (b)(1)(i) of this section and does not advertise that it is in the business of effecting transactions in government securities otherwise than in connection with futures or options on futures trading or the investment of margin or excess funds related to such trading or the trading of any other instrument subject to CFTC jurisdiction, the following transactions in government securities are incidental to the futures-related business of such a futures commission merchant:

(1) Transactions as agent for a customer—

(i) To effect delivery pursuant to a futures contract; or

(ii) For risk reduction or arbitrage of existing or contemporaneously created postions in futures or options on futures;

(2) Transactions as agent for a customer for investment of margin and excess funds related to futures or options on futures trading or the trading of other instruments subject to CFTC jurisdiction, provided further that,

(i) Such transactions involve Treasury securities with a maturity of less than 93 days at the time of the transation.

(ii) Such transactions generate no monetary profit for the futures commission merchant in excess of the costs of executing such transactions, or

(iii) Such transactions are unsolicited, and commissions and other income generated on transactions pursuant to this paragraph (b)(2)(iii) (including transactional fees paid by the futures commission merchant and charged to its customer) do not exceed 2% of such futures commission merchant's total commission revenues;

(3) Exchange of futures for physicals transactions as agent for or as principal with a customer; and

(4) Any transaction or transactions that the Commission exempts, either unconditionally or on specified terms and conditions, as incidental to the futures-related business of a specified futures commission merchant, a specified category of futures commission merchants, or futures commission merchants generally.

(c) Definitions. (1) "Customer" means any person for whom the futures commission merchant effects or intends to effect transactions in futures, options on futures, or any other instruments subject to CFTC jurisdiction.

(2) "Regulated account" means a customer segregation account subject to the regulations of the CFTC; provided, however, that, where such regulations do not permit to be maintained in such an account or require to be maintained in a separate regulated account funds or securities in proprietary accounts or funds or securities used as margin for or excess funds related to futures contracts, options on futures or any other instruments subject to CFTC

jurisdiction that trade outside the United States, its territories, or possessions, the term "regulated account" means such separate regulated account or any other account subject to record-keeping regulations of the CFTC.

(3) "Unsolicited transaction" means a transaction that is not effected in a discretionary account or recommended to a customer by the futures commission merchant, an associated person of a futures commission merchant, a business affiliate that is controlled by, controlling, or under common control with the futures commission merchant, or an introducing broker that is guaranteed by the futures commission merchant.

(4) "Futures" and "futures contracts" mean contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market designated by the CFTC or traded on or subject to the rules of any board of trade located outside the United States, its territories, or possessions.

(5) "Options on futures" means puts or calls on a futures contract traded on or subject to the rules of a contract market designated by the CFTC or traded or subject to the rules of any board of trade located outside the United States, its territories, or possessions.

§ 240.3a44-1 Proprietary government securities transactions incidental to the futures-related business of a CFTC-regulated person.

(a) A person registered with the Commodity Futures Trading Commission ("CFTC"), a contract market designated by the CFTC, such a contract market's affiliated clearing organization, or any floor trader or such a contract market (hereinafter referred to collectively as a "CFTC-regulated person") is not a government securities dealer solely because such person effects transactions for its own account in government securities that are defined in paragraph (b) of this section as incidental to such person's futures-related business.

(b) Provided that a CFTC-regulated person does not advertise or otherwise hold itself out as a government securities dealer except as permitted under rule 3a43-1 (§ 240.3a43-1) the following transactions in government securities for its own account are incidental to the futures-related business of such a CFTC-regulated person:

(1) Transactions to effect delivery of a government security pursuant to a futures contract;

(2) Exchange of futures for physicals transactions with (i) a government securities broker or government securities dealer that has registered with the Commission or filed notice pursuant to section 15C(a) of the Act or (ii) a CFTC-regulated person;

(3) Transactions (including repurchase agreements and reverse repurchase agreements) involving segregated customer funds and securities or funds and securities held by a clearing organization with (i) a government securities broker or government securities dealer that has registered with the Commission of filed notice pursuant to section 15C(a) of the Act or (ii) a bank;

(4) Transactions for risk reduction or arbitrage of existing or contemporaneously created positions in futures or options on futures with (i) a government securities broker or government securities dealer that has registered with the Commission or filed notice pursuant to section 15C(a) of the Act or (ii) a CFTC-regulated person;

(5) Repurchase and reverse repurchase agreement transactions between a futures commission merchant acting in a proprietary capacity and another CFTC-regulated person acting in a proprietary capacity and contemporaneous offsetting transactions between such a futures commission merchant and (i) a government securities broker or government securities dealer that has registered with the Commission or filed notice pursuant to section 15C(a) of the Act, (ii) a bank, or (iii) a CFTC-regulated person acting in a proprietary capacity; and

(6) Any transaction or transactions that the Commission exempts, either unconditionally or on specified terms and conditions, as incidental to the futures related business of a specified CFTC-regulated person, a specified category of CFTC-regulated persons, or CFTC-regulated persons generally.

(c) Definitions. (1) "Segregated customer funds" means funds subject to CFTC segregation requirements.

(2) "Futures" and "futures contracts" means contracts of sale of a commodity for future delivery traded on or subject to the rules of a contract market designated by the CFTC or traded on or subject to the rules of any board of trade located outside the United States, its territories, or possessions.

(3) "Options on futures" means puts or calls on a futures contract traded on or subject to the rules of a contract market designated by the CFTC or traded on or subject to the rules of any board of trade located outside the United States, its territories, or possessions.

By the Commission.

Shirley E. Hollis,

Assistant Secretary.

July 22, 1987.

[FR Doc. 87-16917 Filed 7-23-87; 8:45 am]

BILLING CODE 8010-01-M