product recalls and product hazards. It also oversees operation of the Commission's Internet and fax-on-demand services.

10. Newly redesignated section 1000.29 is revised to read as follows:

§ 1000.29 Directorate for Engineering Sciences.

The Directorate for Engineering Sciences, which is managed by the Associate Executive Director for Engineering Sciences, is responsible for developing technical policy for and implementing the Commission's engineering programs. The Directorate manages hazard assessment and reduction projects as assigned by the Office of Hazard Identification and Reduction; develops and evaluates performance criteria, design specifications, and quality control standards for certain consumer products; provides scientific and technical expertise to the Commission and Commission staff; provides advice on proposed mandatory standards and industry voluntary standard efforts; performs or monitors research in the engineering sciences; and provides analytical services in support of the Commission's enforcement activities. It provides reliability engineering and quality control analysis in support of standards development, product certification, and compliance product testing; and provides engineering technical support to all Commission organizations, activities, and programs. The Directorate analyzes accident data, develops accident scenarios, and recommends solutions.

11. Newly redesignated section 1000.30 is revised to read as follows.

§ 1000.30 Directorate for Health Sciences

The Directorate for Health Sciences, which is managed by the Associate Executive Director for Health Sciences, is responsible for developing science policy and implementing the Commission's Health Sciences program. The Directorate's functional responsibilities include development and evaluation of the content of product safety standards and test methods based on the chemical, biological and medical sciences. The Directorate also provides health sciences and medical expertise to the Commission, and develops and evaluates performance criteria, design specifications, and quality control standards for certain consumer products. It provides advice on proposed standards. It collects health sciences, exposure, and medical data, reviews and evaluates toxicological, medical, and chemical hazards, and determines exposure, uptake and metabolism, including information on population segments at risk. It performs risk assessments for chemical hazards, and physical hazards based on methods such as medical injury modeling, in consumer products. It provides the Commission's primary source of technical expertise for implementation of the Poison Prevention Packaging Act. It provides the expertise on how chemical products are manufactured and provides scientific support to the Commission's regulatory development and enforcement activities. It provides health sciences and medical support to all Commission organizations, activities, and programs. It manages hazard assessment and reduction projects as assigned. The Directorate provides scientific liaison with the National Toxicological Program, the Department of Health and Human Services, the Occupational Health and Safety Administration, the Environmental Protection Agency, other federal agencies and programs, and other organizations concerned with reducing the risks to consumers from exposure to chemical hazards.

12. Section 1000.31 is added to read as follows:

§ 1000.31 Directorate for Laboratory Sciences.

The Directorate for Laboratory Sciences, which is managed by the Associate Executive Director for Laboratory Sciences, is responsible for implementing the Commission's engineering and health sciences laboratories programs. The Directorate's functional responsibilities include development and evaluation of product safety standards, and product safety tests and test methods, based on engineering and other physical sciences, chemical, and biological sciences to support general agency regulatory activities. The Directorate develops and evaluates performance criteria, design specifications and quality control standards for certain consumer products. It provides engineering, scientific, and technical expertise to the Commission, conducts engineering tests and studies of the safety of consumer products, evaluates industry voluntary standards efforts, and participates in the development of product safety standards. It performs and monitors research and conducts studies of the safety of, or improving the safety of, consumer products in engineering, other physical sciences, chemical, and biological sciences. The Directorate is composed of two divisions, the Engineering Laboratory Division and the Health Sciences Laboratory Division. The Directorate provides engineering and scientific services in support of the Commission's enforcement activities. It coordinates engineering research, testing, and evaluation activities with the National Institute of Standards and Technology and other federal agencies, private industry, and consumer interest groups. It provides the Commission's expertise and laboratory support to other laboratories and other chemical and biological testing facilities. It provides chemical and biological laboratory support to all Commission organizations, activities, and programs. The Directorate provides technical supervision and direction of engineering activities including tests and analyses conducted in the field.

13. Newly redesignated section 1000.32 is revised to read as follows:

§ 1000.32 Directorate for Administration.

The Directorate of Administration, which is managed by the Associate Executive Director for Administration, is responsible for formulating general administrative policies supporting the Commission in the areas of financial management, procurement, and general administrative support services including property and space management, physical security, printing, telecommunications, and warehousing. The Directorate is responsible for the payment, accounting, and reporting of all expenditures within the Commission and for operating and maintaining the Commission's accounting system and subsidiary Management Information System which allocates staff work time and costs to programs and projects.

Sadye E. Dunn,

Secretary, Consumer Product Safety Commission.

[FR Doc. 94-31806 Filed 12-27-94;8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

Risk Assessment for Holding Company Systems

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rules.

SUMMARY: On March 1, 1994, the Commodity Futures Trading Commission ("CFTC" or "Commission") published for comment proposed rules to implement the risk assessment authority set forth in Section 4f(c) of the Commodity Exchange Act

(the "Proposal").[1] The comment period on the proposal was scheduled to expire on May 2, 1994. However, the Commission twice extended the comment period to ensure that interested parties had an adequate opportunity to submit comments. Initially, the Commission extended the comment period on the entire set of rule proposals to July 1, 1994. The comment period on the proposed provisions regarding the maintenance and filing by futures commission merchants ("FCMs") of an organizational chart delineating major affiliated persons, risk management policies, procedures and systems, consolidated and consolidating financial statements, and information concerning the occurrence of certain "trigger" events, expired at that time. Subsequently, the Commission extended the comment period on the proposed provisions regarding reporting of certain data concerning affiliate positions and noncustomer accounts carried by the FCM to September 1, 1994. As discussed herein, the Commission has adopted final rules with respect to maintenance and filing of organizational charts, risk management policies, procedures and systems, consolidated and consolidating financial statements and trigger events relating to events occurring at the FCM. Final action on the balance of the Proposal has been deferred following further review and consultation with other regulators.

EFFECTIVE DATE: December 31, 1994.

FOR FURTHER INFORMATION CONTACT: Susan C. Ervin, Deputy Director/Chief Counsel, Lawrence B. Patent, Associate Chief Counsel, or Lawrence T. Eckert, Attorney Adviser, Division of Trading and Markets, Commodity Futures Trading Commission, 2033 K Street N.W., Washington D.C. 20581. Telephone (202) 254–8955.

SUPPLEMENTARY INFORMATION

I. Background

Following the failures of certain FCMs operating within holding company structures, the Commission requested and received new statutory authority, enacted as part of the Futures Trading Practices Act of 1992 ("FTPA"),[2] to obtain information concerning activities of FCM affiliates that could pose material risks to the FCM. New Section 4f(c)[3] of the Commodity Exchange Act ("CEA" or "Act") authorizes the Commission to require each registered FCM to obtain, inter alia, "such information and make and keep such records as the Commission, by rule or regulation, prescribes concerning the registered futures commission merchant's policies, procedures or systems for monitoring and controlling financial and operational risks to it resulting from the activities of any of its affiliated persons, other than a natural person."[4] Section 4f(c) provides that the required records should "describe, in the aggregate, each of the futures and other financial activities conducted by, and the customary sources of capital and funding of, those of its affiliated persons whose business activities are reasonably likely to have a material impact on the financial or operational condition of the futures commission merchant, including its adjusted net capital, its liquidity, or its ability to conduct or finance its operations."[5] The statute further grants the Commission the authority to require, by rule or regulation, summary reports of such information to be filed no more frequently than quarterly and supplemental reports if, as a result of adverse market conditions, based on reports provided pursuant to this section, or other available information, the Commission "reasonably concludes" that it has concerns regarding the financial or operational condition of any registered FCM.[6]

The Commission's statutory risk assessment authority is similar to that granted to the Securities and Exchange Commission ("SEC") in Section 4 of the Market Reform Act of 1990.[7] Pursuant to its risk assessment authority, the SEC adopted on July 21, 1992 "final temporary" rules[8] which generally require securities broker-dealers to maintain and preserve records and file quarterly reports containing information concerning the financial and securities activities of the broker-dealers' material affiliates.[9] The SEC adopted "final temporary" rules as an interim step in the adoption of final regulations to enable the agency to gain familiarity with information filed pursuant to the risk assessment rules and to evaluate the operation of the risk assessment program.[10] In formulating the proposed rules, the CFTC gave extensive consideration to the risk assessment rules adopted by the SEC and consulted extensively with the SEC and other federal financial regulators in an effort to develop, to the extent possible, a coordinated approach to implementation of its risk assessment authority.[11]

On March 1, 1994, the Commission published for comment proposed rules to implement its statutory risk assessment authority. The proposed rules generally would have required the maintenance and reporting of information concerning the activities of affiliates of registered FCMs whose activities are reasonably likely to have a material impact on the financial or operational condition of the FCM. Proposed Rule 1.14(a)(2) defined such affiliates as "Material Affiliated Persons" ("MAPs") of the FCM and set forth criteria to be considered by FCMs in determining which of their affiliates would constitute MAPs for purposes of the risk assessment requirements.[12]

The Proposal included two rules, a rule requiring that certain records be maintained (proposed Rule 1.14) and a rule requiring reporting of certain information to the Commission (proposed Rule 1.15), as well as a proposed form, proposed Form 1.15A, on which an FCM would report the majority of the information required to be reported under the reporting rule. Proposed Rule 1.14 would have required FCMs to maintain and preserve certain records and information concerning, among other things, the organizational structure of which the FCM is a part, the FCM's policies and systems for monitoring and controlling risks arising from the activities of its

[1] 59 FR 9689.

[2] Pub. L. No. 102–546, 106 Stat. 3590 (1992). The FTPA was enacted on October 28, 1992.

[3] 7 U.S.C. 6f(c)(Supp. IV 1992). For a more detailed discussion regarding the background and purpose of the Commission's statutory risk assessment authority, see 59 FR 9689–92 (March 1, 1994).

[4] 7 U.S.C. 6f(c)(2)(A)(Supp. IV 1992).

[5] 7 U.S.C. 6f(c)(2)(B)(Supp. IV 1992).

[6] 7 U.S.C. 6f(c)(3)(A) and 6f(c)(3)(B)(Supp. IV 1992).

[7] Pub. L. No. 101–432, 104 Stat. 963 (1990).

[8] *See* 57 FR 32159, 32161 (July 21, 1992).

[9] 57 FR 32159.

[10] The SEC plans to review the operation of its risk assessment regulations early next year, after the rules have been in effect for over two years. *See* 57 FR 32159 at 32161.

[11] *See* Letter from Andrea M. Corcoran, Director, Division of Trading and Markets, CFTC, to Brandon Becker, Director, Division of Market Regulation, SEC (October 11, 1994); Letter from the Honorable Barbara Pedersen Holum, Acting Chairman, CFTC, to the Honorable Arthur Levitt, Chairman, SEC (October 11, 1994); Letter from the Honorable Barbara Pedersen Holum, Acting Chairman, CFTC, to the Honorable Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System (October 11, 1994); Letter from the Honorable Arthur Levitt, Chairman, SEC, to the Honorable Mary L. Schapiro, Chairman, CFTC (October 31, 1994); Letter from Brandon Becker, Director, Division of Market Regulation, SEC, to Andrea M. Corcoran, Director, Division of Trading and Markets, CFTC (December 13, 1994).

[12] The "material affiliated person" definition used in the Commission's Proposal is similar to that used in the SEC's risk assessment rules. However, for purposes of the Proposal and these rules, the Commission has used the term "affiliated person" rather than "associated person", as used in the SEC's rules, to avoid confusion with the associated person registration category described in Section 4k of the Act and Commission Rule 3.12.

affiliates, consolidated and consolidating financial statements for the FCM and its ultimate parent company, and aggregate information concerning futures, forwards and financial instruments with off-balance sheet risk and concentrations of credit risk. Proposed Rule 1.15 would have required FCMs to file with the Commission, generally on an annual basis, the information required to be maintained under proposed Rule 1.14 and to provide the Commission with notice of the occurrence of specified events, such as large decreases in the reported adjusted net capital of the FCM or the equity of its parent company.

The Proposal would have applied generally to FCMs that hold customer funds of $6,250,000 or greater, maintain adjusted net capital in excess of $5,000,000 or are clearing members of a contract market. However, the proposed rules included exemptive provisions for FCMs dually registered with the SEC as broker-dealers or operating within a holding company group that includes a broker-dealer filing reports pursuant to the SEC's risk assessment rules. Further, the proposed rules would have permitted FCMs that have affiliates subject to regulation by a federal banking agency, a state insurance commission or similar state agency, or a foreign futures authority or other relevant foreign regulatory authority with which the Commission has an information-sharing agreement to comply with certain reporting and recordkeeping requirements by filing or maintaining records that the regulated affiliate is required to file with the relevant regulator.

The Commission received twenty-three comment letters on the provisions of the Proposal relating to maintenance and filing of organizational charts, risk management policies, consolidated and consolidating financial statements, and "trigger event" reporting, for which, following extension of the comment period, comments were due by July 1, 1994.[13] The majority of the commenters either supported, or noted their understanding of, the objectives of the proposed rules. Several commenters, however, criticized the scope of the proposed rules, and a number of commenters urged the Commission to reconcile any differences between the SEC's risk assessment rules and the Commission's proposed rules. Generally, commenters requested additional time to update (if necessary) one-time filings required under the proposed rules (*i.e.*, the organizational chart and risk management policies, procedures and systems) and to file notice with the Commission upon the occurrence of the trigger events specified in the Proposal. A number of commenters requested that the Commission focus its trigger event reporting system on conditions occurring at the FCM rather than at an affiliate or parent of the FCM. Certain commenters requested that general exemptive authority be retained to permit the Commission to address on a case-by-case basis special problems of compliance for some firms in, for example, preparing consolidating financial reports or obtaining access to information concerning foreign affiliates. Comments addressed to specific provisions of the proposed rules and the Commission's resolution of the issues raised by such comments are discussed below in the context of the relevant provisions of the final rules.

Based upon its review of the comments received concerning the Proposal, consultation with other federal regulators and further consideration, the Commission has determined to bifurcate the rulemaking and to defer, pending further review and consultation with other regulators, action on the proposed provisions requiring reporting of information relating to FCMs' noncustomer accounts, financial position and other information relating to FCMs' material affiliates proposed to be required on Form 1.15A, and notice of the occurrence of certain trigger events at material affiliates. The Commission expects to continue to consult with the SEC and other regulators in the interest of maximizing harmonization, minimizing duplication and developing consensus on the information most useful to furthering effective entity-based supervision, consistent with past and continuing efforts to harmonize rules and interpretations concerning financial requirements. In particular, the Commission has indicated that it intends to work with the other financial regulators in connection with any determination on the position reporting section of the Proposal in the interest of developing common data elements to make filings more efficient and compatible.[14]

II. Summary of Rules 1.14 and 1.15

The Commission believes that Rules 1.14 and 1.15, as adopted, are responsive to the concerns of commenters, while also meeting the regulatory objectives of the risk assessment authority conferred by the Act. As adopted, and subject to the terms and conditions stated therein, Rules 1.14 and 1.15 establish two basic types of risk assessment requirements: (1) recordkeeping; and (2) reporting to the Commission of certain information on a routine basis. In addition, the Commission has amended its financial early warning rule, Rule 1.12, to require reporting to the Commission upon the occurrence of certain events at the reporting FCM that warrant further review.

Rule 1.14 will require that FCMs maintain certain records. These records include: (1) an organizational chart depicting the various entities with which the FCM is affiliated and identifying the FCM's MAPs; (2) the FCM's policies, procedures and systems to manage the risks to the FCM's financial condition or operations arising from the activities of its affiliates; and (3) consolidated and consolidating financial statements. Rule 1.15 will require reporting to the Commission of the information required to be maintained by the FCM, either on a one-time basis (absent significant changes in the reported information), with respect to the FCM's organizational chart and risk management policies, or annually with respect to consolidated and consolidating financial statements. With respect to the proposed provision requiring "trigger event" reporting of a reduction of greater than 20 percent in an FCM's adjusted net capital, the Commission has determined to include this notice requirement in its existing financial early warning system, which is set forth in Rule 1.12. Upon receipt of such a notice, the Commission may seek additional information, as warranted in the circumstances, from another regulator and/or from the FCM. By separate **Federal Register** release, the Commission is proposing to make this early warning notice requirement applicable to all FCMs. The Commission also is proposing two additional early warning notice provisions, which would require notice to the Commission in the event that: (1) a margin call that exceeds an FCM's excess adjusted net capital remains unanswered by the close of business on the day following the issuance of the call; and (2) an FCM's excess adjusted net capital falls below six percent of the maintenance margin required to be held or posted for all non-

[13] The commenters included thirteen FCMs, four self-regulatory organizations ("SROs"), three trade associations, one government agency, one bar association and one law firm representing Commission registrants. The Commission received thirteen comment letters on the balance of the proposal, on which comments were due by September 1, 1994.

[14] See correspondence cited in note 11, *supra*.

customer and proprietary positions carried by the FCM. With respect to an FCM's proprietary account positions, maintenance margin shall mean the amount of funds the FCM is required to maintain at the exchange's clearing organization or with its clearing broker, or five percent of the value of the contract, whichever is greater.

The rules being adopted will apply generally to FCMs that hold customer funds of $6,250,000 or greater, maintain adjusted net capital in excess of $5,000,000 or are clearing members of a contract market. The rules, however, include special exemptive provisions for FCMs that are dually registered with the SEC as securities broker-dealers (including government securities broker-dealers) or that are part of a holding company group that includes a securities broker-dealer filing reports pursuant to the SEC's risk assessment rules. Further, the rules allow FCMs that have affiliates subject to regulation by a federal banking agency, a state insurance commission or similar state agency to comply with certain reporting and recordkeeping requirements by filing records that the regulated affiliate is required to file with the relevant regulator. Similarly, in the case of affiliates subject to regulation by a foreign futures authority or other relevant foreign regulatory authority, the Commission will accept the maintenance or filing of records required by such authority if either there is an information-sharing agreement in effect which permits the Commission to obtain the type of information required under these rules or the FCM agrees to use its best efforts to obtain from the foreign firm and to cause the foreign firm to provide, directly or through its foreign regulator, any supplemental financial information the Commission may request and no blocking statute or other restriction precludes the communication of such information to the Commission.

The following discussion focuses principally on changes in or clarifications of the proposed rules made in the final rules. Additional background information relevant to these final rules may be found in the **Federal Register** release accompanying the Commission's Proposal.

III. Discussion

A. Definition of Material Affiliated Person

Section 4f(c) provides that FCMs shall maintain and report information as prescribed by the Commission concerning their affiliated persons [15] "whose business activities are reasonably likely to have a material impact on the financial or operational condition of the [FCM]." [16] For the purpose of determining which of an FCM's affiliated persons are engaged in business activities that are reasonably likely to have a material impact on the financial or operational condition of the FCM, proposed Rule 1.14(a)(2) defined the term "material affiliated person." Proposed Rule 1.14(a)(2) stated that the determination as to whether an affiliate is a MAP "shall involve consideration of all aspects of the activities of, and the relationship between," the FCM and the affiliate, including, without limitation, several illustrative factors relevant to the activities of, and the relationship between, the FCM and its affiliate.[17] In the **Federal Register** release accompanying the proposed rules, the Commission stated that the factors specified in the proposed rule were intended to provide guidance and not to be exhaustive.[18] Proposed Rule 1.14(a)(2) included the following list of factors which an FCM should consider in determining whether an affiliated person is a MAP: (1) the legal relationship between the FCM and the affiliated person, *i.e.*, the nature and proximity of the relationship between the FCM and the affiliated person; (2) the degree of financial dependence of the FCM on its affiliate and the nature of the FCM's financing requirements; (3) the degree to which the FCM or its customers rely upon an affiliated person for operational services or support; (4) the level of market, credit and other risk present in an affiliated entity's activities; and (5) the extent to which an affiliated person has the authority or ability to negatively impact the FCM's capital. As noted in the Proposal, the Commission's statutory risk assessment provisions generally apply to affiliates other than natural persons.[19]

Commenters who addressed the provisions of Rule 1.14(a)(2) concerning determinations as to whether an affiliated person is a MAP generally did not object to the five factors set forth in the proposed rule but sought clarification or modification of certain aspects of this provision. As a threshold matter, two commenters suggested that, although the statutory risk assessment provisions refer to affiliated persons other than natural persons, the Commission should clarify that FCMs would not be required to obtain information concerning their natural person affiliates by explicitly excluding natural persons from the MAP definition. The Commission agrees that such an exclusion is appropriate for the sake of clarity and has revised the MAP definition as suggested. The remaining comments concerning the MAP definition generally fell within one of three categories: (1) requests for clarification as to the degree of an FCM's liability for good faith errors in failing to classify an affiliate as a MAP; (2) requests that the Commission conform its MAP definition to the "material associated person" definition adopted by the SEC; and (3) requests for clarification as to the standards to be used in determining whether an affiliate is a MAP.

The issue that appeared to be of greatest concern to commenters on the MAP definition related to the Commission's position that an FCM should be responsible, in the first instance, for determining whether an affiliate is a MAP. Several commenters urged the Commission to make clear that an FCM who makes a good faith determination that an affiliate is not a MAP would not be subject to enforcement action for violation of Rule 1.14 in the event that the Commission subsequently concluded that such a determination was erroneous. The Commission believes that determinations by an FCM as to an affiliate's status made in good faith and in the exercise of reasonable diligence based upon consideration of the factors set forth in the rule, together with all other relevant facts and circumstances, would not, standing alone, be made the basis of an enforcement proceeding against the FCM.[20] The Commission

[15] Section 4f(c) (1)(i) defines "affiliated person" as "any person directly or indirectly controlling, controlled by, or under common control with a futures commission merchant, as the Commission, by rule or regulation, may determine will effectuate the purposes of this subsection."

[16] *See* Section 4f(c)(2)(B) of the Act, 7 U.S.C. 6f(c)(2)(B) (Supp. IV 1992).

[17] 59 FR at 9693.

[18] *Id.*

[19] 7 U.S.C. 6f(c) (2)(A) and (3)(A) (Supp. IV 1992); *see* 59 FR at 9693 n. 26. In this connection, the Commission staff expects to take the position that certain sole shareholder Subchapter "S" corporations will be treated as natural persons but that partnerships will not, consistent with guidance issued by the SEC. Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC to Douglas G. Preston, Esq., Securities Industry Association at 3 (September 20, 1993).

[20] A pattern of noncompliance, however, may be inconsistent with claims of reasonable diligence and provide a basis for further review and action by the Commission. On a related point, one commenter requested that the Commission apply a "best efforts and good faith" standard with respect to a United States FCM attempting to obtain information concerning its foreign MAPs. This commenter contended that an FCM located in the United States would likely have difficulty

Continued

stresses, however, that FCMs who are uncertain as to whether an affiliate is a MAP may seek informal guidance from Commission staff in particular cases and that, in light of the statutory objective of enhancing access to information about potential risks, the FCM should give careful consideration to the potential for its affiliates to pose material risks to the FCM in various contingencies, thereby warranting their characterization as MAPs.

Other commenters on the MAP definition requested that the Commission conform its MAP definition with the SEC's definition of "material associated person." With only minor exceptions, the MAP definition set forth in the Commission's Proposal is the same as that adopted by the SEC in its risk assessment regulations. With respect to the first factor to be considered in determining which affiliates are MAPs, *i.e.*, the legal relationship between the FCM and the affiliate, the Commission noted that in the context of multi-tiered holding company structures, if the ultimate parent is engaged in activities unrelated to the futures or financial markets, the parent generally would not be required to be designated as a MAP. In the **Federal Register** release accompanying its temporary risk assessment rules, the SEC made a similar statement, noting that "absent unusual circumstances," an ultimate parent not engaged in securities-related activities would not be required to be designated a MAP. Several commenters requested that the Commission confirm that it agrees with the SEC's apparently broader language on this point. One commenter also requested that the Commission confirm that, although a parent company's maintenance of a futures account at a subsidiary FCM may be a fact or circumstance to be considered in determining whether an affiliate is a MAP, the existence of such an account does not automatically make the ultimate parent a MAP, absent a conclusion that the account creates a relationship that may significantly affect the finances or operations of the FCM.

As noted in the **Federal Register** release accompanying the Proposal, the Commission believes that if the ultimate parent in a multi-tiered holding company structure primarily is engaged in activities that are not related to the futures or financial markets, such as manufacturing or retailing, the parent generally would not be required to be designated a MAP.[21] However, an FCM in a holding company group may have substantial exposure to its parent by reason of carrying or clearing the parent's futures account and thus the parent company would be a MAP even though its line of business does not directly involve the futures or financial markets. In a typical scenario, an ultimate parent company engaged in non-financial activities might maintain a futures account at an FCM in the holding company group in order to establish futures positions to manage the risk of cash commodity positions. This relationship, although it may involve a relatively small portion of the assets of the parent, may comprise a substantial portion of the positions carried by the FCM and thus could expose the FCM to potential risks of withdrawal or modification of the parent's business with the FCM or of default on the positions carried. However, if the only relationship between the FCM and the ultimate parent is that the FCM carries the ultimate parent's futures account and that account is not material in the overall context of the FCM's operations, the ultimate parent would not become a MAP solely on the basis of its futures account at the reporting FCM. Thus, the FCM should carefully evaluate the potential risks to which it is exposed as a result of the futures accounts which it carries or clears on behalf of a parent entity in making its determination as to whether its parent is a MAP.[22] Further, as the Commission noted in the release accompanying the proposed rules, if obligations of the FCM are guaranteed by a parent or other affiliate, the FCM is financially dependent upon the guarantor to an extent that, absent unusual circumstances, would require designation of the guarantor entity as a MAP.[23]

Finally, several commenters requested that the Commission confirm that FCMs may employ a materiality standard in applying the factors enumerated for consideration in determining whether an affiliate is a MAP. As noted above, the threshold question with respect to whether an FCM should identify an affiliate as a MAP is whether the affiliate's activities are material in respect of their reasonably anticipatable impact on the FCM. However, materiality should not be determined on a factor-by-factor basis but, rather, in the aggregate, based upon the potential impact of all of the itemized factors taken together and the overall relationship between the FCM and its affiliate. Thus, an affiliate's activities may not appear likely to have a material impact on the FCM's financial or operational condition if each factor set forth in the rule is analyzed in isolation, but may nonetheless be required to be designated as a MAP when all relevant factors are cumulated.

The Commission has determined to adopt the MAP definition as proposed, with an additional provision expressly excluding natural person affiliates.[24]

B. Information Required to be Maintained and Filed on a Routine Basis

The final rules generally require two forms of risk assessment activity by FCMs: recordkeeping and reporting. FCMs subject to the rules are required to maintain specified types of information and to file this information either on a one-time basis, absent a material change in reported data, or annually. The categories of information called for are discussed below, with specific reference to the relevant recordkeeping and reporting requirements of the final rules.

1. Organizational Chart

Proposed Rule 1.14 required that an FCM maintain an organizational chart depicting the holding company structure of which the FCM is a part. As proposed, the organizational chart was required to identify those affiliated persons that are MAPs of the FCM, determined in accordance with the standards discussed above, and to indicate which MAPs file routine financial or risk exposure reports with the SEC, a federal banking agency, an insurance commissioner or other similar official or agency of a state or a foreign regulatory authority. The Commission

ascertaining and verifying from its foreign MAPs the information necessary to determine whether a trigger event has occurred because foreign companies engaging in trading and business activities in global markets regard such information as highly confidential, even with respect to their United States affiliates. Although the Commission has deferred action on the proposed trigger events relating to MAPs, the Commission believes that generally an FCM would be required to exercise reasonable diligence in obtaining information concerning its foreign MAPs or causing such MAPs to provide information to the Commission.

[21] 59 FR at 9694.

[22] For the purpose of determining whether the account is of material size, the appropriate benchmark is the size (capital) of the FCM rather than that of the parent or other affiliate. Moreover, as account sizes may change significantly over time, the FCM should periodically evaluate the need to treat such affiliates as MAPs.

[23] *See* 59 FR at 9694. Some futures exchanges require guarantees of member FCMs' proprietary and noncustomer obligations by the FCM's parent. *See* Chicago Mercantile Exchange Rules 901G and 901L; Parent Guarantee Policy Statement adopted in July 1986 under Board of Trade Clearing Corporation Bylaw 401; Commodity Clearing Corporation Rule 9; Comex Clearing Association Rule 20; and New York Mercantile Exchange Rule 9.20.

[24] Rule 1.14(a)(3).

also proposed to require that the chart indicate whether a MAP is a dealer or end-user (or both) of financial instruments with off-balance sheet risk.

Several commenters opposed, or questioned the regulatory necessity of, a requirement that FCMs identify whether an affiliate is an end-user or dealer of financial instruments with off-balance sheet risk. Two commenters also expressed concern that the definition of a dealer as set forth in the Proposal, *i.e.*, an entity prepared to make two-way markets in financial instruments,[25] is overly broad and recommended that a quantitative test be added to the dealer definition to assure that a MAP engages in a minimum number of transactions before being required to be identified as a dealer. Similarly, one commenter suggested that the terms "end-user" and "dealer" were ambiguous and requested that they be more precisely defined. The Commission did not propose a more specific definition for end-user or dealer because it recognizes that an organizational chart can provide only an outline of the organizational context in which an entity operates and highlight MAPs engaged in a broad category of transactions about which further information would be necessary in order to understand the specific nature of the entity's activities.

The Commission believes that it is appropriate, in the first instance, for the FCM to determine whether a particular MAP is a dealer or both a dealer and end-user but has eliminated the requirement to designate MAPs acting only as end-users. In cases in which the FCM is uncertain as to whether a MAP is an end-user or a dealer, it may resolve that uncertainty by using both categories since there is no penalty for such a characterization. The identification of a MAP as a dealer or as both a dealer and end-user under Rule 1.14(a)(1) is for the purpose of the risk assessment regulations only and would not establish or imply that the entity is a dealer or end-user in financial instruments for any other purpose. An affiliate that is only an end-user of financial instruments with off-balance sheet risk need not be separately identified as such.

One commenter remarked that the Commission should not require the inclusion of all affiliates on the organizational chart but, rather, should require only the inclusion of MAPs and other affiliates that are necessary to understand the FCM's corporate structure. This commenter stated that requiring all affiliates to be included in the chart would be too burdensome given the large number of affiliated companies in certain corporate structures and that many of these affiliated persons are likely to have little substance, to be inactive, or both. The Commission believes that an organizational chart containing all of an FCM's affiliates is essential to provide a comprehensive view of the corporate context in which the FCM operates.[26] Although some FCMs may have many affiliates, the Commission does not believe that FCMs would be unduly burdened by the requirement of a one-time filing (absent material changes) of a complete organizational chart. Consequently, with the modification discussed above with respect to designation of "end-user" MAPs, the Commission is adopting the provision relating to the content of the organizational chart as proposed.

Under the proposed rules, an FCM would be required to file its organizational chart within ninety calendar days after the effective date of the rule or within sixty calendar days of registration if that occurred after the rule's effective date. The proposed rules also required an updated organizational chart to be filed within five calendar days after the end of any fiscal quarter in which a material change in the information provided occurred. No comments were received with respect to the time periods for initial filing of the organizational chart. The Commission is adopting an implementation schedule under which currently registered FCMs will be required to make initial filings of their organizational charts and risk management policies by April 30, 1995. FCMs whose registration becomes effective after December 31, 1994 will be required to make such filings within 60 calendar days after the effective date of registration or by April 30, 1995, whichever comes later.

Several commenters objected to the five calendar day period for filing of updated charts reflecting material changes and recommended that the Commission modify this provision to require filing of the updated chart within sixty days after the end of the fiscal quarter in which the material change occurred in order to harmonize this timeframe with that of the SEC. In order to minimize the burdens on firms dually registered as FCMs and broker-dealers and to ease compliance burdens generally, the Commission has determined to modify these filing deadlines as suggested. Accordingly, the final rule requires that an FCM file an updated organizational chart within sixty days after the end of any fiscal quarter in which a material change in the information required to be provided has occurred. If no material change occurs, no updates are required.

2. Risk Management Policies.

Paragraph (a)(1)(ii) of proposed Rules 1.14 and 1.15, respectively, would require an FCM to maintain and file with the Commission records relating to the FCM's procedures for monitoring and controlling material financial and operational risks to it resulting from the activities of its affiliates. This provision was modeled upon the comparable provision of the SEC's risk assessment rules. However, the Commission's proposed provisions describing the types of policies, procedures and systems of which records are to be maintained and filed by the FCM, while incorporating the matters covered by the SEC's rules, also make specific reference to the FCM's internal controls with respect to the market risk, credit risk and other risks created by the FCM's proprietary and noncustomer clearing activities. This addition to the SEC's description of the written policies, procedures and systems to be maintained and filed reflects risks particular to a typical function of FCMs operating within a holding company structure.

A number of commenters requested clarification as to which entity's risk management policies, *i.e.*, the FCM's policies or those of its affiliates, would be required to be maintained by the FCM under the rule. These commenters stated generally that an FCM's risk management policies should focus on its own credit and market risk monitoring procedures as distinguished from whatever procedures an affiliate maintains. Two commenters stated that this provision of the proposed rules could be interpreted to require a report of a MAP's policies and procedures as they affect the FCM and a discussion by the FCM of the hedging and risk management strategies of its noncustomer affiliates. Three other commenters appeared concerned that the Proposal would place an affirmative duty on an FCM's affiliates to maintain, and to create if none exist, written policies for their trading activities.

As noted above and as discussed in the **Federal Register** release accompanying the proposed rules, proposed Rules 1.14(a)(1)(ii) and 1.15(a)(1)(ii) would require FCMs to maintain and file "*their* written policies,

[25] 59 FR at 9694.

[26] The SEC's risk assessment rules also require that the organizational chart indicate all affiliates. 17 CFR 240.17h-1T(a)(1)(i)(1994). However, the SEC staff indicate that they may give further guidance where the reporting firm is part of a U.S. holding company with a related offshore holding company.

procedures, or systems concerning methods for monitoring and controlling financial and operational risks *resulting from the activities of any of their affiliated persons* . . . ."[27] The proposed rules would not require an FCM to maintain or obtain an affiliate's risk management policies, nor would an FCM be required to discuss in its written policies and procedures the hedging and risk management strategies of its affiliates. FCMs would be required only to maintain and file information concerning their own risk management policies.

Further, the proposed rules would require an FCM to maintain and to file with the Commission, but not by virtue of these rules to create, risk management policies and procedures.[28] However, the Commission's rules, like those of the SEC with respect to broker-dealers, would require that if an FCM operates under informal or oral policies or procedures, it must summarize those policies in written form and file them with the Commission.[29] For purposes of the risk assessment requirements, it is sufficient for an FCM to document, in writing, the policies in place or the absence of such policies in the unlikely event that it operates without them. This application of the rule is consistent with the SEC's approach to its risk assessment rules.[30] Two commenters expressed the view that the Commission's risk assessment rules should affirmatively require FCMs to develop and maintain written financial, operational and risk management policies. These commenters believed that regulations that would require FCMs to maintain and file but not necessarily to create risk management policies and procedures would not effectuate the objectives underlying the statutory grant of risk assessment authority.

The Commission believes that under the existing regulatory structure, FCMs are affirmatively required to maintain certain risk management procedures. For example, under Rule 166.3 and other Commission rules, FCMs are required to maintain appropriate internal controls over their operations and to diligently supervise the handling of accounts and all other activities relating to their business as a Commission registrant.[31] The Commission believes that in the interest of prudent risk management, FCMs subject to these rules should review their existing internal controls and risk management policies, procedures and systems to assure that they are sufficient in light of the potential risks created by their own and their affiliates' activities. The Commission believes that requiring FCMs to establish risk management policies was not a principal objective of the risk assessment program contemplated by Section 4f(c). However, additional guidance as to prudent risk management and internal controls may be provided outside of this rulemaking.[32]

Paragraph (a)(1)(ii) of proposed Rule 1.15 would have required an FCM to file its risk management policies within ninety calendar days after the effective date of the rule or within sixty calendar days of registration if that occurs after the rule's effective date. Proposed Rule 1.15(a)(1)(ii) further required an FCM to file an update within five calendar days after the end of any fiscal quarter in which a material change in the information provided occurred.

One self-regulatory organization commenter opposed the proposed rule's filing requirement with respect to risk management policies and procedures, stating that such a requirement would create voluminous paper filings without providing any benefit to the Commission. As an alternative, the commenter suggested that the Commission require the FCM to file such policies on an as-needed basis. Several commenters opposed the requirement that updates to the policies and procedures filed with the Commission be provided within five calendar days after the end of the fiscal quarter in which a material change occurred. These commenters stated, among other things, that such a timeframe is unrealistic for FCMs with a large number of MAPs and stressed that the SEC's risk assessment regulations allow broker-dealers to report material changes in risk management policies and procedures within sixty days after the end of the fiscal quarter in which the change occurred. Further, two commenters requested additional guidance as to what the Commission would consider to be a material change in risk management policies that would require the filing of updated information.

The Commission believes that the filing of information relating to the FCM's risk management policies and procedures, particularly in conjunction with the organizational chart required to be filed under these rules, provides basic foundational information concerning the context in which an FCM operates. This requirement should not impose any significant burden upon FCMs because it does not call for the creation of any new procedures or reports. Moreover, risk management information is required to be filed only on a one-time basis as part of the FCM's initial filing with the Commission, absent subsequent material changes. With respect to determining what changes are material for purposes of the rule, the Commission believes that the assessment of the materiality of a modification must necessarily be made by the FCM on a case-by-case basis, upon consideration of whether a given change is likely to materially affect the FCM's ability to achieve the particular risk management goal of the relevant policy, procedure or system. Uncertainty as to whether a change is material can be resolved in favor of filing without undue burden or expense.

However, for the reasons discussed above with respect to filing requirements for the FCM's organizational chart, the Commission has determined to modify proposed Rule 1.15(a)(1)(ii) with respect to the deadline for filing updated risk management policies and procedures. The Commission has determined to adopt a requirement that an FCM file revised risk management information within sixty days after the end of any fiscal quarter in which a material change of information has occurred. As is the case with respect to the rules pertaining to the filing of an organizational chart, if no material change occurs, no updates are required.

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[27] 59 FR at 9694 (emphasis added).

[28] However, as noted below and in the Proposal, other provisions of the CEA and Commission regulations may require such policies.

[29] Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC to Douglas G. Preston, Esq., Securities Industry Association at 4 (September 20, 1993).

[30] *See* 57 FR at 32165 (wherein the SEC notes that broker-dealers need not create risk management policies for purposes of the SEC risk assessment requirements if none exist).

[31] *See, e.g.*, 17 CFR 166.3 (1994)("[e]ach Commission registrant . . . must diligently supervise the handling by its partners, officers, employees and agents . . . of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees or agents . . . relating to its business as a Commission registrant.") Other risk management requirements imposed on FCMs by the Act or Commission regulations include daily marking-to-market of positions, periodic reconciliations of key accounts, and maintenance of current books and records. *See generally* 17 CFR 1.17, 1.18, 1.32 and 1.34 (1994).

[32] Guidance in this area has been provided by the international regulatory community in "Operational and Financial Risk Management Control Mechanisms for Over-the-Counter Derivatives Activities of Regulated Securities Firms," issued by the Technical Committee of the International Organization of Securities Commissions (IOSCO) (July, 1994), which includes a compilation of other relevant sources including, *e.g.*, "Risk Management Guidelines for Derivatives," Basle Committee on Bank Supervision (July, 1994).

3. Financial Statements

Proposed Rules 1.14(a)(1)(iii) and 1.15(a)(2)(i) and (ii) would have required maintenance and filing of the following financial statements on a consolidated basis for the FCM and its ultimate parent company: (1) balance sheet; (2) statement of income; (3) statement of cash flows; and (4) explanatory notes to the financial statements. These proposed provisions also would have required a consolidating balance sheet and statement of income for the FCM and its ultimate parent company. Several commenters, including a trade association commenting on behalf of its member FCMs, pointed out that the highest level MAP within an organization may not necessarily be the ultimate parent company. Accordingly, these commenters recommended that the Commission revise the proposed rules such that financial statements would be required only for the FCM and the highest level MAP within the FCM's organizational structure. Further, a number of commenters requested that this provision be revised so as not to require consolidation on an individual MAP-by-MAP basis. These commenters noted that many firms do not currently consolidate in this manner in the course of their normal closing process and that failure to revise the Proposal as recommended would require such firms to change their financial consolidation process, causing undue burden and expense. Two commenters, a trade association representing FCMs and an FCM, noted that in some firms the consolidated balance sheet is prepared entirely by automation and requested that the Commission retain exemptive authority in order to address cases in which compliance would create special hardship, such as where consolidating balance sheets on the required basis are not routinely generated and to do so would be unduly burdensome. As noted below, the Commission has expressly retained authority to grant exemptions in order to address situations such as those raised by the commenters, which may warrant formulation of an alternate data set that is more practicable for the FCM to provide yet yields comparable information. Further, various commenters noted that SEC staff have indicated that under the SEC's risk assessment rules, broker-dealers need only provide financial statements for their ultimate holding company if such holding company is a MAP.[33] SEC staff have also stated that for the purposes of preparing consolidated financial statements, broker-dealers may combine insignificant non-MAPs in a single entry in the financial statements.[34]

The Commission has revised proposed Rules 1.14(a)(1)(iii) and (iv) and 1.15(a)(2)(i) and (ii) in light of the comments received and the approach followed by the SEC. Final Rules 1.14(a)(1)(iii) and (iv) and 1.15(a)(2)(i) and (ii) require, therefore, that consolidated and consolidating financial statements be maintained and filed for the highest level MAP within the FCM's organizational structure, and must include the FCM and its other MAPs. Further, these rules allow an FCM to maintain and submit the consolidating balance sheet and income statement which its highest level MAP prepares as part of its internal financial reporting process. The FCM would, however, be required under Rule 1.15(a)(2)(iii) to provide the Commission with additional information if such information were determined to be necessary for a complete understanding of a particular MAP's financial impact on the FCM's organizational group. Rules 1.14(a)(1)(iii) and (iv) require the FCM to maintain in accordance with those rules any additional information that the Commission may require pursuant to Rule 1.15(a)(2)(iii).

As under the Proposal, the final rules require that the consolidated and consolidating financial statements required to be filed with the Commission be prepared in accordance with United States generally accepted accounting principles, consistently applied ("U.S. GAAP"). With respect to affiliated persons that use a comprehensive set of accounting principles other than U.S. GAAP, a note to the financial statements indicating the comprehensive body of accounting principles used to prepare the financial statements and a narrative description of the items treated differently by U.S. GAAP must be included. In this regard, the Commission requested comment as to whether quantification of any material differences in the contents of the financial statements, in addition to a narrative description of items treated differently from U.S. GAAP, should be required where accounting principles other than U.S. GAAP are used. One self-regulatory organization believed that such quantification would be necessary from a regulatory perspective in order to provide for easier comparative analysis of information. Conversely, a trade association was strongly of the view that the regulations should not require anything more than disclosure of the particular non-U.S. GAAP accounting principles used by the firm, apparently concluding that both quantification of material differences between the accounting standards and a narrative description of items treated differently by U.S. GAAP are unnecessary. The Commission continues to believe that a description of the differences between U.S. GAAP and the non-U.S. GAAP method used by the FCM's affiliate will facilitate understanding and analysis of filings. However, in the interests of minimizing reporting burdens, the Commission has determined to forego requiring quantification of material differences between the U.S. GAAP and non-U.S. GAAP methods employed by an FCM's affiliate at this time. Accordingly, the Commission is adopting this aspect of the rule as proposed.

Proposed Rule 1.15(a)(2) would have required financial statements to be filed on an annual basis, within 105 days of fiscal year-end, rather than quarterly as required under SEC rules. The Commission requested comment as to whether consolidated and consolidating financial statements are customarily prepared on a quarterly basis and, if so, whether they should be required to be filed quarterly so as to provide more current financial data. One self-regulatory organization commented that financial information received 105 days after the FCM's fiscal year-end would be stale and that requiring quarterly information would not make the information more timely or useful. This commenter contended that the annual audited Form 1–FR along with quarterly statements would provide the Commission with the critical financial information it needs. While the information provided on Form 1–FR is of obvious value, Form 1–FR does not, however, provide the same degree of financial information relating to the FCM's organizational group as would be included in consolidated and consolidating financial statements for the FCM and its highest level MAP. The Commission continues to believe that annual filing of FCMs' consolidated and consolidating financial statements, in combination with other financial information currently required by the Commission, such as Form 1–FR, will strike an appropriate balance between providing the Commission with relevant financial information while imposing the lowest possible burden on the FCM required to produce such information. Accordingly, the Commission has

[33] Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC to Douglas G. Preston, Esq., Securities Industry Association at 5 (September 20, 1993).

[34] Id.

determined to adopt this provision of the rule as proposed.

Finally, in connection with the Commission's proposed annual filing requirement, one commenter noted that the FCM and its ultimate parent may have different fiscal year-ends and requested confirmation that the annual filing deadline for financial statements is 105 calendar days after the end of the fiscal year for both the FCM and its ultimate parent. As adopted, Rule 1.15(a)(2) requires an FCM to file consolidated and consolidating financial statements for the FCM and the highest level MAP within the FCM's organizational structure within 105 calendar days of the FCM's fiscal year-end. To the extent that the highest level MAP within the FCM's organizational structure has a fiscal year-end different from that of the FCM, the FCM should include both the most recent certified statements and any interim uncertified statements of the MAP Initial filings will be required to be made by May 15, 1995

C Information Required Upon the Occurrence of Certain Events

In lieu of requiring routine quarterly filing of position data for each of the FCM's material affiliates as is mandated under the SEC's risk assessment rules, the Commission's Proposal was designed to call for a combination of annual filings and ad hoc reporting in situations in which heightened financial scrutiny would be warranted. To this end, proposed Rule 1 15(b)(2) identified certain key events relative to the financial condition of the FCM and its material affiliates the occurrence of which would require notice to the Commission Proposed Rule 1 15(b)(2) set forth eight such "triggering" events: (1) a reduction of greater than 20% in an FCM's adjusted net capital, (2) an "outflow" of an FCM's assets exceeding, in any 30-day period, 20% or more of the FCM's excess adjusted net capital; (3) losses in noncustomer accounts held by the FCM exceeding the greater of (a) $50 million or 10 percent of the FCM's parent's consolidated stockholders' equity in 30 days or (b) $100 million or 20% of the FCM's parent's stockholders' equity in 12 months, (4) a net loss at a MAP exceeding 30% of the MAP's net worth or 20% of the FCM's adjusted net capital, (5) a 20% reduction in the consolidated stockholders' equity of an FCM's parent; (6) a reduction in a MAP's credit rating; (7) a MAP's filing of a notice with a banking regulator of a possible capital category adjustment; and (8) an FCM's entering into an agreement to guarantee an obligation of an affiliate. Under proposed Rule 1.15(b)(1), an FCM would be required to notify the Commission (by notice to the Director of the Division of Trading and Markets or the Director's designee)[35] within three business days of the occurrence of any trigger event unless a shorter period was specified with respect to a particular triggering event.

Comments concerning the proposed triggering events can be divided into two categories: (1) general comments that address the concept of trigger event reporting and issues generally relating to all proposed trigger events; and (2) comments relevant to specific proposed trigger events. The majority of commenters on the subject of trigger event reporting appeared to agree with the concept of a trigger event reporting system, citing, for example, the consequent reduction in routinely reported data that could result from the use of an event-driven reporting approach. However, several commenters opposed this approach, contending that this aspect of the Proposal exceeded the Commission's statutory authority to obtain supplemental data, *i.e.*, its authority to request information on an as-needed basis to augment an FCM's routine filings, and/or would require the reporting of information from entities beyond the Commission's jurisdiction. One commenter argued that the authority to obtain supplemental information provided to the Commission in the FTPA is to be used to complement risk assessment quarterly reports, not to substitute for them. One commenter opposed the trigger event structure proposed by the Commission on the grounds that the Commission's existing capital requirements and large trader reporting system are sufficient to meet the Commission's risk assessment objectives. Several commenters, however, including a trade association representing its member FCMs, recommended that trigger events relating to the activities of FCMs be included in the Commission's net capital or early warning rules and made applicable to all FCMs rather than only to those FCMs subject to the risk assessment regulations.

As discussed below, the Commission has determined to take action at this time only on the first of the proposed triggering events, *i.e.*, notice to the Commission upon a twenty percent or greater decrease in an FCM's adjusted net capital. As recommended by some commenters, this notice requirement is being adopted as an amendment to Rule 1.12, the Commission's early warning rule. However, this notice requirement will initially apply only to FCMs subject to the risk assessment regulations. The Commission is proposing by separate **Federal Register** release to make this notice requirement applicable to all FCMs.

The statutory risk assessment provisions were specifically designed to permit the Commission to obtain information concerning entities over which it does not exercise regulatory jurisdiction and which thus might present risks to regulated firms yet lie beyond the Commission's information-gathering authority. Further, the Commission is not requesting information directly from the affiliates of FCMs, but rather from the FCM itself. Moreover, the trigger reporting approach contemplated under the Proposal was designed to provide the Commission with information concerning material affiliate activity which may or may not consist of futures transactions that would be reflected in large trader reports and which is not addressed by existing minimum capital requirements.[36]

Many of the commenters, while supportive of the concept of requiring notice to the Commission upon the occurrence of triggering events, suggested that such triggering events should relate solely to events that could have a direct effect on the FCM's financial condition and that the Commission should delete any trigger events that relate to a change in a MAP's financial condition. One commenter, for example, recommended that proposed Rules 1.15(b)(2)(iv) (large net loss at a MAP), 1.15(b)(2)(v) (20% reduction in FCM's parent's consolidated stockholder's equity), 1.15(b)(2)(vi) (reduction in a MAP's credit rating) and 1.15(b)(2)(vii) (MAP's filing of a notice of a possible capital category adjustment with a banking regulator) be deleted. Finally, one commenter requested that if the Commission decides not to delete all trigger events that arise as a result of a change at a MAP, the Commission should modify the filing deadline with respect to these notices to five calendar days after the end of the month in which the event occurred.

The FTPA granted the Commission the authority to obtain information concerning affiliate activities that could pose material risks to the FCM. While certain of the proposed trigger events

[35] The Director of the Division of Trading and Markets is generally delegated the authority to act on behalf of the Commission with respect to the risk assessment regulations.

[36] For example, noncustomer futures positions do not affect an FCM's adjusted net capital level because noncustomer accounts are not required to be segregated pursuant to Rule 1.20.

would initially affect an FCM's MAP, these events were designed so as to signal conditions at a MAP that are likely to present a material potential for a direct impact upon the financial and operational condition of the FCM. However, the Commission has determined to proceed in this phase of the rulemaking only with the first of the eight proposed trigger events, *i.e.*, trigger event reporting upon a twenty percent or greater reduction in an FCM's adjusted net capital. Further, as noted above, by separate **Federal Register** release, the Commission is proposing to include certain additional notice requirements as part of its early warning notice system applicable to all FCMs.

As proposed, Rule 1.15(b)(2)(i) would have required an FCM to notify the Commission of any reduction of 20 percent or more in its adjusted net capital as last reported on its financial reports filed with the Commission pursuant to Rule 1.10.[37] As noted above, several commenters recommended that this trigger event be included in Commission Rule 1.17, the Commission's net capital rule, or in the Commission's financial early warning requirements set forth in Rule 1.12, rather than in the risk assessment rules, to ensure their applicability to all FCMs rather than only those FCMs subject to the Commission's risk assessment regulations. The Commission agrees with the view that this "net capital trigger" should apply to all FCMs and has determined to make this provision part of its financial early warning system. Accordingly, the Commission is amending its Rule 1.12 financial early warning requirements to include the notice requirement set forth in proposed Rule 1.15(b)(2)(i).[38] Initially, this new requirement will apply only to those FCMs who are subject to the Commission's risk assessment rules. However, by separate **Federal Register** release, the Commission is proposing to extend this new early warning notice requirement to all FCMs.

As the Commission is adopting this trigger event as part of its early warning system, the Commission has adopted the provision without any modification of the timeframe within which notice must be provided to the Commission. As adopted, Rule 1.12(g) requires that the FCM provide notice to the Commission within two business days of any reduction in its adjusted net capital of twenty percent or greater caused by an activity in the normal course of business, such as an operating loss, proprietary trading loss or increase in charges against net capital, or at least two business days prior to any extraordinary transactions or series of transactions that cause such a reduction, such as a dividend payment or making of a loan.

Proposed Rule 1.15(b)(1) provided that, after reviewing a notice filed by an FCM, the Commission could request additional information from the firm or a relevant regulatory agency, as determined to be necessary in the circumstances. The Commission requested comment as to whether the notice of occurrence of a triggering event should be required to be accompanied by an explanation of the circumstances giving rise to the occurrence such that supplemental inquiries might be obviated in many cases. The Commission received six responses to its request for comment on this aspect of the proposed rule, including comments by two trade associations, three FCMs and one self-regulatory organization. An FCM and a self-regulatory organization expressed the view that an explanation of the circumstances giving rise to the need for the notice would be helpful and should accompany the notice of an occurrence of a trigger event. However, the other four commenters on this issue argued that such an explanation would not be helpful, noting that given the short time period permitted in which to provide notice to the Commission, *i.e.*, generally three business days, it is unlikely that a complete and helpful explanation could be provided. Based upon the comments received and the Commission's review of the issue, the final rules do not include a requirement for explanation of the circumstances giving rise to the twenty percent or greater reduction in the FCM's adjusted net capital. As provided in proposed Rule 1.15(b) and adopted in Rule 1.12(g), however, the Commission may, if it deems it necessary, require supplemental information from the FCM regarding the notice filed with the Commission.

Proposed Rule 1.15(b)(2)(iii) would have required an FCM to notify the Commission when an FCM's aggregate cumulative losses in all non-customer accounts exceeded the greater of: (A) in any thirty-day period, ten percent of the last reported consolidated stockholders' equity of the FCM's parent or $50 million; and (B) in any twelve-month period, twenty percent of the last reported stockholders' equity of the FCM's parent or $100 million. Several commenters opposed this proposed requirement contending, for example, that this trigger event would not be an accurate indicator of potential financial problems at an FCM because it does not take into consideration the effects of offsetting cash positions that are maintained on affiliates' books. These commenters suggested, as an alternative, that the Commission adopt a requirement that an FCM notify the Commission within two business days after a margin call to a non-customer that exceeds twenty percent of the FCM's adjusted net capital remains outstanding for two business days. These commenters also suggested that the Commission adopt as an additional trigger event a reporting requirement that an FCM notify the Commission whenever the FCM's excess net capital is less than 6 percent of the maintenance margin required to be held or posted by the FCM to support the proprietary and noncustomer positions carried by the FCM. As noted by these commenters, the Chicago Mercantile Exchange currently imposes a related capital requirement on its clearing members on an informal basis. In light of these comments and recommendations, the Commission has determined not to adopt Rule 1.15(b)(2)(iii) as proposed but is proposing to amend Rule 1.12 to include new paragraphs (f)(4) and (f)(5) thereof to include these notice requirements. These proposals appear elsewhere in this edition of the **Federal Register**. Proposed Rule 1.12(f)(4) would require notice to be filed whenever an account carried by an FCM, whether customer, noncustomer or omnibus, is subject to a margin call that exceeds the FCM's excess adjusted net capital and such call is not satisfied by the close of business on the day following the issuance of the call. Proposed Rule 1.12(f)(5) would require notice from an FCM whenever its excess adjusted net capital is less than six percent of the total of: (i) maintenance margin required by the FCM on noncustomer account positions; and (ii) maintenance margin applicable to an FCM's proprietary positions. With respect to an FCM's proprietary account positions, maintenance margin shall mean the amount of funds the FCM is required to maintain at the exchange's clearing organization or with its clearing broker, or five percent of the value of the contract, whichever is greater.

The Commission has determined to defer action on the remaining six trigger

[37] Similarly, proposed Rule 1.15(b)(2)(ii) would have required an FCM to notify the Commission of any outflow of assets from the FCM which in the aggregate in any 30 calendar day period exceeds 20 percent or more of the FCM's excess adjusted net capital. The Commission has determined to defer consideration of this trigger event.

[38] This requirement is being adopted as Rule 1.12(g).

reporting events set forth in the Proposal pending further review.

D. Exemptions and Special Provisions

As proposed, the risk assessment rules would provide an exemption from all recordkeeping and reporting requirements under proposed Rules 1.14 and 1.15 for FCMs who, based on the amount of customer funds held and adjusted net capital maintained, appear to have very limited futures and commodity options activities. Further, the proposed rules would provide special provisions for entities which are subject to the regulatory oversight of other domestic and foreign regulatory bodies. With respect to FCMs that are not otherwise exempt, the rules permit an FCM, by application, to request individual exemptions from the rules which would be considered by the Commission on a case-by-case basis.

1. Exemption based on level of customer funds and net capital

Proposed Rules 1.14(d)(1) and 1 15(c)(1) would have provided an exemption from the risk assessment regulations for all FCMs, other than clearing member firms, that hold customer funds of less than $6,250,000 and maintain adjusted net capital of less than $5,000,000, calculated as of the FCM's fiscal year-end. The Commission received comment on all three conditions to applicability of the exemption.

First, two commenters stated that the rules should not require all FCMs that are clearing firms to comply with the rules. One of these commenters, a self-regulatory organization, argued that such a requirement unfairly discriminates against clearing firms, which are already subject to exchange risk management and surveillance systems. The other commenter, a bar association, expressed the view that the distinction between clearing FCMs and non-clearing FCMs is an inappropriate line of demarcation for determining which firms should be subject to the risk assessment requirements. One trade association commenter representing FCMs, however, took the opposite view and noted its support of the Commission's decision to require all clearing FCMs to comply with the rules. The Commission believes that FCMs that are clearing members of exchanges have the potential, by virtue of their clearing status, to create risks to the clearing organizations and other clearing members that differ in kind and degree from those created by non-clearing FCMs.[39]

The Commission requested comment as to the appropriateness of the adjusted net capital and customer funds[40] exemption levels set forth in the proposed rules.[41] In this regard, two commenters contended that both levels were too low and that the rules consequently might not exempt FCMs whose activities do not pose risks sufficient to warrant the imposition of risk assessment reporting burdens. One of these commenters recommended that the customer funds and adjusted net capital levels should, at a minimum, be doubled or made consistent with the levels established by the SEC in its risk assessment regulations.[42] Additionally, one commenter stated that the level of adjusted net capital maintained by an FCM should not determine whether an FCM is exempt from the risk assessment requirements because this use of adjusted net capital as an exemption benchmark might encourage potentially exempt FCMs to maintain a small capital base.

The Commission noted in the **Federal Register** release accompanying the proposed rules that it chose $6,250,000 in customer funds as an initial level for applicability of the risk assessment requirements because, based upon current Commission and National Futures Association ("NFA") requirements, that is the level whereby an increase in the amount of customer funds held by the FCM will require an increase in its adjusted net capital requirement above the minimum requirement.[43] The Commission also noted that given the relative size of securities and futures market activity, the degree of leverage in futures transactions, and the fact that the Commission proposed a materiality threshold of $20 million for determining whether an FCM would be required to report certain financial information concerning its MAPs,[44] (as compared to the SEC's $100 million materiality threshold), a $5 million adjusted net capital ceiling for exemption from these rules appeared to be an appropriate level. The adjusted net capital level criterion was included in the rule as an additional safeguard so that FCMs which do not carry customer funds and are not clearing members are not automatically exempted from the risk assessment rules.

The Commission is adopting the exemptive provision as proposed but will review the operation of the exemptive levels following implementation of the risk assessment rules and may also revisit these levels with respect to those portions of the Proposal that have been deferred for further consultation and review.

2. Special Provisions for Certain Regulated Entities

a. *Broker-Dealers*. The proposed rules were developed after extensive review of, and consultation with the SEC concerning, the SEC's risk assessment rules. Like the proposed rules, the final rules adopted herein are intended to produce a coordinated reporting structure for FCMs that either are also registered as broker-dealers and subject

[39] One commenter noted that proposed Rules 1.14(d)(1) and 1.15(c)(1) could be interpreted to exempt all non-clearing member FCMs. The text of the rule has been modified to more clearly reflect the Commission's intention in this regard.

[40] The Commission requested comment as to whether the calculation of customer funds for this purpose should be the same as that for Rule 1.17 capital computation purposes, *i.e.*, whether long option values should be deducted. One commenter responded to this request and stated that the calculation of customer funds should be the same for both Rule 1.17 and the risk assessment rules. The Commission has determined to adopt this approach for the sake of maintaining consistent treatment between the risk assessment rules and the Commission's net capital rule. Accordingly, in determining an FCM's customer funds level for purposes of these risk assessment rules, the computation should be made net of fully paid long options.

[41] The Commission notes that different exemption levels may be determined to be applicable for purposes of position reporting requirements to be addressed in the second phase of this rulemaking.

[42] The SEC's risk assessment rules generally provide an exemption for broker-dealers that: (1) maintain capital of less than $20,000,000; (2) do not hold funds or securities for, or owe money or securities to customers; and (3) do not carry customer accounts. In no case is a broker-dealer subject to the SEC's requirements if it maintains capital of less than $250,000. *See* 17 CFR 240.17h-1T(d) and 240.17h-2T(b).

[43] Rule 1.17(a)(1)(i) requires an FCM to calculate its minimum adjusted net capital requirement by multiplying the amount it is required to segregate and set aside in special accounts for the benefit of its customers by four percent, subject to a minimum dollar requirement of $50,000. However, Commission Rule 170.15 provides that "[e]ach person required to register as a futures commission merchant must become and remain a member of at least one futures association which is registered under section 17 of the Act and which provides for the membership therein of such futures commission merchant, unless no such futures association is so registered." The Commission approved an increase in the minimum dollar requirement for member FCMs of the NFA, currently the only registered futures association, from $50,000 to $250,000, effective December 31, 1990. This increase effectively requires all FCMs to maintain adjusted net capital of at least $250,000. Thus, based upon the NFA's minimum dollar requirement and the Commission's capital requirement of four percent of segregated funds, an FCM holding any amount greater than $6,250,000 in customer funds is required to increase its adjusted net capital level above NFA's $250,000.

[44] *See* proposed Rule 1.14(a)(4) setting the level of a MAP's financial activity at which an FCM would have been required under the Proposal to separately list financial information concerning that MAP.

to the SEC's risk assessment rules or are part of a holding company group that includes a broker-dealer reporting pursuant to the SEC's rules. Proposed Rules 1.14(b)(1) and 1.15(d)(1) and these same provisions of the final rules permit FCMs that are, or that have affiliates that are, registered broker-dealers or registered government securities broker-dealers to file SEC Form 17–H, the SEC's risk assessment information form, in partial compliance with the Commission's proposed rules. Generally, under proposed Rule 1.15(d)(1), an FCM that is registered as a broker-dealer or that has an affiliate registered as a broker-dealer would be deemed to be in compliance with all of the routine reporting requirements of proposed Rule 1.15,[45] except the filing of risk management policies pursuant to paragraph (a)(1)(ii) of proposed Rule 1.15, if the FCM files SEC Form 17–H with the Commission. However, if the SEC filing does not include as MAPs all of the entities that would be MAPs of the FCM under the CFTC's rules, the SEC filing would be required to be supplemented to include those MAPs. Similar relief is provided in Rule 1.14 with respect to recordkeeping requirements.

Commenters addressing this provision generally stated that the Commission should accept Form 17–H from dually registered entities in full compliance with Commission requirements. As the Commission has determined to defer adoption of final rules regarding position reporting and trigger reporting concerning FCM affiliates, FCMs that report, or have affiliates who report, under the SEC's risk assessment rules will have few, if any, additional requirements under the final rules adopted herein. FCMs filing SEC Form 17–H have the option under Rule 1.15(d)(1) of filing Form 17–H with the Commission in its entirety or without the information required under Part II of the Form 17–H. Such FCMs will be required to file with the Commission on a one-time basis (absent material changes) copies of their risk management policies, procedures and systems in accordance with Commission requirements. The relief provided does not extend to filing of risk management policies because although the SEC's rules require filing of most of the same types of written policies and procedures as the Commission's rules, the Commission's requirements relating to records of policies, procedures and systems with respect to trading activity include specific reference to the FCM's internal controls with respect to the market risks, credit risks and other risks created by the FCM's proprietary and noncustomer clearing activities, reflecting risks entailed in the performance of the clearing function typical of FCMs operating within a holding company structure. These include, for example, as specified in Rule 1 14(a)(1)(ii), systems and policies for supervising, monitoring, reporting and reviewing trading activities in securities, futures contracts, commodity options, forward contracts or financial instruments such as swaps, and policies for hedging or managing risks created by its proprietary trading activities and with respect to supervision of noncustomer accounts. In addition, the relief provided under Rules 1.14(b)(1) and 1 15(d)(1) does not extend to trigger reporting requirements under the rule. Accordingly, the FCM would remain responsible for notifying the Commission of the occurrence of a twenty percent or greater decrease in adjusted net capital as set forth in new paragraph (g) of Rule 1.12 and providing supplemental information, if requested.[46] Finally, an FCM that is also registered as a broker-dealer, and plans to file Form 17–H pursuant to Rule 1.15(d)(1), is required to supplement its organizational chart to include those MAPs, if any, that would be MAPs for purposes of the Commission's rules but not for purposes of its SEC filing.

b. *Banks.* With respect to an FCM with a MAP that is subject to supervision by a federal banking agency, the Proposal provided that an FCM would be deemed to be in compliance with all of the routine reporting requirements of proposed Rule 1.15(a)(2) with respect to such MAP, if the FCM maintains in accordance with Rule 1.14 copies of all reports filed by the MAP with the relevant bank regulator.[47] Paragraph (b)(2) of proposed Rule 1.14 provided similar treatment with respect to recordkeeping requirements. Those commenters who addressed this aspect of the Proposal overwhelmingly favored the Commission's approach of providing relief from the regulations where a MAP is subject to the supervision of a federal banking regulator The comments received in this area generally requested an expansion of the relief proposed and/or requested clarification regarding particular provisions of the Proposal. One commenter requested that the Commission conform proposed Rules 1 14(b)(2) and 1.15(d)(2), such that a bank would not be required to file an organizational chart with the Commission. In this regard, the Commission understands that Form FR Y–6 ("Annual Report of Bank Holding Companies") includes, among other things, a corporate organizational chart. All FCMs must file an organizational chart but if one has been prepared for banking regulators that will provide the information required under these rules, such a chart can be used for this purpose, provided that the additional information required under these rules, *e.g.*, designation of MAPs, is included.

Further, one commenter expressed the view that the Proposal was unclear as to whether the FCM or its MAP must maintain copies of those reports submitted by the MAP with its federal banking regulator. Proposed Rule 1.14(b)(2) would require the FCM to maintain and make available "copies of all reports submitted by [a MAP to] the Federal banking agency. . . ." Proposed Rule 1.15(d)(2) stated that the FCM or its MAP may maintain such reports in order to be eligible for the exemption. The Commission intends this exemption to be available with respect to FCMs that have MAPs that are subject to the supervision of a federal banking agency provided that either the FCM or its MAP, as the FCM and the relevant MAP determine to be appropriate, maintains the reports specified in the rule. The final rules have been modified to clarify this point. Of course, if the MAP is the repository for reports required to be maintained, the Commission must be afforded access to such reports on the same terms and to the same extent as it would if the FCM held such records directly and the FCM will remain responsible for assuring that the Commission has access to the required records.

The **Federal Register** release accompanying the Commission's proposed rules also stated that, generally, foreign banking organizations that are subject to U.S. banking regulation will be treated in the same fashion as domestic banks for purposes of the application of the Commission's

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[45] These requirements included all reporting requirements of proposed Rule 1.15 except the trigger reporting requirements set forth in proposed Rule 1.15(b). Part I of Form 17–H includes an organizational chart and consolidated and consolidating financial statements.

[46] Certain exchanges have a similar requirement. *See* Chicago Mercantile Exchange Rule 972A; Chicago Board of Trade Rule 285.03; New York Mercantile Exchange Rule 2.14(d) and Clearing Rule 9.22(c)(i) and (ii); Commodity Exchange, Inc. Rule 7.08(a); Coffee, Sugar and Cocoa Exchange, Inc. Clearing Rule 302(c)(i); Kansas City Board of Trade Rule 1311.00; Kansas City Board of Trade Clearing Corporation Rule 6.01(c); and Minneapolis Grain Exchange Rule 2088.00.

[47] With respect to Form FR 2068, the Confidential Form of Operations required to be filed with the Board of Governors of the Federal Reserve System by foreign banking organizations, Commission staff are exploring with Federal Reserve officials procedures by which access to Form 2068 may be obtained on an as-needed basis.

rules.[48] One commenter requested that the Commission codify this similarity of treatment by providing in its regulations that a United States regulated foreign banking organization will be treated in the same manner as United States banks and United States bank holding companies, that is, that it would only be required to make available to the Commission what it files with the relevant U.S. banking regulator.[49] The Commission agrees that such clarification is helpful and has modified the language of the Proposal in this regard. Accordingly, under Rule 1.15(d)(2) an FCM that has a MAP that is either a foreign banking organization or a domestic banking organization, subject to examination by, or the reporting requirements of, a federal banking agency will be deemed to be in compliance with the reporting requirements of Rule 1.15(a)(2) (i.e., filing of annual consolidated and consolidating financial statements) with respect to such MAP, if the FCM maintains in accordance with Rule 1.14 copies of all reports filed by the MAP with bank regulators. Rule 1.14(b)(2) provides similar treatment with respect to recordkeeping requirements. With respect to foreign banks, FCMs (or the MAP) may either maintain what the foreign bank files with the U.S. banking authorities or, if the foreign bank has no U.S. nexus, the reports that would be required to be maintained or filed would be determined as if the bank were a non-bank foreign firm.[50]

c. *Firms Subject to Foreign Regulatory Supervision.* With respect to foreign MAPs that are regulated in a foreign jurisdiction, proposed Rules 1.14(c) and 1.15(e) permitted an FCM to maintain and file any financial or risk exposure reports filed by a MAP with a foreign futures authority, as that term is defined in Section 1a(10) of the Commodity Exchange Act,[51] or other foreign regulatory authority, with which the Commission has an information-sharing agreement in effect. Several commenters pointed out that proposed Rules 1.14 and 1.15 appear to differ in their treatment of this subject. Proposed Rule 1.14(c) states that in order for an FCM to take advantage of the exemption provided therein from recordkeeping requirements the FCM is required to maintain copies of any financial or risk disclosure report filed by the FCM's MAP "with a foreign futures authority or other relevant foreign authority." Proposed Rule 1.15(e), however, requires an FCM to maintain copies of such reports filed "with a foreign futures authority or other foreign regulatory authority with which the Commission has entered into an information sharing agreement which remains in effect as of the [FCM's] fiscal year end." The Commission notes that the different language in Proposed Rules 1.14(c) and 1.15(e) was deliberate and was intended to provide a broader exemption with respect to recordkeeping than reporting. This discrepancy is, in any event, eliminated under the revised provisions as adopted, as discussed below.

Three commenters requested that the Commission accept information the FCM's MAP files with any home country regulator in compliance with the Commission's risk assessment regulations rather than limiting exemptions to foreign MAPs that file information with a foreign futures authority with which the Commission has an information-sharing agreement. These commenters stated that this treatment would be consistent with the SEC's practice of accepting information which the foreign MAP files with its home country regulator even though such information may not conform in content or frequency of filing with the SEC's regulations.

Recognizing that the Commission does not yet have information-sharing agreements with all jurisdictions in which FCM MAPs may be reporting to foreign regulators but that such reports may nonetheless be accessible from the FCM for risk assessment purposes, the Commission has modified proposed Rule 1.15(e), the exemptive provision for MAPs subject to the supervision of a foreign regulatory authority. As adopted, Rule 1.15(e) provides that an FCM shall be deemed to be in compliance with the routine reporting requirements of the risk assessment regulations if the FCM files with the Commission copies of any financial or risk exposure reports filed with a foreign regulator, provided that: (1) the FCM agrees to use its best efforts to obtain from the foreign firm and to cause the foreign firm to provide, directly or through its foreign regulator, any supplemental information the Commission may request and the foreign jurisdiction in which the MAP is located does not have a blocking statute or other restriction that would preclude the provision of such supplemental information; or (2) the foreign regulator with whom the MAP files such reports has a current information-sharing agreement with the Commission which would permit the Commission to obtain the type of information called for under the risk assessment rules.

4. Reporting FCMs

Proposed Rules 1.14(d)(2) and 1.15(c)(2) provided a mechanism whereby only one FCM within an organizational structure would be required to comply with the Commission's risk assessment regulations. These proposed provisions stated generally that the Commission could, upon written application, exempt an FCM affiliated with a "Reporting Futures Commission Merchant" from the recordkeeping and reporting requirements of the rules. Proposed Rules 1.14(d)(2) and 1.15(c)(2) defined a Reporting Futures Commission Merchant as the FCM which maintains the greater amount of adjusted net capital as compared to any other FCM(s) within the same holding company structure that is subject to the risk assessment reporting requirements. A trade association responding on behalf of its members noted that there may be exceptions to the general rule that the FCM with the greatest amount of adjusted net capital should be the Reporting Futures Commission Merchant. This commenter noted, for example, that a broker-dealer/FCM that files reports under the SEC's risk assessment rules may have an affiliate that would be the Reporting Futures Commission Merchant under the definition set forth in the Proposal. In this case the commenter noted that it would be appropriate to allow the broker-dealer/FCM to be the Reporting Futures Commission Merchant. The commenter also urged that the Commission would likely be overburdened with initial exemption requests and that the Commission should permit FCMs to rely upon an exemption provided under Rules 1.14(d)(2) and 1 15(c)(2) upon filing of their requests, pending a response from the Commission.

In order to accommodate circumstances where it is more appropriate for an FCM other than the FCM with the greater amount of adjusted net capital to be deemed the

[48] 59 FR at 9701.

[49] Commission staff have discussed the risk assessment proposals with the domestic banking regulators, and they have confirmed that they will cooperate with the Commission in developing mechanisms for sharing information from such reports to assist the Commission in discharging its supervisory responsibilities.

[50] This analysis is more relevant to the deferred part of these proposals relating to position information although it may also be relevant to "consolidating" decisions.

[51] Section 1a(10) defines the term "foreign futures authority" as "any foreign government, or any department, agency, governmental body, or regulatory organization empowered by a foreign government to administer or enforce a law, rule, or regulation as it relates to a futures or options matter, or any department or agency of a political subdivision of a foreign government empowered to administer or enforce a law, rule, or regulation as it relates to a futures or options matter."

reporting FCM and in order to minimize administrative burdens on Commission staff, the final rules permit an FCM to file a self-executing notice with the Commission identifying as the Reporting FCM an FCM other than the FCM within the organizational structure with the greater amount of adjusted net capital and explaining the basis for the designation of the reporting FCM. The rule provides that the Commission has thirty days from receipt of the notice to object to the designation of a particular FCM as the Reporting FCM. After this period of time, the notice is deemed effective. Additionally, the definition of Reporting Futures Commission Merchant has been modified to include either the FCM within an affiliated group with the greatest amount of adjusted net capital or an FCM acting as the Reporting Broker or Dealer pursuant to the SEC's risk assessment rules. Accordingly, an FCM acting as the Reporting Broker or Dealer under the SEC's risk assessment rules need not file a notice of exemption with the Commission in order to be deemed the Reporting Futures Commission Merchant under Rules 1.14(d)(2) and 1.15(c)(2) as adopted.

The exemptions provided under Rules 1.14(d)(2) and 1.15(c)(2) do not extend to the maintenance and filing of risk management policies, procedures and systems by FCMs affiliated with the Reporting Futures Commission Merchant. Consequently, such affiliate FCMs must maintain their risk management policies, procedures and systems in accordance with Rule 1.14(a)(1)(ii), and the Reporting Futures Commission Merchant must file, in accordance with Rule 1.15(a)(1)(ii), a copy of its own risk management policies, procedures and systems as well as those of its affiliated FCMs. However, if such policies, procedures and systems are identical in all respects, the Reporting Futures Commission Merchant may so indicate when it makes it filing under Rule 1.15(a)(1)(ii).

5. General Exemptive Authority

In response to requests from certain commenters, the Commission has reserved, in Rules 1.14(d)(3) and 1.15(c)(3), authority to exempt any FCM from any of the provisions of either Rule 1.14 or Rule 1.15 if the Commission finds that the exemption is not contrary to the public interest and the purposes of the provisions from which the exemption is sought. The Commission may grant the exemption subject to such terms and conditions as it may find appropriate. This exemptive authority is similar to that set forth in Commission Rule 4.12(a) with respect to provisions of the Part 4 rules governing commodity pool operators and commodity trading advisors. The Commission envisions that it may entertain requests for exemption from FCMs that are particularly concerned about consolidating financial reports or the availability of information concerning foreign MAPs, for example.

IV. Effective Date

The Commission has determined to require the initial filings and reports herein based on an "as of" date of December 31, 1994. The Commission has further determined, however, that with respect to the filing of an organizational chart and risk management policies, procedures and systems, an FCM shall have an additional thirty days to make such filing beyond the ninety days originally proposed. Accordingly, such filings must be made initially by April 30, 1995 instead of March 31, 1995 as proposed. Similarly, with respect to consolidating and consolidated financial statements, the first such reports for fiscal years ending December 31, 1994 must be filed no later than May 15, 1995, which is 135 days following the fiscal year-end rather than the 105 days proposed.

V. Confidentiality

Several commenters expressed concerns about the confidentiality protection afforded to the information prepared and submitted pursuant to the Commission's regulations. Specifically, these commenters, while recognizing that the information received under these rules will be treated as confidential for purposes of Section 8 of the Act, nonetheless were concerned about the rules of certain SROs which require their members to file with them copies of any financial reports required to be filed with any other regulatory or self-regulatory authority. One commenter recommended, however, that notices provided to the Commission upon the occurrence of a trigger event should be provided to all SROs to alert them to any potential problems. The Commission recognizes the sensitivity of certain information required to be reported under these rules. In this regard, the Commission plans to make the information reported to it available only on an as-needed basis, as determined in its sole discretion.

VI. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601–611 (1988), requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The rules discussed herein will affect FCMs. The Commission already has established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on such small entities in accordance with the RFA.[52] FCMs have been determined not to be small entities under the RFA. Additionally, smaller FCMs generally will not be affected by the final rules because the rules exempt from their requirements certain smaller entities. The Commission believes that these rules will not have a significant economic impact on smaller entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1980 (PRA), 44 U.S.C. 3501 *et seq.*, imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. In compliance with the PRA the Commission has submitted these rules and their associated information collection requirements to the Office of Management and Budget ("OMB"). The burden associated with this entire collection, including these rules, is as follows:

Average Burden Hours Per Response: 18.00
Number of Respondents: 1,782
Frequency of Response: annually and on occasion

The burden associated with these specific rules, is as follows:

Average Burden Hours Per Response: 2.50
Number of Respondents: 412
Frequency of Response: annually and on occasion

Persons wishing to comment on the estimated paperwork burden associated with these rules should contact Jeff Hill, Office of Management and Budget, room 3228, NEOB, Washington, DC 20503 (202) 395–7340. Copies of the information collection submission to OMB are available from Joe F Mink, CFTC Clearance Office, 2033 K Street, NW., Washington, DC 20581, (202) 254–9735.

C. Electronic Filing

Any person filing information under these rules who wishes to explore electronic filing with the Commission may contact Charles E. Tanner, Director of the Office of Information Resources Management, on 202–653–7495. The Commission will work with the reporting entities to define and

[52] 47 FR 18618–18621 (April 30, 1982).

implement a secure, cost-effective reporting method.

List of Subjects in 17 CFR Part 1

Financial reporting, Recordkeeping requirements, Risk assessment.

In consideration of the foregoing, and pursuant to the authority contained in the Commodity Exchange Act, and in particular, sections 4f(b), 4f(c) 4g and 8a, 7 U.S.C. 6f(b), 6f(c), 6g and 12a, the Commission is amending part 1 of chapter 1 of title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23 and 24

2. Section 1.12 is amended by redesignating paragraph (g) as paragraph (h) and by adding new paragraph (g) to read as follows:

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

* * * * *

(g) A futures commission merchant required to file reports under § 1.15 and any futures commission merchant affiliated with such a futures commission merchant shall provide written notice of any reduction in adjusted net capital in excess of 20 percent of the futures commission merchant's adjusted net capital as last reported in financial reports filed with the Commission pursuant to § 1.10. This notice shall be provided as follows:

(1) With respect to activities in the normal course of business (*e.g.*, operating losses, proprietary trading losses, increased charges against net capital) that cause reduction, written notification must be received within two business days of such reduction; and

(2) With respect to any extraordinary transaction or series of transactions that will cause such reduction, written notification must be received at least two business days in advance of the transaction or the first in the series of transactions.

(3) Upon receipt of such notice from a futures commission merchant, the Director of the Division of Trading and Markets or the Director's designee may require that the futures commission merchant provide or cause a Material Affiliated Person (as that term is defined in § 1.14(a)(2)) to provide, within three business days from the date of request or such shorter period as the Division Director or designee may specify, such other information as the Division Director or designee determines to be necessary based upon market conditions, reports provided by the futures commission merchant, or other available information.

* * * * *

3. Section 1.12 is further amended by revising the references in the first sentences of paragraphs (a)(1) and (b)(3) and in paragraph (e) to "paragraph (g) of this section" to read "paragraph (h) of this section" and by revising the reference in the last sentence of newly designated paragraph (h)(2) to "this paragraph (g)" to read "this paragraph (h)."

4. Section 1.14 is added to read as follows:

§ 1.14 Risk assessment recordkeeping requirements for futures commission merchants.

(a) *Requirement to maintain and preserve information.*

(1) Each futures commission merchant registered with the Commission pursuant to Section 4d of the Act, unless exempt pursuant to paragraph (d) of this section, shall prepare, maintain and preserve the following information:

(i) An organizational chart which includes the futures commission merchant and each of its affiliated persons. Included in the organizational chart shall be a designation of which affiliated persons are "Material Affiliated Persons" as that term is used in paragraph (a)(2) of this section, which Material Affiliated Persons file routine financial or risk exposure reports with the Securities and Exchange Commission, a federal banking agency, an insurance commissioner or other similar official or agency of a state, or a foreign regulatory authority, and which Material Affiliated Persons are dealers in financial instruments with off-balance sheet risk and, if a Material Affiliated Person is such a dealer, whether it is also an end-user of such instruments;

(ii) Written policies, procedures, or systems concerning the futures commission merchant's:

(A) Method(s) for monitoring and controlling financial and operational risks to it resulting from the activities of any of its affiliated persons;

(B) Financing and capital adequacy, including information regarding sources of funding, together with a narrative discussion by management of the liquidity of the material assets of the futures commission merchant, the structure of debt capital, and sources of alternative funding;

(C) Establishing and maintaining internal controls with respect to market risk, credit risk, and other risks created by the futures commission merchant's proprietary and noncustomer clearing activities, including systems and policies for supervising, monitoring, reporting and reviewing trading activities in securities, futures contracts, commodity options, forward contracts and financial instruments; policies for hedging or managing risks created by trading activities or supervising accounts carried for noncustomer affiliates, including a description of the types of reviews conducted to monitor positions; and policies relating to restrictions or limitations on trading activities: *Provided, however,* that if the futures commission merchant has no such written policies, procedures or systems, it must so state in writing;

(iii) Fiscal year-end consolidated and consolidating balance sheets for the highest level Material Affiliated Person within the futures commission merchant's organizational structure, which shall include the futures commission merchant and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated balance sheets shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which shall include appropriate explanatory notes. The consolidating balance sheets may be those prepared by the futures commission merchant's highest level Material Affiliated Person as part of its internal financial reporting process. Any additional information required to be filed under § 1.15(a)(2)(iii) shall also be maintained and preserved; and

(iv) Fiscal year-end consolidated and consolidating income statements and consolidated cash flow statements for the highest level Material Affiliated Person within the futures commission merchant's organizational structure, which shall include the futures commission merchant and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated statements shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which shall include appropriate explanatory notes. The consolidating statements may be those prepared by the futures commission merchant's highest level Material Affiliated Person as part of its internal financial reporting process. Any additional information required to be filed under § 1.15(a)(2)(iii) shall also be maintained and preserved.

(2) The determination of whether an affiliated person of a futures commission merchant is a Material Affiliated Person shall involve consideration of all aspects of the activities of, and the relationship between, both entities, including without limitation, the following factors:

(i) The legal relationship between the futures commission merchant and the affiliated person;

(ii) The overall financing requirements of the futures commission merchant and the affiliated person, and the degree, if any, to which the futures commission merchant and the affiliated person are financially dependent on each other;

(iii) The degree, if any, to which the futures commission merchant or its customers rely on the affiliated person for operational support or services in connection with the futures commission merchant's business;

(iv) The level of market, credit or other risk present in the activities of the affiliated person; and

(v) The extent to which the affiliated person has the authority or the ability to cause a withdrawal of capital from the futures commission merchant.

(3) For purposes of this section and § 1.15, the term Material Affiliated Person does not include a natural person.

(4) The information, reports and records required by this section shall be maintained and preserved, and made readily available for inspection, in accordance with the provisions of § 1.31.

(b) *Special provisions with respect to Material Affiliated Persons subject to the supervision of certain domestic regulators.* A futures commission merchant shall be deemed to be in compliance with the recordkeeping requirements of paragraphs (a)(1)(i), (a)(1)(iii) and (a)(1)(iv) of this section with respect to a Material Affiliated Person if:

(1) The futures commission merchant is required, or that Material Affiliated Person is required, to maintain and preserve information, or such information is maintained and preserved by the futures commission merchant on behalf of the Material Affiliated Person, pursuant to § 240.17h–1T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt, and maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of the records and reports maintained and filed on Form 17–H (or such other forms or reports as may be required) by such futures commission merchant or its Material Affiliated Person with the Securities and Exchange Commission pursuant to §§ 240.17h–1T and 240.17h–2T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt;

(2) In the case of a Material Affiliated Person (including a foreign banking organization) that is subject to examination by, or the reporting requirements of, a Federal banking agency, the futures commission merchant or such Material Affiliated Person maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of all reports submitted by such Material Associated Person to the Federal banking agency pursuant to section 5211 of the Revised Statutes, section 9 of the Federal Reserve Act, section 7(a) of the Federal Deposit Insurance Act, section 10(b) of the Home Owners' Loan Act, or section 5 of the Bank Holding Company Act of 1956; or

(3) In the case of a Material Affiliated Person that is subject to the supervision of an insurance commissioner or other similar official or agency of a state, the futures commission merchant or such Material Affiliated Person maintains and makes available for inspection by the Commission in accordance with the provisions of this section copies of the annual statements with schedules and exhibits prepared by the Material Affiliated Person on forms prescribed by the National Association of Insurance Commissioners or by a state insurance commissioner.

(c) *Special provisions with respect to Material Affiliated Persons subject to the supervision of a Foreign Regulatory Authority.* A futures commission merchant shall be deemed to be in compliance with the recordkeeping requirements of paragraphs (a)(1)(iii) and (a)(1)(iv) of this section with respect to a Material Affiliated Person if such futures commission merchant maintains and makes available, or causes such Material Affiliated Person to make available, for inspection by the Commission in accordance with the provisions of this section copies of any financial or risk exposure reports filed by such Material Affiliated Person with a foreign futures authority or other foreign regulatory authority, provided that: (1) the futures commission merchant agrees to use its best efforts to obtain from the Material Affiliated Person and to cause the Material Affiliated Person to provide, directly or through its foreign futures authority or other foreign regulatory authority, any supplemental information the Commission may request and there is no statute or other bar in the foreign jurisdiction that would preclude the futures commission merchant, the Material Affiliated Person, the foreign futures authority or other foreign regulatory authority from providing such information to the Commission; or (2) the foreign futures authority or other foreign regulatory authority with whom the Material Affiliated Person files such reports has entered into an information-sharing agreement with the Commission which is in effect as of the futures commission merchant's fiscal year-end and which will allow the Commission to obtain the type of information required herein. The futures commission merchant shall maintain a copy of the original report and a copy translated into the English language. For the purposes of this section, the term "Foreign Futures Authority" shall have the meaning set forth in section 1a(10) of the Act.

(d) *Exemptions.* (1) The provisions of this section shall not apply to any futures commission merchant which holds funds or property of or for futures customers of less than $6,250,000 and has less than $5,000,000 in adjusted net capital as of the futures commission merchant's current fiscal year-end; provided, however, that such futures commission merchant is not a clearing member of an exchange.

(2) The Commission may, upon written application by a Reporting Futures Commission Merchant, exempt from the provisions of this section, other than paragraph (a)(1)(ii) of this section, either unconditionally or on specified terms and conditions, any futures commission merchant affiliated with such Reporting Futures Commission Merchant. The term "Reporting Futures Commission Merchant" shall mean, in the case of a futures commission merchant that is affiliated with another registered futures commission merchant, the futures commission merchant which maintains the greater amount of adjusted net capital as last reported on financial reports filed with the Commission pursuant to § 1.10 unless another futures commission merchant is acting as the Reporting Broker or Dealer under § 240.17h–2T of this title, or the Commission permits another futures commission merchant to act as the Reporting Futures

Commission Merchant. In granting exemptions under this section, the Commission shall consider, among other factors, whether the records required by this section concerning the Material Affiliated Persons of the futures commission merchant affiliated with the Reporting Futures Commission Merchant will be available to the Commission pursuant to this section or § 1.15. A request for exemption filed under this paragraph (d)(2) shall explain the basis for the designation of a particular futures commission merchant as the Reporting Futures Commission Merchant and will become effective on the thirtieth day after receipt of such request by the Commission unless the Commission objects to the request by that date.

(3) The Commission may exempt any futures commission merchant from any provision of this section if it finds that the exemption is not contrary to the public interest and the purposes of the provisions from which the exemption is sought. The Commission may grant the exemption subject to such terms and conditions as it may find appropriate.

(e) *Location of records* A futures commission merchant required to maintain records concerning Material Affiliated Persons pursuant to this section may maintain those records either at the principal office of the Material Affiliated Person or at a records storage facility, provided that, except as set forth in paragraph (c) of this section, the records are located within the boundaries of the United States and the records are kept and available for inspection in accordance with § 1.31 If such records are maintained at a place other than the futures commission merchant's principal place of business, the Material Affiliated Person or other entity maintaining the records shall file with the Commission a written undertaking, in a form acceptable to the Commission, signed by a duly authorized person, to the effect that the records will be treated as if the futures commission merchant were maintaining the records pursuant to this section and that the entity maintaining the records will permit examination of such records at any time, or from time to time during business hours, by representatives or designees of the Commission and promptly furnish the Commission representative or its designee true, correct, complete and current hard copy of all or any part of such records. The election to maintain records at the principal place of business of the Material Affiliated Person or at a records storage facility pursuant to the provisions of this paragraph shall not relieve the futures commission merchant required to maintain and preserve such records from any of its responsibilities under this section or § 1.15.

(f) *Confidentiality* All information obtained by the Commission pursuant to the provisions of this section from a futures commission merchant concerning a Material Affiliated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(g) *Implementation schedule* (1) Each futures commission merchant registered as of December 31, 1994 and subject to the requirements of this section shall maintain and preserve the information required by paragraphs (a)(1)(i) and (a)(1)(ii) of this section commencing April 30, 1995 and the information required by paragraphs (a)(1)(iii) and (a)(1)(iv) of this section commencing May 15, 1995 or, if December 31, 1994 is not the futures commission merchant's fiscal year-end, 135 calendar days following the first fiscal year-end occurring after December 31, 1994.

(2) Each futures commission merchant whose registration becomes effective after December 31, 1994 and is subject to the requirements of this section shall maintain and preserve the information required by paragraphs (a)(1)(i) and (a)(1)(ii) of this section commencing 60 calendar days after registration become effective and the information required by paragraphs (a)(1)(iii) and (a)(1)(iv) of this section commencing 105 calendar days following the first fiscal year-end occurring after registration becomes effective.

5. Section 1.15 is added to read as follows:

§ 1.15 Risk assessment reporting requirements for futures commission merchants.

(a) *Reporting requirements with respect to information required to be maintained by § 1.14.* (1) Each futures commission merchant registered with the Commission pursuant to Section 4d of the Act, unless exempt pursuant to paragraph (c) of this section, shall file the following with the regional office with which it files periodic financial reports and with its designated self-regulatory organization by no later than April 30, 1995, provided that in the case of a futures commission merchant whose registration becomes effective after December 31, 1994, such futures commission merchant shall file the following within 60 calendar days after the effective date of such registration, or by April 30, 1995, whichever comes later:

(i) A copy of the organizational chart maintained by the futures commission merchant pursuant to paragraph (a)(l)(i) of § 1.14. Where there is a material change in information provided, an updated organizational chart shall be filed within sixty calendar days after the end of the fiscal quarter in which the change has occurred; and

(ii) Copies of the financial, operational, and risk management policies, procedures and systems maintained by the futures commission merchant pursuant to paragraph (a)(l)(ii) of § 1.14. If the futures commission merchant has no such written policies, procedures or systems, it must file a statement so indicating. Where there is a material change in information provided, such change shall be reported within sixty calendar days after the end of the fiscal quarter in which the change has occurred.

(2) Each futures commission merchant registered with the Commission pursuant to Section 4d of the Act, unless exempt pursuant to paragraph (c) of this section, shall file the following with the regional office with which it files periodic financial reports within 105 calendar days after the end of each fiscal year or, if a filing is made pursuant to a written notice issued under paragraph (a)(2)(iii) of this section, within the time period specified in the written notice:

(i) Fiscal year-end consolidated and consolidating balance sheets for the highest level Material Affiliated Person within the futures commission merchant's organizational structure, which shall include the futures commission merchant and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated balance sheets shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which consolidated balance sheets shall include appropriate explanatory notes. The consolidating balance sheets may be those prepared by the futures commission merchant's highest level Material Affiliated Person as part of its internal financial reporting process;

(ii) Fiscal year-end annual consolidated and consolidating income statements and consolidated cash flow statements for the highest level Material Affiliated Person within the futures commission merchant's organizational structure, which shall include the futures commission merchant and its other Material Affiliated Persons, prepared in accordance with generally accepted accounting principles, which consolidated statements shall be audited by an independent certified public accountant if an annual audit is performed in the ordinary course of business, but which otherwise may be unaudited, and which consolidated statements shall include appropriate explanatory notes. The consolidating statements may be those prepared by the futures commission merchant's highest level Material Affiliated Person as part of its internal financial reporting process; and

(iii) Upon receiving written notice from any representative of the Commission and within the time period specified in the written notice, such additional information which the Commission determines is necessary for a complete understanding of a particular affiliate's financial impact on the futures commission merchant's organizational structure.

(3) For the purposes of this section, the term Material Affiliated Person shall have the meaning used in § 1.14.

(4) The reports required to be filed pursuant to paragraph (a)(1) of this section shall be considered filed when received by the regional office of the Commission with whom the futures commission merchant files financial reports pursuant to § 1.10 and by the designated self-regulatory organization, and the reports required to be filed pursuant to paragraph (a)(2) of this section shall be considered filed when received by the regional office of the Commission with whom the futures commission merchant files financial reports pursuant to § 1.10.

(b) [Reserved]

(c) *Exemptions.* (1) The provisions of this section shall not apply to any futures commission merchant which holds funds or property of or for futures customers of less than $6,250,000 and has less than $5,000,000 in adjusted net capital as of the futures commission merchant's fiscal year-end; provided, however, that such futures commission merchant is not a clearing member of an exchange.

(2) The Commission may, upon written application by a Reporting Futures Commission Merchant, exempt from the provisions of this section, other than paragraph (a)(1)(ii) of this section, either unconditionally or on specified terms and conditions, any futures commission merchant affiliated with such Reporting Futures Commission Merchant. The term "Reporting Futures Commission Merchant" shall mean, in the case of a futures commission merchant that is affiliated with another registered futures commission merchant, the futures commission merchant which maintains the greater amount of net capital as last reported on its financial reports filed with the Commission pursuant to § 1.10 unless another futures commission merchant is acting as the Reporting Broker or Dealer under § 240.17h–2T of this title or the Commission permits another futures commission merchant to act as the Reporting Futures Commission Merchant. In granting exemptions under this section, the Commission shall consider, among other factors, whether the records and other information required to be maintained pursuant to § 1.14 concerning the Material Affiliated Persons of the futures commission merchant affiliated with the Reporting Futures Commission Merchant will be available to the Commission pursuant to the provisions of this section. A request for exemption filed under this paragraph (c)(2) shall explain the basis for the designation of a particular futures commission merchant as the Reporting Futures Commission Merchant and will become effective on the thirtieth day after receipt of such request by the Commission unless the Commission objects to the request by that date. The Reporting Futures Commission Merchant must submit the information required by paragraph (a)(1)(ii) of this section on behalf of its affiliated futures commission merchants.

(3) The Commission may exempt any futures commission merchant from any provision of this section if it finds that the exemption is not contrary to the public interest and the purposes of the provisions from which the exemption is sought. The Commission may grant the exemption subject to such terms and conditions as it may find appropriate.

(d) *Special provisions with respect to Material Affiliated Persons subject to the supervision of certain domestic regulators.* (1) In the case of a futures commission merchant which is required to file, or has a Material Affiliated Person which is required to file, Form 17–H (or such other forms or reports as may be required) with the Securities and Exchange Commission pursuant to § 240.17h–2T of this title, or such other risk assessment regulations as the Securities and Exchange Commission may adopt, such futures commission merchant shall be deemed to be in compliance with the reporting requirements of paragraphs (a)(1)(i) and (a)(2) of this section if the futures commission merchant furnishes, in accordance with paragraph (a)(2) of this section, a copy of the most recent Form 17–H filed by the futures commission merchant or its Material Affiliated Person with the Securities and Exchange Commission, provided however, that if the futures commission merchant has designated any of its affiliated persons as Material Affiliated Persons for purposes of this section and § 1.14 which are not designated as Material Associated Persons for purposes of the Form 17–H filed pursuant to §§ 240.17h–1T and 240.17h–2T of this title, the futures commission must also designate any such affiliated person as a Material Affiliated Person on the organizational chart required as Item 1 of Part I of Form 17–H. To comply with paragraphs (a)(1)(i) and (a)(2) of this section, such futures commission merchant may, at its option, file Form 17–H in its entirety or file such form without the information required under Part II of Form 17–H.

(2) In the case of a Material Affiliated Person (including a foreign banking organization) that is subject to examination by, or the reporting requirements of, a Federal banking agency, the futures commission merchant shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to such Material Affiliated Person if the futures commission merchant or such Material Affiliated Person maintains in accordance with § 1.14 copies of all reports filed by the Material Affiliated Person with the Federal banking agency pursuant to section 5211 of the Revised Statutes, section 9 of the Federal Reserve Act, section 7(a) of the Federal Deposit Insurance Act, section 10(b) of the Home Owners' Loan Act, or section 5 of the Bank Holding Company Act of 1956.

(3) In the case of a futures commission merchant that has a Material Affiliated Person that is subject to the supervision of an insurance commissioner or other similar official or agency of a state, such futures commission merchant shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to the Material Affiliated Person if:

(i) With respect to a Material Affiliated Person organized as a mutual insurance company or a non-public stock company, the futures commission merchant or such Material Affiliated Person maintains in accordance with § 1.14 copies of the annual statements with schedules and exhibits prepared by the Material Affiliated Person on forms prescribed by the National Association of Insurance Commissioners or by a state insurance commissioner; and

(ii) With respect to a Material Affiliated Person organized as a public stock company, the futures commission merchant or such Material Affiliated Person maintains, in addition to the annual statements with schedules and exhibits required to be maintained pursuant to § 1.14, copies of the filings made by the Material Affiliated Person pursuant to sections 13 or 15 of the Securities Exchange Act of 1934 and the Investment Company Act of 1940.

(4) No futures commission merchant shall be required to furnish to the Commission any examination report of any Federal banking agency or any supervisory recommendations or analyses contained therein with respect to a Material Affiliated Person that is subject to the regulation of a Federal banking agency. All information received by the Commission pursuant to this section concerning a Material Affiliated Person that is subject to examination by or the reporting requirements of a Federal banking agency shall be deemed confidential for the purposes of section 8 of the Act.

(5) The furnishing of any information or documents by a futures commission merchant pursuant to this section shall not constitute an admission for any purpose that a Material Affiliated Person is otherwise subject to the Act.

(e) *Special provisions with respect to Material Affiliated Persons subject to the supervision of a Foreign Regulatory Authority.* A futures commission merchant shall be deemed to be in compliance with the reporting requirements of paragraph (a)(2) of this section with respect to a Material Affiliated Person if such futures commission merchant furnishes, or causes such Material Affiliated Person to make available, in accordance with the provisions of this section, copies of any financial or risk exposure reports filed by such Material Affiliated Person with a foreign futures authority or other foreign regulatory authority, provided that: (1) the futures commission merchant agrees to use its best efforts to obtain from the Material Affiliated Person and to cause the Material Affiliated Person to provide, directly or through its foreign futures authority or other foreign regulatory authority, any supplemental information the Commission may request and there is no statute or other bar in the foreign jurisdiction that would preclude the futures commission merchant, the Material Affiliated Person, the foreign futures authority or other foreign regulatory authority from providing such information to the Commission; or (2) the foreign futures authority or other foreign regulatory authority with whom the Material Affiliated Person files such reports has entered into an information sharing agreement with the Commission which is in effect as of the futures commission merchant's fiscal year-end and which will allow the Commission to obtain the type of information required herein. The futures commission merchant shall file a copy of the original report and a copy translated into the English language. For the purposes of this section, the term "Foreign Futures Authority" shall have the meaning set forth in section 1a(10) of the Act.

(f) *Confidentiality.* All information obtained by the Commission pursuant to the provisions of this section from a futures commission merchant concerning a Material Associated Person shall be deemed confidential information for the purposes of section 8 of the Act.

(g) *Implementation schedule.* Each futures commission merchant registered as of December 31, 1994 and subject to the requirements of this section shall file the information required by paragraph (a)(1) of this section no later than April 30, 1995 and the information required by paragraph (a)(2) of this section no later than May 15, 1995. Each futures commission merchant whose registration becomes effective after December 31, 1994 and is subject to the requirements of this section shall file the information required by paragraph (a)(1) of this section within 60 calendar days after registration is granted, or by April 30, 1995, whichever comes later and the information required by paragraph (a)(2) of this section within 105 calendar days after registration is granted or by May 15, 1995, whichever comes later.

Issued in Washington, DC on December 21, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 94-31828 Filed 12-27-94; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 240, and 249

[Release No. 34-35123; File No. S7-17-94]

RIN: 3235-AG15

Proposed Rule Changes of Self Regulatory Organizations; Annual Filing of Amendments to Registration Statements of National Securities Exchanges, Securities Associations, and Reports of the Municipal Securities Rulemaking Board

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting amendments to Rule 19b-4 and Form 19b-4 under the Securities Exchange Act of 1934 to expand the scope of proposed rule changes filed by self-regulatory organizations that may become effective immediately. The Commission also is amending its rules to delegate to the Director of the Division of Market Regulation certain related functions. The amendments implement recommendations contained in the Market 2000 report and are designed to expedite and streamline the process by which proposed rule changes of self-regulatory organizations are filed and become effective. In addition, the Commission is streamlining and conforming the requirements for national securities exchanges and securities associations to file annual amendments to their registration statements, and for the Municipal Securities Rulemaking Board to file annual reports.

EFFECTIVE DATE: January 27, 1995.

FOR FURTHER INFORMATION CONTACT: (prior to the effective date) Catherine McGuire, Chief Counsel, or Andrew S. Margolin, Senior Counsel, Office of Chief Counsel, at (202) 942-0073; (after the effective date) for exchange rules, Sharon Lawson, Assistant Director, at (202) 942-0182, or Ivette Lopez, Senior Special Counsel, at (202) 942-0765; for National Association of Securities Dealers and Municipal Securities Rulemaking Board rules, Katherine A. England, Assistant Director, at (202) 942-0154; for clearing agency rules, Jerry Carpenter, Assistant Director, at (202) 942-4187, Office of Market Supervision, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5-1, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

On June 1, 1994, the Commission proposed for public comment amendments to Rule 19b-4 [1] and Form 19b-4 [2] under the Securities Exchange Act of 1934 [3] ("Exchange Act" or "Act"), the rule and form applicable to the process by which self-regulatory organizations ("SROs") file proposed rule changes with the Commission.[4] The proposal was intended to expedite the rule filing process by expanding the categories of proposed rule changes that may become effective upon filing pursuant to Section 19(b)(3)(A) [5] of the

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[1] 17 CFR 240.19b-4.

[2] 17 CFR 249.819.

[3] 15 U.S.C. 78a, *et seq.*

[4] Securities Exchange Act Release No. 34140 (June 1, 1994), 59 FR 29393 ("Proposing Release").

[5] 15 U.S.C. 78s(b)(3)(A).

Act to include certain systems changes and other noncontroversial filings. The Commission also proposed amendments to Rules 6a–2,[6] 15Aj–1,[7] 17a–21,[8] and Form X–15AJ–2[9] under the Act, to streamline and conform the annual filing requirements of amendments to registration statements of national securities exchanges and securities associations, and annual reports of the Municipal Securities Rulemaking Board ("MSRB").

The proposals implement recommendations contained in the Division of Market Regulation's ("Division") *Market 2000* report.[10] The report recommended that the rule filing process be expedited for routine procedural and administrative modifications to existing order-entry and trading systems. The Division also agreed to consider other types of SRO proposals that could be subject to an expedited review process.

The Commission received nine comment letters in response to its request for comments.[11] Commenters expressed general support for these proposals, and also suggested other ways to improve the SRO rule filing process. The Commission has determined to adopt the amendments substantially as proposed with some modifications designed to address the comments received.[12] The Commission also is providing further clarification on the application of amended Rule 19b–4.

II. Amendments to Rule 19b–4

Under Section 19(b) of the Act, an SRO is required to file with the Commission its proposed rule changes.[13] Once a proposed rule change is filed, the Commission is required to publish notice of it and provide an opportunity for public comment. The proposed rule change may not take effect unless approved by the Commission or unless the rule change is within the class of rule changes effective upon filing pursuant to Section 19(b)(3)(A).[14]

Under Section 19(b)(3)(A) of the Act and Rule 19b–4(e) thereunder, a proposed rule change may take effect upon filing without the notice and approval procedures required by Section 19(b)(2) if the proposed rule change comes within prescribed statutory categories,[15] including matters which the Commission may, consistent with the public interest and the purposes of this subsection, specify by rule. Accordingly, the Commission is amending Rule 19b–4 to add two new categories of proposed rule changes that can become effective in this manner: (1) Routine procedural and administrative modifications to existing order-entry and trading systems (the "existing systems category"); and (2) certain other noncontroversial filings (the "noncontroversial category").[16] The Commission believes that these amendments are consistent with the general principles of the Exchange Act applicable to the approval of SRO rule changes that ensure that meaningful public comment is reflected where necessary. All rule changes that become effective under Section 19(b)(3)(A) will continue to be subject to abrogation by the Commission within 60 days of the filing.[17]

A. Systems Changes

In the Proposing Release, the Commission proposed to allow SRO rule changes dealing with routine procedural and administrative modifications to existing order-entry and trading systems to become effective upon filing pursuant to Section 19(b)(3)(A) of the Act. Historically, it has been required that these modifications be filed under Section 19(b)(2).[18] The proposed amendments limit the scope of the existing systems category to those systems changes that: (1) Do not significantly affect the protection of investors or the public interest; (2) do not impose any significant burden on competition; and (3) do not have the effect of limiting the access to or availability of the system.

Commenters supported this proposal because it would address concerns that the filing process with respect to these types of rule changes can be too lengthy, and hampers the ability of SROs to provide prompt, flexible, and innovative systems changes. Several commenters, however, requested further clarification of when a systems change requires a filing, and whether such filings would be eligible to become effective upon filing under the existing systems category.

1. Systems Changes that Require Rule Change Filings

The NASD commented that certain changes related to order-entry and trading systems should not be considered proposed rule changes at all and should be exempt from the filing process. The NASD cited changes involving the format and appearance of screens, keystroke commands, underlying hardware and software changes, and the user manuals and technical guides to system operation. The NASD stated that these filings rarely would pose significant concerns in the areas of investor protection, public interest, or fair competition.

While changes to the format and appearance of screens, or changes involving the underlying hardware and software may not need to be filed pursuant to Section 19(b)(2) in many instances, the Commission cannot state as a general matter that these changes are never required to be filed. For example, if an SRO decided to alter the format and appearance of a system providing quotation information by excluding the market maker or market specialist identifier, thus making it virtually impossible for a system user to

[6] 17 CFR 240.6a–2.

[7] 17 CFR 240.15Aj–1.

[8] 17 CFR 240.17a–21.

[9] 17 CFR 249.803.

[10] Division of Market Regulation, *Market 2000: An Examination of Current Equity Market Developments* (January, 1994).

[11] *See* Letters to Jonathan G. Katz, Secretary, Securities and Exchange Commission, from: James E. Buck, Senior Vice President and Secretary, New York Stock Exchange ("NYSE"), dated August 12, 1994; Richard G. Ketchum, Chief Operating Officer and Executive Vice President, National Association of Securities Dealers ("NASD"), dated August 16, 1994; James F. Duffy, Executive Vice President and General Counsel, American Stock Exchange ("Amex"), dated August 18, 1994; Michael L. Myers, Schiff Hardin & Waite (on behalf of the Chicago Board Options Exchange ("CBOE") and the Options Clearing Corporation ("OCC")), dated August 12, 1994; J. Craig Long, Secretary, Chicago Stock Exchange ("CHX"), dated August 8, 1994; Larry R. Shotwell, Executive Vice President, Pacific Stock Exchange ("PSE"), dated August 12, 1994; David C. Clapp, Chairman, Municipal Securities Rulemaking Board ("MSRB"), dated August 3, 1994; William W. Uchimoto, First Vice President and General Counsel, Philadelphia Stock Exchange ("Phlx"), dated August 19, 1994; and John I. Fitzgerald, Executive Vice President, Boston Stock Exchange ("BSE"), dated August 8, 1994. The comment letters and a summary of comments are contained in Public File No. S7–17–94.

[12] These amendments may affect clearing agencies for which the Commission is not the appropriate regulatory agency as defined in Exchange Act § 3(a)(34), 15 U.S.C. 78c(a)(34). Therefore, in accordance with Exchange Act § 17A(d)(3)(A)(i), 15 U.S.C. 78q–1(d)(3)(A)(i), at least 15 days before this announcement, the Commission consulted and requested the views of the Board of Governors of the Federal Reserve System.

[13] 15 U.S.C. 78s(b)

[14] *See* Proposing Release for a more complete discussion of this process.

[15] These include rule changes that (1) Constitute a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the SRO, (2) establish or change a due, fee, or other charge imposed by the SRO, or (3) that are concerned solely with the administration of the SRO. 15 U.S.C. 78s(b)(3)(A).

[16] These categories will be established by amending Rule 19b–4 to add paragraph (e)(5) for the systems category and paragraph (e)(6) for the noncontroversial category, and by making conforming changes to Form 19b–4.

[17] 15 U.S.C. 78s(b)(3)(C).

[18] *See, e.g.*, Letter from Richard T. Chase, Assistant Director, SEC, to Frank Wilson, Executive Vice President, NASD (February 4, 1983).

determine the origination of a quote, the SRO would then be required to file a proposed rule change with the Commission. The Exchange Act requires SROs to have rules designed, among other things, to remove impediments to and perfect the mechanism of a free and open market and a national market system.[19] Thus, any change to a system providing quotation information that would affect the maintenance of a free and open market or a national market system would be required to be filed with the Commission.

Similarly, changes to keystroke commands would generally not require a filing. If such a change, however, would have the effect of prohibiting entry of certain types of orders, such as a series of keystrokes so cumbersome that it has the effect of prohibiting the entry of orders priced outside the current inside market, that change would require a filing pursuant to Section 19(b)(2).[20] While software or hardware changes generally do not require a filing pursuant to Section 19(b)(2), the Commission has suggested that significant hardware and software changes be reported to the Commission on an annual and an as-needed basis, as stated in its most recent Automation Review Policy.[21]

User manuals and technical guides for a particular system, as a general matter, need not be filed with the Commission. It has been the Commission's experience, however, that at times, a clear understanding of how the system functions may be achieved only by reviewing the rules of the SRO in conjunction with the user manual or technical guide. The Commission believes that it is more appropriate to have the relevant information in the SRO's rules so that it may be available to anyone seeking an understanding of the system's operation.[22] It is the SRO's responsibility to make the initial determination of whether an action an SRO is contemplating will require a filing, including whether to file user manuals and technical guides. Whether any particular guide needs to be filed must be determined on a case by case basis.[23]

2. Scope of Filings Eligible for the Existing Systems Category

In the Proposing Release, the Commission cited examples of the type of proposed rule change that would be within the existing systems category. For example, a proposed rule change that would increase marginally the maximum number of shares per order that could be executed through an SRO's small order routing and execution system, or a proposed rule change that would expand the number of series or classes eligible for options routing and execution systems generally could be filed pursuant to Section 19(b)(3)(A).

In addition, the Commission believes that the following recent filings also exemplify the type that would qualify for the existing systems category: a rule change requiring the use of a special indicator for average-priced trade reports,[24] and one requiring OTC Bulletin Board ("OTCBB") market makers to append a fifth character to their market maker identifier as a geographic indicator when trading away from primary offices.[25]

The NASD suggested that the term "trading system" should be clarified to include automated services that support trading, trade reporting, and clearance and settlement, such as the OTCBB and the Automated Confirmation Transaction service ("ACT"). The NASD recommended that changes to these systems should be eligible under either the existing systems category, or the noncontroversial category discussed below.

The Amex requested that the Commission make clear that changes to automatic equity order execution systems that could interfere with providing best execution would be precluded from filing under Section 19(b)(3)(A). The Amex also requested that the Commission not limit the availability of the existing systems category to only marginal increases in the number of shares per order that can be entered and executed through a small order routing and execution system, as stated in the Proposing Release, but also include significant increases in certain circumstances.

While the Commission generally believes that it may be reasonable to interpret broadly the term "trading system," to include related automated services such as the OTCBB or ACT, such that changes to those services could be eligible for filing under the existing systems category, the Commission also believes, for example, that a proposal to expand the category of eligible securities in connection with a system to include foreign securities would raise investor protection and competitive concerns, and would thus be subject to review pursuant to Section 19(b)(2).

The Commission recognizes, as noted by the Amex, that a proposed rule change that interferes with best execution obligations would significantly affect the protection of investors and thus would not satisfy the conditions for expedited treatment set forth in the rule. The Commission also believes that a proposed rule change that substantially increases the number of shares per order routed or executed through a small order execution system may in some circumstances be eligible for expedited treatment. Such a proposed rule change, however, generally would not be eligible to

[19] 15 U.S.C. 78f(b)(5) and 78o-3(b)(6).

[20] In fact, the Commission recently was presented with a situation which raised this very issue and demonstrated the need for filing pursuant to Section 19(b)(2). On October 25, 1993, the NASD filed with the Commission a proposed rule change to modify the SelectNet service by prohibiting entry of orders in SelectNet priced outside the inside Nasdaq market. Securities Exchange Act Release No. 33101 (Oct. 25, 1993), 58 FR 58363 (File No. SR-NASD-93-60). The NASD filed that rule change pursuant to Section 19(b)(3)(A) of the Act which became effective immediately. On October 29, 1993, pursuant to Section 19(b)(3)(C) of the Act, the Commission abrogated the rule change on the basis that it should have been filed pursuant to Section 19(b)(2) and thus, subject to notice and comment. Securities Exchange Act Release No. 33116 (Oct. 29, 1993), 58 FR 58883. On November 1, 1993, the NASD refiled with the Commission the proposed rule change pursuant to Section 19(b)(2) of the Act. Securities Exchange Act Release No. 33141 (Nov. 3, 1993), 58 FR 59504 (File No. SR-NASD-93-61). Due to concerns about whether the NASD's proposal was consistent with the Act, the Commission instituted proceedings pursuant to Section 19(b)(2)(B) of the Act to determine whether the proposed rule change should be disapproved. Securities Exchange Act Release No. 34000 (May 3, 1994), 59 FR 23909. Subsequently, the NASD modified the SelectNet keystroke procedures for entering and accepting orders outside the inside Nasdaq market. The modification provided a warning to SelectNet participants that the order is priced outside the inside market but allows participants to override the warning. Because this modification neither significantly altered SelectNet nor denied access to SelectNet, the change was not considered a proposed rule change and thus did not require filing with the Commission. As a result, the NASD withdrew its proposed rule change and the Commission terminated the proceedings to determine whether to disapprove the proposal. Securities Exchange Act Release No. 34486 (Aug. 4, 1994), 59 FR 40933.

[21] Securities Exchange Act Release No. 29185 (May 9, 1991), 56 FR 22490.

[22] The SRO's rules should indicate, for example, the types and size of orders, and with specificity, the manner in which orders will be processed in the system. Specifically, with respect to a system such as SelectNet, it is important to know how the different types of orders are displayed and to whom they are displayed. *See* Letter from David Humphreville and Caroline B. Austin, Co-Chairs, National Specialist Association to Jonathan G. Katz, Secretary, SEC, dated November 6, 1992 (commenting on File No. SR-NASD-92-16). Information explaining the combination of keystrokes that must be used to accept an order may be more appropriate for a user manual or technical guide.

[23] If an SRO has failed to explain clearly in its rules how a particular system functions, including who has access to the system, it should consider submitting a proposed rule change comprising the relevant information contained in the guide or manual.

[24] File No. SR-NASD-93-20.

[25] File No. SR-NASD-93-74.

become effective upon filing under the existing systems category because a change in the order size of substantial magnitude would not qualify as a modification of an existing system, but in effect establishes a new system. Thus, it generally will be more appropriate to file significant increases in order size under the noncontroversial category discussed below.

The Commission is adopting the amendments concerning existing systems changes as originally proposed. The Commission believes that, because these types of proposed rule changes deal with operational details of existing systems and are subject to certain limitations in the rule, they do not require the full notice and review procedures of Section 19(b)(2). The amendments bring the filing procedures for this type of proposed rule change in line with procedures that have been in effect for clearing agencies since 1980.[26]

B. Noncontroversial Filings

As proposed, the amendments to Rule 19b-4 also would expand the scope of proposed rule changes that may become effective upon filing under Section 19(b)(3)(A) to include certain noncontroversial filings. For these filings, SROs would be required to provide written notice to the Commission five business days prior to the filing.[27] This notice would provide Commission staff an opportunity to discuss with the SRO whether there exists an adequate basis upon which the proposed rule change may properly qualify under Section 19(b)(3)(A), and could elicit guidance from Commission staff to help the SRO identify those aspects of a proposed rule change that the Commission deems important.[28] Proposed rule changes in the noncontroversial category, by their terms, would become operative 30 days after the date of publication of the notice, or such shorter time as the Commission may designate.

The proposal of the noncontroversial category elicited significant comment. The comments focused on the timing of the effectiveness of these noncontroversial filings, and the scope of proposed rule changes that may be filed under this category. Commenters also voiced concerns relating to the publication of notices of proposed rule changes generally.

1. Timing of Effectiveness

Commenters indicated that the 30-day delayed operational date was too lengthy for noncontroversial rule filings and that, in any case, the operational date was not predictable.[29] Commenters offered a variety of suggestions about how to address this issue. While some suggested that the period be shortened,[30] others suggested eliminating the period altogether or granting authority to delay the operation of the rule only in specific circumstances.[31] Several recommended that the 30-day period run from the date of the filing rather than the date of publication.[32] The Amex requested that the Commission clarify procedures applicable to the filing of amendments to proposed rule changes under the noncontroversial category, and requested that there be an explicit mechanism for requesting that the 30-day period be shortened. The Amex also recommended that the five-day period for submitting a pre-filing notice be a maximum, and not a minimum period, so as not to preclude submission of the subsequent filing less than five days later, in the event that the Commission determines in a shorter time that the filing is appropriately filed under this category.

Related to the timing of effectiveness is the matter of publishing notices of proposed rule changes. Several commenters were critical of the length of time between the filing of a proposed rule change and its publication in the **Federal Register**. The CBOE, for example, argued that in some cases the publication of the notice has been inordinately delayed. The Phlx stated that the delay results from a lengthy prepublication review by the Commission. The NYSE and the NASD suggested that the Commission adopt an internal guideline on publishing notices to address this perceived problem.

The Commission believes that a 30-day delayed operational date for noncontroversial filings is necessary and appropriate. If, as a result of either subsequent Commission review or public comment, it is determined that a proposed rule change was not properly filed as within the noncontroversial category, the 30-day period would allow the Commission to abrogate the rule change without a significant disruption in existing operations.

To address concerns of commenters, however, the Commission has determined to commence the 30-day period with the filing date of the proposed rule change, instead of the publication date as originally proposed. This will enable SROs to implement a proposed rule change more quickly, while preserving the opportunity for meaningful public comment. A 30-day period triggered by the filing date provides predictability while assuring that the filing is reviewed not only by the staff but also by commenters.

With respect to amendments to filings in the noncontroversial category, the Commission believes that any substantive amendment would trigger a new 30-day period, assuming that the changes do not render the filing ineligible for this category. The staff would, however, have discretion to accept editorial changes without triggering a new 30-day period. The Commission notes that this procedure was designed to expedite those SRO filings that are inherently simple and concise, and that would otherwise require little in the way of extended review or analysis by the Commission. A filing requiring further substantive amendments may indicate that it is not appropriate for the expedited treatment afforded by the noncontroversial category.

Form 19b–4 also has been amended to state that an SRO requesting the Commission to shorten the 30-day period should provide a statement explaining why the Commission should do so. With respect to the five-day pre-filing period, the Commission is amending the rule to permit the Commission to designate a shorter period if appropriate.

As the Commission has stated in the past, its intent is to publish all notices

[26] A proposed rule change of a registered clearing agency can become effective upon filing pursuant to Rule 19b-4 if it effects a change in an existing service that (1) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (2) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service. See Securities Exchange Act Release No. 17258 (October 30, 1980), 45 FR 73906.

[27] As stated in the Proposing Release, the Commission expects that such notices will be informal and often transmitted by facsimile. The notice should be directed to the appropriate Division staff responsible for reviewing that SRO's filings of proposed rule changes. The Commission intends to place this notice in a public file. *See* Exchange Act § 23(a)(3), 15 U.S.C. 78w(a)(3).

For every clearing agency for which the Commission is not the appropriate regulatory agency, the notice also must be filed with the appropriate regulatory agency for the clearing agency as required by Exchange Act § 17(c)(1), 15 U.S.C. 78q(c)(1). Consistent with the requirements of that section, the Commission also would expect the MSRB to file such notices with each agency enumerated in Exchange Act § 3(a)(34)(A), 15 U.S.C. 78c(a)(34)(A).

[28] This also should help the SRO articulate in its subsequent filing the purpose and effects of the proposed rule change, which in turn should further facilitate and expedite the filing process.

[29] *See, e.g.*, Letter from NYSE.

[30] *See, e.g.*, Letter from Amex.

[31] Letter from NYSE.

[32] Letters from CBOE, CHX, Phlx.

of proposed rule changes promptly.[33] In light of comments received, the Commission will redouble its efforts to do so in the future. The Commission notes, however, that notices of proposed rule changes need to be clear in order to elicit meaningful public comment. Although a proposed rule change may be accepted as filed, the Commission believes that it should not be published until it has reached an adequate level of clarity regarding the issues raised by the filing. For complex filings, this can require more extensive review. Filings of rule changes also need to include information necessary to enable the Commission's staff to conduct a complete review. Any filings that fail to comply with the requirements of Form 19b–4 may be returned to the SRO and will be deemed not to have been filed with the Commission.

2. Scope of Filings Eligible for the Noncontroversial Category

Many commenters requested further clarification of the scope of this proposal. While it would be impossible to identify with certainty in advance every type of proposed rule change that may qualify for the noncontroversial category, the discussion below should assist SROs in assessing its availability.

The noncontroversial category applies only to those proposed rule changes that are properly designated by the SRO as not significantly affecting the protection of investors or the public interest and not imposing any significant burden on competition. As indicated in the Proposing Release, proposed rule changes meeting these criteria generally are less likely to engender adverse comments or require the degree of review attendant with more controversial filings.

In the Proposing Release, the Commission cited examples of proposed rule changes that would be eligible for the noncontroversial category, such as certain proposed rule changes that would add an existing rule to an SRO's minor rule violation plan, and proposed rule changes that permit the transmission of data to or from the SRO by computer interface or other electronic means. The Proposing Release also made clear, however, that for policy reasons, a proposed rule change that would reduce public representation in the administration of the affairs of an SRO or that would amend the procedures for arbitration or disciplinary proceedings would not be a proper candidate to become effective under Section 19(b)(3)(A).

In its comment letter, the NYSE stated that the scope of the proposal for noncontroversial filings would depend on the interpretation of the term "significant" as it is used in the amendments. In requesting that the Commission provide further guidance on the scope of this proposal, the NYSE indicated that, based on a survey of its filings for 1993 and the first half of 1994, its staff believed that the overwhelming majority of its rule changes would not have been eligible for expedited treatment. The NASD and the Amex suggested that the Commission apply an expedited approach to proposed rule changes that "clone" or are virtually identical to other rule changes filed by another SRO that already have been approved by the Commission. The NASD also questioned the general utility of the noncontroversial category to the extent that a competitor could unjustifiably impede the expedited treatment of an SRO's proposed rule change simply by filing a perfunctory adverse comment letter.

The Commission would like to make clear that although it intends to expedite the rule filing process, it is doing so only with respect to the universe of proposed rule changes that are not likely to engender adverse comments or otherwise warrant the type of review required by Section 19(b)(2) of the Act. With respect to the NYSE's survey of its filings, the Commission staff has determined that, of 72 NYSE proposed rule changes identified as being filed during the period surveyed by the NYSE, at least seventeen, in retrospect, would have qualified for expedited treatment under the noncontroversial category. These include filings that: (1) conformed the NYSE pre-opening application to the Intermarket Trading System by clarifying the use of a cancellation notification sent after a pre-opening notification;[34] (2) similar to other proposals approved for the Amex and CBOE, provided for the listing and trading of quarterly index expiration options;[35] (3) amended floor conduct and safety guidelines not dealing with procedural rights of offender (two filings);[36] (4) rescinded two NYSE rules, Rules 391 and 392, which served little purpose in light of the Commission's rescission of its Rule 10b–2;[37] (5) extended until January 31, 1994, off-hours trading and the matched market-on-close pilot program;[38] (6) added to the exchange's minor rule violation plan NYSE Rule 410B, which requires members and member organizations to report trades in exchange listed stocks not otherwise reported to the Consolidated Tape;[39] (7) related to registration and fingerprinting of floor members and employees;[40] (8) amended the exchange's minor rule violation plan to include exchange procedures with respect to entry and cancellation of market-at-the-close orders on expiration days, and other rules for which determinations of violations can be made objectively (two filings);[41] (9) extended for one year the NYSE's pilot program for position limit exemptions for certain hedged equity and stock index option positions;[42] (10) increased insubstantially the exchange's continuing listing fees;[43] (11) extended Rule 103A relating to specialist stock reallocation;[44] (12) amended NYSE Rule 321 by clarifying the term "control" and substituting the word "subsidiary" for the word "affiliate" in Rules 113 and 122;[45] (13) authorized the NYSE to provide to the Central Registration Depository information concerning pending formal disciplinary proceedings;[46] (14) for audit trail reporting purposes, added identification codes for short sales exempt from Commission or exchange rules;[47] and (15) extended the exchange's circuit breaker pilot program.[48]

In addition, the staff of the Commission has identified other filings that are representative of the types of filings that could qualify for the noncontroversial category. These include filings that: (1) deleted that part of Schedule D to NASD by-laws concerning publication and dissemination of quotations to the news media, to reflect current NASD practice;[49] (2) deleted the section of NASD by-laws regarding a local quotations program that had been phased out;[50] (3) required members to adjust certain orders when securities are quoted ex-dividend, ex-rights, and ex-

[33] Securities Exchange Act Release No. 17258 (October 30, 1980), 45 FR 73906.

[34] File No. SR–NYSE–93–01.

[35] File No. SR–NYSE–93–04.

[36] File Nos. SR–NYSE–93–14 and SR–NYSE–93–25.

[37] File No. SR–NYSE–93–20.

[38] File No. SR–NYSE–93–23.

[39] File No. SR–NYSE–93–24.

[40] File No. SR–NYSE–93–28.

[41] File Nos. SR–NYSE–93–35 and SR–NYSE–93–38.

[42] File No. SR–NYSE–93–42.

[43] File No. SR–NYSE–93–46. *See* discussion on fee-related filings in this section, *infra*.

[44] File No. SR–NYSE–94–07

[45] File No. SR–NYSE–94–09.

[46] File No. SR–NYSE–94–11.

[47] File No. SR–NYSE–94–16.

[48] File No. SR–NYSE–94–34.

[49] File No. SR–NASD–93–14.

[50] File No. SR–NASD–93–40.

interest;[51] (4) eliminated existing regulatory requirements for non-Nasdaq OTC securities once real-time reporting of those securities had been approved by the Commission;[52] (5) extended previously approved pilot linkages between Nasdaq and foreign exchanges;[53] (6) mandated market maker use of registered clearing agencies;[54] and (7) provided a procedure for the immediate publication of final disciplinary sanctions.[55] Moreover, it is the Commission's view that mechanical or simple editorial changes to existing rules, such as when a change in an SRO's rule numbering system results in incorrect cross-references in other rules, may be filed within the noncontroversial category.

As noted above, under Section 19(b)(3)(A)(ii) of the Act, rule changes that establish or change a due, fee, or other charge imposed by the SRO may become effective upon filing.[56] The Commission notes that the filing of a proposed fee applicable to members may nonetheless raise significant regulatory issues and thus be required, consistent with current Commission policy, to be submitted pursuant to Section 19(b)(2).[57] In addition, the Commission continues to believe that, as a matter of general policy, an SRO proposed rule change that establishes or changes a due, fee or other charge applicable to a non–member or non–participant must be filed under Section 19(b)(2) for full notice and comment.[58] While filings concerning fees applicable to non–members have not been eligible to become effective upon filing under Section 19(b)(3)(A)(ii), some such filings now may qualify for expedited treatment under the noncontroversial category.[59]

Furthermore, the Commission will retain a flexible approach in applying amended Rule 19b–4. For example, absent unusual circumstances, filings that are virtually identical to an SRO filing already approved by the Commission will be eligible for expedited treatment under the noncontroversial category. While the Commission generally requires that proposals for exchange listing of new hybrid securities be submitted to the Commission for full review pursuant to Section 19(b)(2) of the Act to ensure that all significant regulatory concerns have been addressed, the Commission also believes that new proposals relating to these products that only change certain characteristics of the products could be eligible for expedited treatment under the noncontroversial category. Once the staff has completed the review process for a particular new product, the need for a full review of subsequent similar proposals is significantly reduced. For example, the Commission has required exchanges to submit for full review under Section 19(b)(2) proposals to list and trade MITTS and SUNS, which are products linked to various baskets of securities.[60] Because the review of new proposals that seek to change, for example, only the composition of the underlying baskets generally will be limited to the composition of those baskets, and because the Commission is now familiar with the basic structure for MITTS and SUNS, subsequent proposals should be eligible for the noncontroversial category.[61] This will expedite the approval of the listing of these products.

The Commission notes, however, that an expedited approach would not necessarily apply, as the Amex suggested, to a proposal to trade index warrants on a stock index previously approved by the Commission for options trading. While use of the procedure could be considered on a case by case basis, as a general rule different types of derivative products, albeit based on the same underlying index, may not be sufficiently identical to be eligible for this treatment.

With respect to the concern that a competitor may cause a proposed rule change of an SRO to be deemed improperly filed under the noncontroversial category merely by submitting a comment letter critical of the filing, the Commission expects that a comment letter would have to raise issues that legitimately suggest that the proposed rule change is inconsistent with the requirements of the Exchange Act or regulations thereunder applicable to that SRO in order for the rule change to be abrogated and refiled under Section 19(b)(2).

The CBOE commented that it is unclear whether the notice published by the Commission indicating that a rule change has become effective upon filing would be sufficient to prevent a collateral attack based on the assertion that the rule change was improperly filed under the Act. The Commission concurs with the CBOE's interpretation that a rule change filed under Rule 19b-4(e) is deemed to have been properly filed thereunder if the Commission fails to abrogate it within the 60 day period for such action.

Finally, the CHX urged the Commission to interpret all corporate governance changes that do not decrease the number of public governors as being within the provision of Section 19(b)(3)(A) that permits a proposed rule change to take effect upon filing if it is "concerned solely with the administration of the SRO." The governance structure of the SROs is the subject of specific statutory standards. Because a change in the overall makeup of the governance structure of an SRO could be effected without necessarily decreasing the number of public governors, the Commission does not concur in this interpretation.

In sum, the Commission is adopting amendments to Rule 19b-4 for the noncontroversial category with the following modifications: (1) the 30-day period after which a noncontroversial filing may become effective will begin with the filing date; (2) Form 19b-4 will state that an SRO requesting the Commission to shorten the 30-day period should provide a statement explaining its reasons for so requesting; and (3) Rule 19b-4 will permit the Commission to shorten the 5-day period in which SROs are required to file a notice of their intent to file, if appropriate.[62]

[51] File No. SR–NASD–93–52.

[52] File No. SR–NASD–93–68.

[53] File Nos. SR–NASD–94–23, SR–NASD–94–25, and SR–NASD–94–30.

[54] File No. SR–NASD–94–28.

[55] File No. SR–NASD–94–59.

[56] *See* note 15, *supra*.

[57] See, *e.g.*, Securities Exchange Act Release No. 32377 (May 27, 1993), 58 FR 31568 (File No. SR–NYSE–93–08) (approving NYSE proposal to grant an additional system credit to member and member organizations for all individual and agency orders of a certain size, except orders for the account of a non–member competing market maker, routed through the NYSE's SuperDot system for execution); Securities Exchange Act Release No. 27286 (September 21, 1989), 54 FR 40224 (File No. SR–NASD–88–55) (approving NASD proposal relating to the imposition on certain member firms of an assessment on annual gross income from transactions in U.S. Government Securities).

[58] Securities Exchange Act Release No. 17258 (October 30, 1980), 45 FR 73906, at 73910 n.40. *See, e.g.*, Securities Exchange Act Release Nos. 33123 (October 29, 1993), 58 FR 59083 (File No. SR–NASD–93–49) (approving NASD proposal to extend Bond Quotation Data Service fees to non–member subscribers); 34272 (June 28, 1994), 59 FR 34701 (File No. SR–Amex–94–12) (approving Amex proposal to reduce maximum fees for original stock listings by domestic and foreign issuers).

[59] For example, if an SRO proposes a reasonable and relatively minor increase in an existing fee, or a proposal that is virtually identical to fees of other SROs, provided that the proposal does not raise other regulatory issues, such proposal would qualify under the noncontroversial category.

[60] *See* Securities Exchange Act Release No. 32840 (September 2, 1993), 58 FR 47485 (order approving Global Telecommunications MITTS portfolio).

[61] *See, e.g.*, Securities Exchange Act Release No. 34655 (September 12, 1994), 59 FR 47966 (order approving the listing of REIT Portfolio MITTS); Securities Exchange Act Release No. 33495 (January 19, 1994), 59 FR 03883 (order approving the listing of Telecommunications Basket SUNS).

[62] The Commission is delegating to the Director of the Division of Market Regulation the functions of

Continued

C. Delegation of Authority to the Director of the Division of Market Regulation

The Commission currently has the authority under Section 19(b)(3)(C) of the Exchange Act to abrogate summarily within 60 days of filing any proposed rule change that becomes effective under Section 19(b)(3)(A) if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.[63] The Proposing Release indicated that if the proposals to expand the scope of Section 19(b)(3)(A) are adopted, the Commission will revise its rules to delegate this abrogation authority to the Director of the Division of Market Regulation.

As indicated in the Proposing Release, this would be necessary to facilitate an expected increase in the volume of proposed rule changes that would be filed under Section 19(b)(3)(A). In particular, the Commission expects that the staff will abrogate filings if it becomes aware of issues that would warrant further consideration under the procedures set forth in Section 19(b)(2), such as those involving possible burdens on competition or effects on investor protection. Accordingly, the Commission is delegating this function, as well as the related functions of shortening the 30 and five-day periods under paragraph (e)(6) of Rule 19b-4, to the Director of the Division.

In addition, the Commission is delegating to the Director of the Division the authority under Section 19(b)(2)(B) of the Exchange Act to institute proceedings to determine whether a proposed rule change should be disapproved.[64] It is the Commission's view at this time that filings that are not resolved within six months of submission generally should be withdrawn or, in the alternative, subject to disapproval proceedings. Although the Commission has directed its staff to request that SROs withdraw a number of filings of proposed rule changes not approved within that period, this delegation of authority is necessary to enable the Division to implement these internal guidelines.

The Commission does not intend to prevent SROs from moving forward with their rule changes. The Commission suggests, however, that when it becomes obvious that a resolution of issues for a particular filing is not forthcoming, it may be more appropriate for the SRO to advance the initiative outside of the rule filing mechanism until such time as it is in form for approval. The staff of the Commission will be available to assist SROs in this regard.[65] The Commission believes that this will maintain accountability on the part of both Commission staff and SROs by assuring that complex filings are not abandoned and allowed to stagnate within the rule filing process. These amendments add new paragraphs (a)(57), (a)(58), and (a)(59) to Rule 30–3 of the Commission's rules of Organization and Program Management.

D. Submission of Form 19b–4 on Computer Diskette and Miscellaneous Amendments

The Commission noted in the Proposing Release that significant staff resources are devoted to processing proposed rule changes and preparing them for publication, and encouraged SROs to submit Form 19b–4 and the notice for publication (Exhibit 1 to the form) on computer diskette in an appropriate wordprocessing format.[66] The paper version of these documents would continue to be required, but the electronic version would provide a more efficient way for Commission staff to review and prepare the initial notice for publication in the **Federal Register**.

The Commission also is adopting amendments as proposed that will reduce the number of copies of Form 19b–4 and Exhibit 1 that SROs must submit from twelve to nine, including the manually signed original. Although the Commission originally proposed reducing the number of copies to eight, it has determined that nine copies would be optimal based on current staff distribution requirements. In addition, the Commission is correcting miscellaneous outdated references contained in the form with respect to the Commission's address and appropriate offices within the Division to which filings of proposed rule changes should be directed.

III. Amendments to the Annual Filing Requirements for SROs and the MSRB

A registered or exempted securities exchange generally must file annual amendments to its registration statement with the Commission pursuant to Rule 6a–2 under the Exchange Act.[67] The information contained in these annual filings includes, among other things, lists of officers, governors, and committee members, as well as various forms used by the exchange, listing applications, listing fee schedules, membership lists, and securities listed on the exchange.[68] Exchange Act rules also contain similar annual filing requirements for national securities associations[69] and the MSRB.[70]

In the Proposing Release, the Commission stated that some of this information is either publicly available, becomes available to the Commission through other means, or is not useful enough to justify the burden placed on the exchanges in collecting and filing it with the Commission each year. The Commission thus proposed amendments to streamline and conform the annual filing requirements for SROs.

A. Rule 6a–2: Annual Filing Requirements of Exchanges

The proposed amendments would eliminate or reduce the annual filing requirement for certain information, and give exchanges flexibility in making their filings. Commenters supported this proposal. The NYSE suggested that the Commission adopt more extensive amendments that would relieve SROs of the need to file any information annually that is made available to the Commission throughout the year in periodic publications, such as an exchange's bulletins and information memos.

The Commission has determined to adopt the amendments to Rule 6a–2 as proposed, with the exception of one minor modification concerning the proposal to add the date of election to membership for each member, discussed below at Section III.B. The amendments to Rule 6a–2 will eliminate or reduce the information required to be filed annually in the following exhibits to exchange registration: Exhibit *B* (forms pertaining to application for membership and approval as a person associated with a member); Exhibit *C* (forms of financial statements, reports, or questionnaires relating to financial

shortening the 30 and five-day periods. *See* Section II.C. below

[63] 15 U.S.C. 78s(b)(3)(C).

[64] 15 U.S.C. 78s(b)(2)(B).

[65] The Commission recognizes that in certain instances there will be differences in opinion between the staff and SROs regarding the handling of a rule filing. In such instances, the SROs are always free to inform the Commission so that it may help expedite the processing of the filing in an appropriate manner.

[66] Currently, the staff of the Commission uses Wordperfect 5.0.

[67] Exchange Act Rule 6a–2, 17 CFR 240.6a–2. These filings are submitted on Exchange Act Form 1–A, 17 CFR 249.1a.

[68] Rule 6a–2(b) also requires the filing of complete sets of the constitution, by-laws, rules, and related documents of the exchange, but only once every three years.

[69] *See* Exchange Act Rule 15Aj–1, 17 CFR 240.15Aj–1; Form X–15AJ–2, 17 CFR 249.803. Currently, the NASD is the only national securities association registered with the Commission.

[70] *See* Exchange Act Rule 17a–21, 17 CFR 240.17a–21.

responsibility); Exhibit *D* (documents comprising listing applications including agreements required in connection therewith, and a schedule of listing fees); Exhibit *I* (list of all individual members and related information); Exhibit *J* (certain information related to a list of all member organizations of the exchange); and Exhibit *K* (schedule of securities listed on the exchange).

In addition, the amendments to Rule 6a–2 would provide the following alternatives to the annual filing requirement for the remaining exhibits to exchange registration other than Exhibits *E* and *F* (i.e., Exhibits *A(1)*, *A(2)*, *A(3)*, *G*, *H*, *J*, *L*, and *M*).[71] Exchanges would have the option, in lieu of the annual filing, to publish or cooperate in the publication of this information on an annual or more frequent basis, and to certify to the accuracy of the information. Exchanges would have the additional option of keeping the information in Exhibits *A(1)*, *A(2)*, *A(3)*, *L*, and *M* up to date, and certifying that the information is up to date and available to the Commission and the public upon request.

In response to the recommendation that SROs be relieved of the need to file altogether any information that may be available to the Commission, the Commission believes that it would be inconsistent with the requirements of Section 6 of the Exchange Act to rely upon informal, piecemeal publications as a surrogate for a comprehensive filing that is a component of an exchange's registration with the Commission. Furthermore, some of the required exhibits deal with financial information of the exchange that enable the Commission to comply with its obligations to provide Congress with a statement and analysis of the expenses and operations of each SRO.[72]

B. Rule 15Aj–1 and Form X–15AJ–2, Rule 17a–21: Annual Filing Requirements for Securities Associations and Reports of the Municipal Securities Rulemaking Board

Both the NASD and the MSRB endorsed the proposal to streamline their annual filing requirements and conform them to the requirements now applicable to exchanges.[73] The Commission is adopting amendments to Rules 15Aj–1, 17a–21, and Form X–15AJ–2 under the Exchange Act to streamline the annual filing requirements for the NASD and MSRB and make them more uniform. Like exchanges, these SROs will have similar alternative options for the filing of comparable information.

With respect to the proposal to add the date of election to membership for each member, the NASD commented that in some cases this date is not readily available and may be difficult to report. While the Commission is adopting the requirement to add the date of election to membership for each member, this information will be required only for those members elected to membership after December 31, 1994. A conforming modification also has been made to Rule 6a–2 for exchanges, thus applying the same standard to all SROs. This information serves an important purpose by enabling Commission staff to monitor the obligation of broker-dealers to become members of an SRO,[74] and designate an appropriate designated examining authority for member broker-dealers.[75]

IV. Effects on Competition and Regulatory Flexibility Act Considerations

Section 23(a)[76] of the Act requires the Commission, in adopting rules under the Act, to consider the impact on competition of those rules, if any, and to balance that impact against the regulatory benefits gained in terms of furthering the purposes of the Act. The amendments to Rule 19b–4 apply to all SROs. Furthermore, the amendments are intended to expedite for all SROs a process to which they already are subject under the Act. Similarly, the amendments to the annual filing requirements for SROs are designed to streamline and make uniform those requirements. The Commission is of the view, therefore, that adoption of the proposed amendments to Rules 19b–4, 6a–2, 15Aj–1, 17a–21, and Forms 19b–4 and X–15AJ–2 would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

In addition, Section 3(a) of the Regulatory Flexibility Act[77] requires the Commission to undertake an initial regulatory flexibility analysis of the proposed amendments on small entities unless the Chairman certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.[78] Rule 19b–4 and Form 19b–4 apply only to SROs. Rule 6a–2 applies only to national securities exchanges. Rule 15Aj–1 and Form X–15AJ–2 apply only to national securities associations. Rule 17a–21 applies only to the MSRB. Furthermore, the proposed amendments are intended to streamline a process to which these SROs already are subject. In the Proposing Release, the Commission indicated that the Chairman has certified that the amendments to Rule 19b–4, Form 19b–4, and Rule 6a–2 would not have a significant economic impact on a substantial number of small entities. The Commission did not receive any comments on the regulatory flexibility certification. The Chairman also has certified that the amendments to Rules 15Aj–1 and 17a–21, and Form X–15AJ–2 would not have a significant economic impact on a substantial number of small entities. This certification, including the reasons therefore, is attached as Appendix A to this release.

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organizations and functions (Government organizations).

17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

Statutory Basis and Text of Proposed Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of

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[71] Exhibit *A(1)* contains the constitution, articles of incorporation, by-laws, and rules of the exchange; Exhibit *A(2)* contains written rulings, settled practices, and interpretations not contained in A(1); Exhibit *A(3)* contains the constitution, articles of incorporation, by-laws, and rules of each affiliate or subsidiary of the exchange; Exhibit *G* contains a list of officers and committee members; Exhibit *H* contains similar information for affiliates or subsidiaries; Exhibit *L* contains a schedule of securities admitted to unlisted trading practices; and Exhibit *M* contains a schedule of unregistered securities admitted to trading on the exchange that are exempt from registration.

[72] *See* Exchange Act § 23(b), 15 U.S.C. 78w(b).

[73] In its comment letter, the NASD also recommended that the Commission review the filing requirements applicable to exclusive securities information processors ("SIPs"), similarly to eliminate obsolete or duplicate filing requirements. This suggestion is outside the scope of the original proposal. Nevertheless, the Commission intends to review and streamline the annual filing requirements applicable to exclusive SIPs.

[74] Exchange Act § 15(b)(8), 15 U.S.C. 78o(b)(8). The importance of this information is also highlighted by Exchange Act § 15(b)(1)(B), 15 U.S.C. 78o(b)(1)(B), as amended by the Government Securities Act Amendments of 1993, Pub. L. No. 103–202, 107 Stat. 2345 (1993), which conditions the effectiveness of broker-dealer registration with the Commission on such SRO membership.

[75] Where a broker-dealer is a member of more than one SRO, the Commission has authority to designate to one SRO the responsibility for examining the member for compliance with applicable financial responsibility rules. Exchange Act § 17(d)(1), 15 U.S.C. 78q(d)(1); 17 CFR 240.17d–1.

[76] 15 U.S.C. 78w(a)(2).

[77] 5 U.S.C. 603(a).

[78] 5 U.S.C. 605(b).

Federal Regulations is amended as follows:

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The authority citation for Part 200, subpart A continues to read in part as follows:

Authority: 15 U.S.C. 77s, 78d–1, 78d–2, 78w, 78*ll*(d), 79t, 77sss, 80a–37, 80b–11, unless otherwise noted.

* * * * *

2. Section 200.30–3 is amended by adding paragraphs (a)(57), (a)(58), and (a)(59) to read as follows:

§ 200.30–3 Delegation of authority to Director of Division of Market Regulation.

* * * * *

(a) * * *

(57) Pursuant to Section 19(b)(2)(B) of the Act, 15 U.S.C. 78s(b)(2)(B), to institute proceedings to determine whether a proposed rule change of a self-regulatory organization should be disapproved.

(58) Pursuant to Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C), to abrogate a change in the rules of a self-regulatory organization and require that it be refiled in accordance with Section 19(b)(1), 15 U.S.C. 78s(b)(1), and reviewed in accordance with Section 19(b)(2), 15 U.S.C. 78s(b)(2), of the Act.

(59) Pursuant to paragraph (e)(6)(iii) of Rule 19b–4 (§ 240.19b–4 of this chapter), to reduce the period before which a proposed rule change can become operative, and to reduce the period between an SRO submission of a filing and a pre-filing notification.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

§ 2640.6a–2 [Amended]

4. Paragraph (a)(1) of § 240.6a–2 is amended by removing ", or in Exhibits B, C and D," and "and Exhibits B, C and D".

5. Revise paragraph (a)(3) of § 240.6a–2 to read as follows:

§ 240.6a–2 Periodic amendments to registration statements or exemption statements of exchanges.

(a) * * *

(3) Complete Exhibits G, H, J, L and M, which shall be up to date as of the latest practicable date within 3 months of the date on which the annual amendment is filed, except that:

(i) Exhibit J need only contain the name and principal place of business of each member organization, and for each member organization elected to membership after December 31, 1994, the date of election to membership;

(ii) If a national securities exchange publishes or cooperates in the publication of the information required in these exhibits on an annual or more frequent basis, in lieu of filing such an exhibit a national securities exchange may:

(A) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(B) Certify to the accuracy of such information as of its date;

(iii) If a national securities exchange keeps the information required in Exhibits L and M up to date and makes it available to the Commission and the public on request, in lieu of filing such an exhibit, a national securities exchange may certify that the information is kept up to date and is available to the Commission and the public upon request.

* * * * *

6. Section 240.6a–2 is amended by revising paragraph (b) to read as follows:

§ 240.6a–2 Periodic amendments to registration statements or exemption statements of exchanges.

* * * * *

(b) Unless exempted pursuant to paragraph (c) of this section, on or before June 30, 1983, and every three years thereafter each exchange registered as a national securities exchange shall file complete Exhibits A(1), A(2) and A(3) to its registration statement, which shall be up to date as of the latest practicable date within 3 months of the date on which these exhibits are filed, except that:

(1) If a national securities exchange publishes or cooperates in the publication of the information required in these exhibits on an annual or more frequent basis, in lieu of filing such an exhibit a national securities exchange may:

(i) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(ii) Certify to the accuracy of such information as of its date;

(2) If a national securities exchange keeps the information required in these exhibits up to date and makes it available to the Commission and the public on request, in lieu of filing such an exhibit, a national securities exchange may certify that the information is kept up to date and is available to the Commission and the public upon request.

* * * * *

7. Paragraph (c)(1) of § 240.15Aj–1 is revised to read as follows:

§ 240.15Aj–1 Amendments and supplements to registration statements of securities associations.

* * * * *

(c) *Annual supplements.* (1) Promptly after March 1 of each year, the association shall file with the Commission an annual consolidated supplement as of such date on Form X–15AJ–2 (§ 249.803) except that:

(i) If the securities association publishes or cooperates in the publication of the information required in Items 6(a) and 6(b) of Form X–15AJ–2 on an annual or more frequent basis, in lieu of filing such an item the securities association may:

(A) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(B) Certify to the accuracy of such information as of its date.

(ii) Promptly after March 1, 1995, and every three years thereafter each association shall file complete Exhibit A to Form X–15AJ–2. The information contained in this exhibit shall be up to date as of the latest practicable date within 3 months of the date on which these exhibits are filed. If the association publishes or cooperates in the publication of the information required in this exhibit on an annual or more frequent basis, in lieu of filing such exhibit the association may:

(A) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(B) Certify to the accuracy of such information as of its date. If a securities association keeps the information required in this exhibit up to date and makes it available to the Commission and the public upon request, in lieu of filing such an exhibit a securities association may certify that the information is kept up to date and is available to the Commission and the public upon request.

* * * * *

8. By revising paragraph (a)(4) of § 240.17a–21 to read as follows:

§ 240.17a–21 Reports of the Municipal Securities Rulemaking Board.

(a) * * *

(4) The Municipal Securities Rulemaking Board shall include in its annual report a statement and an analysis of its expenses and operations including:

(i) A balance sheet as of the end of the period covered by the report and a statement of revenues and expenses for the Board for that period;

(ii) The rules of the Board including any written interpretations of the rules or staff interpretive letters, except that this information may be included in the annual report once every three years and shall be up to date as of the latest practicable date within 3 months of the date on which this information is filed. If the Board publishes or cooperates in the publication of this information on an annual or more frequent basis, in lieu of including such information in the annual report the Board may:

(A) Identify the publication in which such information is available, the name, address, and telephone number of the person from whom such publication may be obtained, and the price thereof; and

(B) Certify to the accuracy of such information as of its date. If the Board keeps this information up to date and makes it available to the Commission and the public upon request, in lieu of filing such information the Board may certify that the information is kept up to date and is available to the Commission and the public upon request;

(iii) The following information concerning members of the Board:

(A) Name;

(B) Dates of commencement and termination of present term of office;

(C) Length of time each member has held such office;

(D) Name of principal organization with which connected;

(E) Title; and

(F) City wherein the principal office of such organization is located;

(iv) Address of the Board, the name and address of each person authorized to receive notices on behalf of the Board from the Commission, and the name and address of counsel to the Board, if any; and

(v) A list, including addresses, as of the latest practicable date, alphabetically arranged, of all municipal securities brokers and municipal securities dealers which have paid to the Board fees and charges to defray the costs and expenses of operating the Board.

* * * * *

9. Paragraph (e) of § 240.19b-4 is revised to read as follows:

§ 240.19b–4 Filings with respect to proposed rule changes by self-regulatory organizations.

* * * * *

(e) A proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act, 15 U.S.C. 78s(b)(3)(A), if properly designated by the self-regulatory organization as:

(1) Constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule;

(2) Establishing or changing a due, fee, or other charge;

(3) Concerned solely with the administration of the self-regulatory organization;

(4) Effecting a change in an existing service of a registered clearing agency that:

(i) Does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible; and

(ii) Does not significantly affect the respective rights or obligations of the clearing agency or persons using the service;

(5) Effecting a change in an existing order-entry or trading system of a self-regulatory organization that:

(i) Does not significantly affect the protection of investors or the public interest;

(ii) Does not impose any significant burden on competition; and

(iii) Does not have the effect of limiting the access to or availability of the system; or

(6) Effecting a change that:

(i) Does not significantly affect the protection of investors or the public interest;

(ii) Does not impose any significant burden on competition; and

(iii) By its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

* * * * *

PART 249—FORM, SECURITIES EXCHANGE ACT OF 1934

10. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a, *et seq.*, unless otherwise noted;

* * * * *

§ 249.803 [Amended]

11. Form X–15AJ–2 (referenced in § 249.803) is amended by removing items numbered 7 through 28 and redesignating item 29 as number 7.

Note: Form X–15AJ–2 does not and these amendments will not appear in the Code of Federal Regulations.

§ 249.803 [Amended]

12. Form X–15AJ–2 (referenced in § 249.803) is amended by revising Exhibit C to reads as follows:

Note: Form X–15AJ–2 does not and these amendments will not appear in the Code of Federal Regulations.

Form X–15AJ–2

* * * * *

Exhibits to be Furnished With This Supplement

* * * * *

Exhibit C. A list, as of latest practicable date, alphabetically arranged, of all members of the association indicating for each—

(1) the name;

(2) the principal place of business; and

(3) the date of election to membership for each member elected to membership after December 31, 1994.

§ 249.819 [Amended]

13. By revising the first sentence of instruction F of the general instructions of Form 19b–4 (referenced in § 249.819) to read as follows, and by removing the asterisk contained therein along with its accompanying footnote:

Note: Form 19b–4 does not and these amendments will not appear in the Code of Federal Regulations.

Form 19b–4

* * * * *

General Instructions

* * * * *

F. Signature and Filing of the Completed Form

Nine copies of Form 19b–4, nine copies of Exhibit 1, four copies of Exhibits 2 and 3, and two copies of Exhibit 4 shall be filed with, in the case of filings by securities exchanges, the Assistant Director for Derivatives and Exchange Oversight, in the case of filings by securities associations or the Municipal Securities Rulemaking Board, the Assistant Director for NMS and OTC, and in the case of filings by clearing agencies, the Assistant

Director for Securities Processing, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington D.C. 20549. * * *

* * * * *

§ 249.819 [Amended]

14. Item 7 of the Information to Be Included in the Completed Form of Form 19b–4 (referenced in § 249.819) is amended by removing the word "or" from the end of paragraph (b)(iii) and adding paragraphs (b)(v) and (b)(vi) to read as follows:

Note: Form 19b–4 does not and these amendments will not appear in the Code of Federal Regulations.

Form 19b–4

* * * * *

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2).

* * * * *

(b) * * *

(v) effects a change in an existing order-entry or trading system of a self-regulatory organization that (A) does not significantly affect the protection of investors or the public interest; (B) does not impose any significant burden on competition; and (C) does not have the effect of limiting the access to or availability of the system, or

(vi) effects a change that (A) does not significantly affect the protection of investors or the public interest; (B) does not impose any significant burden on competition; and (C) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. If it is requested that the proposed rule change become operative in less than 30 days, provide a statement explaining why the Commission should shorten this time period.

* * * * *

§ 249.819 [Amended]

15. Section IV of Exhibit 1 of Form 19b–4 (referenced in § 249.819) is amended by removing "500 North Capitol Street," and adding in its place "450 Fifth Street, N.W.," and removing "Public Reference Section, 1100 L Street N.W.," and adding in its place "Public Reference Room in".

Note: Form 19b–4 does not and these amendments will not appear in the Code of Federal Regulations.

By the Commission.

Dated: December 20, 1994.

Margaret H. McFarland,

Deputy Secretary.

Note: This Appendix to the Preamble will not appear in the Code of Federal Regulations

Appendix A

Securities and Exchange Commission Regulatory Flexibility Act Certification

I Arthur Levitt, Chairman of the Securities and Exchange Commission, hereby certify pursuant to 5 U.S.C. 605(b) that proposed amendments to Rules 15Aj–1 and 17a–21, and Form X-15AJ–2 under the Securities Exchange Act of 1934 set forth in Securities Exchange Act Release No. 35123, if promulgated, will not have a significant economic impact on a substantial number of small entities. The reason for this certification is that the rules and form apply only to the National Association of Securities Dealers and the Municipal Securities Rulemaking Board, and consequently would not impose any significant economic impact on a substantial number of small entities, as that term is defined under the Regulatory Flexibility Act. Furthermore, the proposed amendments are intended to streamline a process to which these self-regulatory organizations already are subject.

Dated: December 20, 1994.

Arthur Levitt,

Chairman.

[FR Doc. 94–31657 Filed 12–27–94; 8:45 am]

BILLING CODE 8010–01–P

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17 CFR Parts 240 and 249

[Release No. 34–35124; File No. S7–3–94]

RIN 3235–AG03

Recordkeeping and Reporting Requirements for Trading Systems Operated by Brokers and Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting Rule 17a–23 ("Rule") and Form 17A–23 under the Securities Exchange Act of 1934 to establish recordkeeping and reporting requirements for brokers and dealers that operate automated trading systems. Under the Rule, registered broker-dealers that sponsor these systems would be required to maintain participant, volume, and transaction records, and to report system activity to the Commission and, in certain circumstances, to an appropriate self-regulatory organization.

EFFECTIVE DATE: June 1, 1995.

FOR FURTHER INFORMATION CONTACT: Kristen N. Geyer, Senior Counsel, 202/942–0799, Office of Automation and International Markets, Division of Market Regulation, Securities and Exchange Commission (Mail Stop 5–1), 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction and Summary

On February 9, 1994, the Securities and Exchange Commission ("Commission") proposed for comment Rule 17a–23 ("Proposed Rule")[1] and Form 17A–23 ("Proposed Form")[2] under the Securities Exchange Act of 1934 ("Act").[3] The Proposed Rule would have required specific recordkeeping and reporting by registered broker-dealer sponsors of certain automated trading systems (as defined in the Rule, "Broker-Dealer Trading System," or "BDTS"). The Proposed Form specified the information to be included in each filing required by the Proposed Rule.

The Commission received ten comment letters in response to the Proposing Release. Commenters generally supported the Proposed Rule's goal of standardizing recordkeeping and reporting for BDTSs.[4] The majority of

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[1] 17 CFR 240.17a–23.

[2] 17 CFR 249.636.

[3] 15 U.S.C. 78a *et seq. See* Securities Exchange Act Release No. 33605 (Feb. 9, 1994), 59 FR 8368 ("Proposing Release").

[4] The comment letters and a summary of comments prepared by the Division of Market Regulation have been placed in Public File No. S7–3–94, which is available for inspection in the Commission's Public Reference Room. Commenters consisted of two industry associations, two self-regulatory organizations, four sponsors of automated proprietary trading systems, and two automated broker-dealers. *See* letters from: John F Olson, Chair, Committee on Federal Regulation of Securities, and Roger D. Blanc, Chair, Subcommittee on Market Regulation, the Business Law Section of the American Bar Association, dated May 10, 1994 ("ABA"); Robert A. McTamaney, Attorney, Carter, Ledyard & Milburn (representing RMJ Securities Corporation, RMJ Options Trading Corporation, and RMJ Special Brokerage, Inc.), dated April 15, 1994 ("CLM/RMJ"); John E. Herzog, Chairman & CEO, Herzog, Heine, Geduld, dated April 12, 1994 ("HHG"); Charles R. Hood, Senior Vice President & General Counsel, Instinet Corporation, dated April 25, 1994 ("Instinet"); Alan D. Rudolph, Vice President, Intervest Financial Services, Inc. and President, CrossCom Trading Network, Inc., dated March 15, 1994 ("Intervest"); Raymond L. Killian, Jr., President & CEO, Investment Technology Group, Inc. (sponsor of Portfolio System for Institutional Trading ("POSIT")), dated May 18, 1994 ("ITG"); Leonard Mayer, Vice President, Mayer & Schweitzer, Inc., dated July 11, 1994 ("M&S"); Joseph R. Hardiman, President, National Association of Securities Dealers, Inc., dated May 27, 1994 ("NASD"); John E. Buck, Senior Vice President & Secretary, New York Stock Exchange, dated June 30, 1994 ("NYSE"); and Mark T Commander, Chairman of

commenters recommended specific modifications to the Proposed Rule. Two commenters, the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE"), objected to the Commission's overall regulatory treatment of certain BDTSs and the competitive implications of such regulatory treatment.[5]

After considering the comments, the Commission is adopting the Rule and Form, with certain modifications. The Commission does not believe that these modifications materially alter the scope of the Proposed Rule or the entities to which it applies. The recordkeeping and reporting approach adopted in the Rule will provide the Commission with information necessary to effectively monitor, evaluate, and examine such systems.

II. Basis and Purpose of the Rule

In January 1994, the Commission's Division of Market Regulation ("Division") published its *Market 2000 Study*,[6] which reviewed, among other things, the Commission's existing oversight of automated trading systems. The Study recognized that the activities of such systems differ from the activities of traditional broker-dealers, and recommended that the Commission closely monitor the effects of proliferation of such systems.[7] The Commission proposed Rule 17a–23 immediately following publication of the *Market 2000 Study*.[8]

The majority of commenters supported the concept of a recordkeeping and reporting rule and recognized the importance of ongoing monitoring and evaluation of technological advances in the securities industry.[9] Several commenters, however, questioned the necessity for applying the Proposed Rule to specific types of systems. In particular, two commenters suggested that the Proposed Rule should not apply to systems that allow a dealer's customers and other dealers to execute orders against the sponsoring dealer's bid or offer (*i.e.*, "hit" the sponsor's quotations) through automated means ("automated dealer systems").[10] Another commenter objected to application of the Proposed Rule to non-equity systems.[11]

In the Proposing Release, the Commission noted that, although automated systems have proliferated in the securities industry, the Commission receives little information about such systems.[12] The Commission concluded that its efforts to gauge the effect of automation on the U.S. markets and to regulate broker-dealers that operate such systems appropriately are being hindered by a lack of critical information regarding the activity of BDTSs.

The Commission identified three ways in which additional information about BDTSs would assist in evaluating, monitoring, and examining such systems. First, the Rule will allow the Commission to evaluate BDTSs with regard to national market system goals.[13] The Commission noted in the Proposing Release that BDTSs have the potential to significantly affect trading patterns, market transparency, and the distribution of trading activity among different markets; consequently, access to uniform, reliable information about BDTSs is critical to the Commission's evaluation of these issues.[14] This is true regardless of whether such systems automate the market-making function, automate an order-interaction function, or automate trading of illiquid or non-equity securities.

Second, the information will help the Commission to monitor the competitive effects of these systems and to ascertain whether broker-dealer regulation remains appropriate for the operation of BDTSs.[15] As is clear from the comments, the ongoing debate regarding the competitive consequences of the Commission's regulation of BDTSs remains vigorous.[16] Finally, the Rule will help the Commission identify areas where monitoring of such systems may be improved and where self-regulatory organization ("SRO") surveillance may be more appropriately tailored to the detection of fraudulent, deceptive, and manipulative practices in an automated environment.[17]

Notwithstanding the views of commenters that the risks posed by automated market-maker systems are sufficiently addressed by existing broker-dealer regulations[18] or that automated systems are less susceptible to manipulation than traditional broker-dealers,[19] the Commission believes that the evolution of both automated broker systems and automated dealer systems present new challenges in maintaining

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Self-Regulation & Supervisory Practices Committee, Securities Industry Association, dated June 17, 1994 ("SIA").

[5] *See* letters from NASD and NYSE. The NASD expressly opposed adoption of the Proposed Rule.

[6] Division of Market Regulation, *Market 2000: An Examination of Current Equity Market Developments* (January 1994) ("*Market 2000 Study*").

[7] *Id.* at 26–27

[8] *See* Proposing Release, *supra* note 3. Concurrently with the publication of the Proposed Rule, the Commission withdrew a previous rule proposal (Rule 15c2–10) which would have required certain BDTSs to seek Commission approval prior to operation of a proprietary trading system and imposed additional conditions on the operation of such systems. The Commission concluded that, based on its experience since 1989 in overseeing BDTSs, including the proposal of Rule 17a–23, a separate regulatory structure governing proprietary trading systems was not necessary at this time. *See* Securities Exchange Act Release No. 33621 (Feb. 14, 1994), 59 FR 8379.

[9] *See, e.g.*, Letter of ABA, at 1; Letter of HHG, at 1; Letter of ITG, at 1; and Letter of M&S, at 2.

[10] *See* Letter of ABA, at 3; Letter of NASD, at 6.

[11] *See* Letter of CLM/RMJ, at 3.

[12] The extent of information currently accessible to the Commission, the history of the Commission's oversight of such systems, and other background information can be found in the Proposing Release. *See* Proposing Release, *supra* note 3, 59 FR at 8369–71. Currently, BDTSs are subject to Commission oversight through broker-dealer registration, recordkeeping, and reporting requirements in the Act. In addition, sponsors of a number of BDTSs have obtained no-action assurances from the Division that it will not recommend enforcement action if the systems operate without registering as exchanges. These staff no-action letters require supplemental recordkeeping and reporting by the sponsor as a condition of the no-action position. *See* Proposing Release, *supra* note 3, 59 FR at 8369. The Rule does not address the issue of whether a particular trading system may be required to register as a national securities exchange, clearing agency, or other self-regulatory organization. Sponsors of BDTSs seeking relief from exchange, clearing agency, and other registration requirements may continue to request no-action positions from the Division.

[13] *See* Proposing Release, *supra* note 3, 59 FR at 8369–70.

[14] For example, in its *Market 2000 Study*, the Division advocated improving transparency for limit orders and after-hours trading, order-exposure rules, disclosure of broker-dealer order-handling practices, assessment of market quality by users of automated routing systems, and surveillance of third market trading. *Market 2000 Study*, *supra*, note 6, at 16–32. The Commission's consideration of each of these issues is directly affected by its understanding of different trading mechanisms, including BDTSs. In particular, the Commission must examine how, and the extent to which, order flow is directed to different trading mechanisms, the extent to which orders entered into different trading mechanisms are integrated into national quotation and trade reporting systems, the extent to which various trading mechanisms offer price improvement, and the order handling and execution practices of different trading mechanisms. Information reported pursuant to the Rule will assist the Commission in understanding how BDTSs operate and how they interact, and are integrated, with other market participants and mechanisms, and consequently will assist the Commission in evaluating these issues.

[15] *See* Proposing Release, *supra* note 3, 59 FR at 8370.

[16] Three commenters discussed the competitive implications of the Commission's adoption of a recordkeeping and reporting rule applicable to BDTSs. *See* Letter of ABA, at 2; Letter of NASD, at 5; and Letter of NYSE, at 2–4. Two of these commenters, the NASD and NYSE, opposed the Commission's determination not to adopt previously proposed Rule 15c2–10, which would have subjected sponsors to a number of procedural and substantive requirements. *Cf.* Securities Exchange Act Release No. 26708 (April 13, 1989), 54 FR 15429; Proposing Release, *supra* note 3, 59 FR at 8369.

[17] *See* Proposing Release, *supra* note 3, 59 FR at 8370–71.

[18] See Letter of ABA, at 2; Letter of NASD, at 5.

[19] See Letter of Instinet, at 2–4.

market quality and customer protection. BDTSs contribute to the concentration of order flow among a few, large, automated broker-dealers, execute trades at a more rapid rate than traditional services, and make execution of the customers' orders dependent on the reliability of the automated system rather than individual traders.

The Commission believes that the Rule as adopted will provide important information to assist it in accomplishing these goals, without imposing unnecessary or overly burdensome requirements that do not relate to the purposes of the Rule.

III. Discussion

As adopted, the Rule requires a registered broker-dealer who acts as the sponsor[20] of a "broker-dealer trading system" to make and keep current specified records, and file reports with the Commission (and, in certain circumstances, with the appropriate SRO) on Form 17A-23.

A. Scope of the Rule and Application to Specific Types of Systems

The Rule as proposed and adopted would apply to registered brokers or dealers[21] that sponsor a "broker-dealer trading system." Commenters requested clarification of which automated systems would be considered "broker-dealer trading systems" as defined in the Proposed Rule.[22] Several commenters suggested narrowing the definition of BDTS to exempt certain systems. In particular, two commenters questioned the inclusion of automated dealer systems that allow a dealer's customers and other dealers to execute against the sponsoring dealer's bids and offers.[23] One commenter also recommended that the Commission exempt non-equity trading systems from application of the Proposed Rule.[24] In view of the comments, the Commission has simplified the definition of BDTS and clarified the Rule's application to various systems, as discussed below, but has not materially altered the scope of the Rule.

The definition of "broker-dealer trading system" has been modified in the Rule to mean any system that meets the following criteria: the system must provide a mechanism, automated in full or in part, for (1) collecting or disseminating system orders and (2) matching, crossing, or executing system orders, or otherwise facilitating agreement to the basic terms of a purchase or sale of a security between system participants, or between a system participant and the system sponsor, through use of the system. As made clear in the Rule, the term "broker-dealer trading system" does not include any system that does not meet both of these requirements.

The modified definition of BDTS captures the essential features of the types of systems that the Proposed Rule was intended to encompass. The Proposed Rule also described several types of systems that were excluded from the definition of BDTS.[25] As discussed below, the Commission believes that those systems continue to be excluded from the Rule as adopted, because they do not meet the required characteristics of a BDTS as defined.[26]

1. System Automation

As adopted, the Rule applies to systems that may be only partially automated, as well as to fully automated systems. Some systems may automate the collection and dissemination of orders through a screen available for viewing by participants, but require participants to contact the sponsor by telephone in order to finalize a trade based on such orders. Other systems may collect orders via telephone contact with customers, and enter those orders into a system that automates the matching of such orders. Although neither of these systems are "fully" automated, both are BDTSs under the Rule as adopted. The lack of complete automation does not alter the potential market effects of automated execution systems, nor does it alter the need to tailor oversight of the sponsor to reflect the distinctive characteristics of automated systems. The Commission notes in particular that it is not necessary for participants to have the ability to enter orders electronically through a system terminal or screen in order for the system to be subject to the Rule. Some systems permit customers to participate in the system's matching, crossing, or other features by communicating orders to the sponsor by telephone, to be entered into the system by the sponsor's trading personnel.[27]

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[20] The Rule defines a sponsor as "any entity that organizes, operates, administers, or otherwise directly controls a broker-dealer trading system." In addition, the Rule includes within this term any registered broker-dealer that regularly executes transactions on behalf of participants of a system operated by a non-registered entity. See Proposing Release, supra note 3, 59 FR at 8371.

[21] As noted in the Proposing Release, absent an exemption from or exception to the broker-dealer registration provisions of the Act, the types of activities conducted by BDTSs can be lawfully conducted only by a broker-dealer registered with the Commission pursuant to the Act. See Proposing Release, supra note 3, 59 FR at 8371. The Commission notes that the term "registered broker or dealer" is defined in Section 3(a)(48) of the Act, and includes the majority of broker-dealers. The term does not include government securities brokers or government securities dealers registered under Section 15C of the Act, which are required to comply with the recordkeeping and reporting requirements promulgated by the Department of the Treasury, 17 CFR 400 et seq., under the Government Securities Act of 1986, 15 U.S.C. 78o-5. Accordingly, the Rule would not apply to systems sponsored by broker-dealers registered solely under Section 15C of the Act. In addition, the Rule would not apply to operators of systems that do not involve activities requiring broker-dealer registration. See Letters regarding Farmland Industries, Inc. (Aug. 26, 1991); Troy Capital Services, Inc. (May 1, 1990); Real Estate Financing Partnership (May 1, 1990); Ivestex Investment Exchange, Inc. (April 9, 1990); and Petroleum Information Corporation (Nov. 28, 1989). Cf. Securities Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013, text accompanying n.66.

[22] See, e.g., Letter of NASD, at 7. The Proposed Rule defined "broker-dealer trading system" as:

(i) any system that automates the execution of orders to buy or sell securities based on quotations of the system sponsor or its affiliates (whether such quotations are disseminated through the system, a quotation consolidation system operated pursuant to a plan approved by the Commission under Section 11A of the Act, an electronic interdealer quotation system operated by a registered national securities association, or otherwise); or

(ii) any system that both automates the dissemination or collection of quotations, orders to buy or sell securities, or indications by any person announcing a general interest in buying or selling a security, submitted by entities other than the system sponsor and its affiliates, and provides a mechanism for matching or crossing, or for otherwise facilitating agreement between participants to the basic terms of a purchase or sale of a security through use of the system.

See Proposing Release, *supra* note 3, 59 FR at 8374.

[23] *See* Letter of ABA, at 3; Letter of NASD, at 6.

[24] See Letter of CLM/RMJ, at 3.

[25] One commenter noted that the Proposing Release discussed other systems that the Proposed Rule would not encompass, but that were not expressly excluded from the definition of BDTS. The commenter requested that the Commission reconcile the Rule with the excluded systems described in the Proposing Release. *See* Letter of ABA, at 3–4. Given the ongoing evolution of automated trading systems, however, the Commission believes it would be impractical to attempt to enumerate all types of systems that would not be considered "broker-dealer trading systems" under the Rule. In view of this, the Rule as adopted does not contain express exclusions.

[26] The Proposed Rule excluded certain order routing systems. *See* Proposing Release, *supra* note 3, 59 FR at 8372 (Sections (b)(2)(ii)(A) and (B) of the Proposed Rule). These systems do not meet the requirements of the Rule as adopted, and therefore are not subject to the Rule. Specifically, systems that only allow participants to post trading interest, or only route orders to the execution facilities of established markets or other broker-dealers do not effect the purchase or sale of a security between system participants or between a system participant and the system sponsor through the system.

[27] The Commission also notes in this context that transactions resulting from orders entered into the system through the sponsor's trading personnel would be considered to be executed through the system to the same extent as trades entered directly by system participants. One commenter noted that certain systems may permit the system sponsor to execute trades manually and to enter the matched trade into the system for reporting and other execution related activities. *See* Letter of M&S, at 2. The commenter suggested that system sponsors should not be required to segregate out such trades

This lack of automated access to a system does not exempt such a system from application of the Rule.

2. System Execution Mechanism

The Rule applies only to those automated trading systems that offer users the ability to effect securities transactions through their use of the system, either with other participants or with the system sponsor. Numerous automated systems have developed that facilitate securities trading, but do not create opportunities to effect transactions apart from the facilities of established markets. These systems range from purely informational "bulletin board" systems that allow participants to announce their trading interest (typically by posting quotation or order information and participant telephone numbers on the system's screen)[28] to "routing" systems that direct order flow to an exchange or other established market or dealer but do not otherwise interact with such order flow. Bulletin boards, routing systems, and other similar systems essentially disperse information; they do not allow users to effect securities transactions with other system participants or with the system sponsor through the system. Accordingly, such systems are not subject to the Rule. In the Commission's view, these "non-execution" systems do not create the same potential for market effects and correspondingly create less need for ongoing monitoring and evaluation by the Commission than systems that fall within the definition of broker-dealer trading system.[29]

for purposes of the recordkeeping and reporting requirements of the Rule. Neither the Rule nor Form 17A–23 requires a system sponsor to segregate transaction records or reports based on the method by which the order was accepted into the system (*i.e.*, telephone, computer terminal, etc.). System sponsors would not be required, therefore, to segregate out manually handled trades. The Commission expects, however, that a system's ability to process manually handled orders would be described in the system sponsor's filings pursuant to Part I of Form 17A–23.

[28] The Commission uses the term "bulletin board systems" in this context to mean only those systems that allow participants to announce their trading interest, but do not provide further opportunity to interact with the system or the system sponsor to execute transactions. Such systems do not allow participants to agree to the terms of a transaction "through use of the system"; participants must contact each other outside of system facilities or the system sponsor to conclude a transaction. Therefore, such systems do not meet the definition of a BDTS under the Rule, and the Rule would not apply to these systems.

[29] Although the Commission requested comment on whether the Proposed Rule should apply to "non-execution" systems, no commenter suggested that such systems be subject to the Rule. *See* Proposing Release, *supra* note 3, at 8373.

3. Application of the Rule to Automated Dealer Systems

Two commenters argued that the Proposed Rule only should apply to systems that offer a "locked-in trade" between or among customers or other dealers as part of an interactive system.[30] These commenters questioned the Commission's rationale for applying the Proposed Rule to automated dealer systems, arguing that automated dealer systems "do no more than what any market-maker has done since the enactment of the 1934 Act," other than providing fuller automation of the market-maker function.[31] One commenter supported inclusion of automated dealer systems in the Proposed Rule.[32]

The Commission has concluded that the Rule should apply to automated dealer systems as well as other BDTSs. Systems that automate execution functions make it possible for a broker-dealer to concentrate a significant volume of securities transactions. This is true whether such an "execution" system allows participants to interact directly with each other, or whether the system allows participants to interact with a single dealer. As discussed above and in the Proposing Release, this potential concentration of volume outside of national market systems may have significant market effects. The Commission believes that in today's highly complex, integrated trading environment, it must fully consider the effect of technological advances on the broker-dealer's role in both auction market and dealer market trading.[33]

4. Application of Rule to Non-Equity Systems

The Rule as adopted applies both to systems trading equity and systems trading non-equity securities. One commenter objected to application of the Proposed Rule to systems that deal exclusively with non-equity instruments.[34] That commenter noted that "[t]he nature of and detail imposed by these recordkeeping and reporting requirements suggest that the real intention behind the Proposed Rule is to enable the SEC to gather and evaluate information on BDTSs dealing in equity instruments only."[35]

The need for uniform, reliable information as discussed above and in the Proposing Release is equally applicable to systems trading non-equity securities. It is probable that sponsors will continue to create BDTSs to facilitate transactions in products that do not trade in organized markets, including various debt and derivative products. Systems that trade these non-equity, and typically less liquid, securities are especially opaque under existing regulations; they are not integrated into market quotation and reporting mechanisms to the same degree as systems that trade equity products. Some of these "niche" systems may provide the only readily identifiable source of trading in a particular instrument. The Rule will help alleviate the difficulty of obtaining accurate information on a regular basis about trading in these instruments.

The Commission recognizes that information that is relevant to equity security trading may not be relevant to non-equity security trading. Accordingly, the Rule and Form direct the sponsor of a non-equity trading system to provide information relevant to such non-equity securities (such as number of bonds, contracts, etc.).[36]

B. Regulation of Certain BDTSs

Three commenters urged the Commission to reconsider its regulatory approach to BDTSs, or in the alternative to reconsider its regulation of traditional markets.[37] Specifically, both the NYSE and the NASD identified concerns regarding the competitive implications of the Commission's adoption of a recordkeeping and reporting rule governing BDTSs in light of the regulatory structures that apply to registered exchanges and interdealer

[30] *See* Letter of ABA, at 3; Letter of NASD, at 5–6.

[31] *See* Letter of NASD, at 6.

[32] *See* Letter of NYSE, at 2.

[33] The NASD in its comment letter suggested that market-maker execution systems should be distinguished from other BDTSs because the executions provided by a market-maker are based on the market-maker's own quotes, subject to its best execution obligations and affect the market-maker's own inventory. According to the NASD, other BDTSs permit the direct interaction of customer orders or provide for the quotations of multiple market-makers and are thus more akin to the functions performed by traditional markets. *See* Letter from NASD, at 6. The Commission is not persuaded that this difference in operation is a sufficient basis on which to exclude market-maker systems from the Rule. A broker-dealer firm sometimes trades for its own account as dealer and sometimes for the account of its customers as broker; in either case, the broker-dealer uses its facilities to bring together buyers and sellers with the intent of effecting a securities transaction. *See* Securities Exchange Act Release No. 27611 (Jan. 12, 1990), 55 FR 1890, 1898.

[34] *See* Letter of CML/RMJ, at 3–5.

[35] *Id.* In addition to CML/RMJ, one other sponsor of a system trading non-equity securities commented on the Proposed Rule. *See* Letter of Intervest.

[36] *See* 17 CFR 240.17a23(c)(1)(ii)(B) and 249.636, Form 17A–23, Part II, 1.

[37] *See* Letter of ABA, at 5–6; Letter of NASD, at 1–7; Letter of NYSE, at 1–2, 4.

quotation systems.[38] The Commission does not believe it is necessary at this time to adopt regulations governing BDTSs beyond those existing requirements applicable to the broker-dealer sponsors of such systems and the enhanced recordkeeping and reporting that will be provided pursuant to the Rule. The Commission is not precluded from reconsidering the issues raised by the commenters concerning the Commission's regulatory approach to BDTSs at a later time, should circumstances warrant such reconsideration.

These commenters also urged the Commission to reconsider its regulation of trading services provided by registered exchanges and securities associations. In particular, commenters recommended that the Commission streamline its requirements governing the filing of SRO rule proposals, and that SROs be allowed to develop trading systems under the same regulatory requirements applicable to BDTSs.[39] In that regard, the Commission notes that today it has adopted amendments to the Commission's rules governing the SRO rule filing process.[40] The Commission also notes that the regulation of SRO trading services is largely dictated by statutory requirements. Consequently, SRO operation of trading systems outside of existing SRO regulations would require a careful, case-by-case analysis under the Act. BDTSs are governed by the regulatory structure applicable to other registered broker-dealers. The Commission has not created a separate regulatory structure for BDTS trading; it has adopted enhanced recordkeeping and reporting for such systems.

C. Recordkeeping Requirements

Under the Rule, system sponsors are required to keep and make available to the Commission, upon request, records of: (1) daily summaries of trading in the system; (2) the identities of system participants (including any affiliations between those participants and the sponsor); and (3) time-sequenced records of each transaction effected through the system. The sponsor is required to keep these records, as well as any notices provided by the sponsor to participants, for three years (the first two years in an easily accessible place). The Commission has modified some of the proposed recordkeeping requirements in response to comments as discussed below.

1. Duplicative Recordkeeping

The Commission requested comment on whether the Proposed Rule's requirements would be duplicative or burdensome. Commenters suggested that the recordkeeping requirements appear to be duplicative of those already required under other rules promulgated under Section 17, and questioned the justification for such duplication.[41] Two commenters expressed reservations that the Proposed Rule would penalize broker-dealers that use automation to become more efficient, and would thus deter further automation.[42] Only one commenter stated that the Proposed Rule would impose undue financial burden on BDTS sponsors.[43] No commenter provided information sufficient to quantify the extent to which BDTSs would be financially burdened by the Proposed Rule.

While existing regulations require registered broker-dealers to maintain much of the information required under the Rule, they do not require broker-dealers to keep records that present BDTS activity separately from other brokerage activity.[44] Consequently, the Commission does not have ready access to system-specific information. The Commission's ability, and the ability of SROs,[45] to adequately evaluate, monitor, and examine these systems is correspondingly limited.[46] Although the Rule may result in changes to some existing BDTS sponsors' recordkeeping practices, the Commission believes that it has made sufficient provision in the Rule to minimize the need for BDTS sponsors to keep duplicative records. The Rule does not dictate a format for maintaining information and does not require BDTS sponsors to maintain such information separately from its other records, so long as the sponsor can promptly retrieve such information upon request in the format, and for the time periods, specified in the Rule.

2. Records Regarding Applicants Denied Participation on the System.

Commenters questioned the need to retain information regarding specific applicants denied participation in the system, and indicated that quantifying such information would be difficult.[47] In view of the comments, the Commission has deleted this requirement from the Rule. Sponsors, however, are required to describe, in filings under Part I and IA of Form 17A-23, the factors relied upon by the sponsor in granting participation in the system.

3. Daily Trading Summaries

The Proposed Rule required sponsors to retain daily summaries of, among other things, securities trading in the system. The Proposed Rule also would have required sponsors to retain daily summaries identifying the number of "quotations" and "orders" placed in the system, expressed separately for limit and market orders and other relevant order specifications. This requirement was intended to provide the Commission with a basis for comparing potential system trading interest with trading volume. Commenters expressed concern that the configuration of specific systems would make it difficult to determine what would constitute a single "quotation" or "order." [48] Commenters also noted that, depending upon system configuration, identifying the number of quotations or orders may not provide the Commission with useful information regarding system trading interest.[49]

The Commission has modified the Rule in view of these commenter concerns regarding the terms "quotations" and "orders." [50] As adopted, the Rule requires sponsors to identify the number of "system

[38] *See* Letter of NASD, at 1–4; Letter of NYSE, at 1–2, 4. *See also*, Letter of ABA, at 5–6.

[39] *See* Letter of ABA, at 5–6; Letter of NASD, at 5; Letter of NYSE, at 4.

[40] *See* Securities Exchange Act Release No. 35123 (December 20, 1994). The amendments expand the category of proposed rule changes that may become effective upon filing under Section 19(b)(3)(A) of the Act to include certain changes to existing systems and other noncontroversial filings.

[41] *See* Letter of NASD, at 7 *Cf* Letter of SIA, at 2.

[42] *See* Letter of ABA, at 3 and Letter of NASD, at 6.

[43] *See* Letter of CLM/RMJ, at 3–4.

[44] *See* Proposing Release, *supra* note 3, 59 FR at 8368–69.

[45] Staff of the Division met with representatives of the NASD to discuss its use of the information provided by the records maintained pursuant to the Rule and the reports filed pursuant to Form 17A-23. The Commission expects that the NASD and other SROs that have the responsibility to examine and otherwise oversee BDTSs will use such information to tailor their oversight of BDTSs to reflect the distinctive features of automated broker-dealers.

[46] *See* Proposing Release, *supra* note 3, 59 FR at 8370–71.

[47] *See* Letter of ABA, at 5; Letter of CLM/RMJ, at 5; Letter of HHG, at 3–4; Letter of Instinet, at 6–7; Letter of ITG, at 2; Letter of NASD, at 7–8; and Letter of SIA, at 3.

[48] *See* Letter of ABA, at 4; Letter of HHG, at 3; and Letter of Instinet, at 8–9.

[49] *See* Letter of ABA, at 4 and Letter of Instinet, at 8–9. One commenter questioned the use of the term "quotations" in the Proposed Rule to refer to trading interest entered into an automated system, noting that its system users place "orders," not "quotations." *See* Letter of Instinet, at 8. The Commission does not believe that such distinctions between the terms "order" and "quotation" are relevant for purposes of this Rule.

[50] A corresponding requirement in Form 17A-23, Part II, has been modified as well, for the reasons discussed above with regard to modification of the recordkeeping requirement in the Rule.

orders,"[51] or any other identifiable indicator that accurately reflects participant trading interest, as appropriate in light of system configuration. If applicable in light of system configuration, sponsors must express such number separately for priced and unpriced orders. In modifying this requirement, the Commission relies on the sponsor's knowledge of its system configuration to determine which statistics would provide the most accurate assessment of participant trading interest, and to retain those statistics accordingly.[52]

The Commission also has modified the Rule, in response to one commenter's concern, to clarify that a sponsor must be able to identify on a daily basis only those securities for which transactions have been executed through the system.[53]

4. Participant Notices

Three commenters requested clarification of the extent to which communications to individual participants or non-written communications must be preserved as notices to participants under paragraph (c)(2)(ii) of the Proposed Rule.[54] The Rule as adopted requires sponsors to preserve only those notices that are disseminated (whether through written or other means) generally to all participants, or to one or more classes of participants. The Rule does not require the sponsor to preserve communications directed solely to an individual participant.

D. Reporting Requirements

Under the Rule as adopted, a BDTS sponsor is required to file reports with the Commission (and, in certain circumstances, with the appropriate SRO), in accordance with Form 17A–23. Form 17A–23 contains three parts: (1) operation reports, including initial operation reports filed at least 20 calendar days prior to the operation of the system and subsequent operation reports filed as necessary prior to implementing material system changes; (2) quarterly reports filed within 30 calendar days after the end of the calendar quarter;[55] and (3) a final report filed within 10 calendar days after a sponsor ceases to operate the trading system. The operation reports would describe the system, its procedures for reviewing capacity, security and contingency planning, and protecting participant funds and securities (if an entity other than the sponsor will hold or safeguard participant funds or securities on a regular basis). It also would identify an appropriate system contact. The quarterly reports would contain summary trading information. The report notifying the Commission of cessation of operations would contain, in addition to the notification, a final transaction summary.

1. Filing Reports Prior to Operation or Implementation of a Material Change

The Rule requires initial operation reports to be filed at least 20 days prior to operation, and subsequent operation reports regarding material changes to be filed at least 20 days prior to implementing such material change, or, where it is commercially impracticable to do so, as soon as possible after the sponsor determines that it will implement such material change and in any event no later than 10 days following the implementation of such change.

The Commission notes that the Rule does not require system sponsors that alter the operation of their BDTS subsequent to filing an initial operation report to file additional or amended operation reports prior to beginning operation. In the Commission's experience, it is not uncommon for automated systems to be altered routinely to respond to participant comments or concerns, incorporate technological advances, or otherwise upgrade a system's operation. Accordingly, sponsors that file initial operation reports with the Commission might alter the operation of their BDTS subsequent to such filing, but prior to beginning operation. If a sponsor materially changes system operation subsequent to filing an initial operation report, but prior to beginning operation, the sponsor should contact the Division to apprise them of such material change.

The Commission also notes that currently, material changes to automated systems generally require significant planning and development prior to implementation. Accordingly, the Commission believes that most sponsors will be able to notify the Commission at least 20 days prior to implementing a material change. Nonetheless, if a sponsor is able to implement a material system change on a greatly expedited basis, the Commission recognizes that it may not be commercially feasible to notify the Commission 20 days prior to implementation without delaying implementation. In such circumstances, the Rule allows a sponsor to notify the Commission as soon as possible after it determines to implement a material change, but in any event no later than 10 days following the implementation of such change.

2. Availability of Reports to SROs

As adopted, the Rule requires sponsors to file Parts I and III of Form 17A–23 with both the Commission and the SRO that is its designated examining authority. The quarterly reports covered by Part II of Form 17A–23 are required to be filed only with the Commission; however, the sponsor must make such reports available to the appropriate SRO upon request.[56] Two commenters expressed concern that SRO access to information contained in reports filed pursuant to the Proposed Rule might adversely affect a BDTS's competitive position.[57] One commenter recommended that the Commission require SROs to adopt procedures to restrict access to BDTS reports to the SRO's surveillance personnel, or, in the alternative, dispense with the reporting obligation.[58]

The Commission recognizes that the activities of SROs as both market operators and market regulators may create tension between the SROs and SRO members. For example, documents obtained in the conduct of an SRO's regulatory duties may contain competitively sensitive information. Notwithstanding this, SROs must have access to relevant member information in order to fulfill their self-regulatory

[51] The Rule defines "system order" as any order or other communication or indication submitted by any system participant for entry into the system announcing an interest in purchasing or selling a security. The Rule also clarifies that the term "system order" does not include inquiries or indications of interest that are not entered into the system. 17 CFR 240.17a23(b)(4).

[52] The Commission expects sponsors that intend to fulfill this requirement by retaining and reporting statistics other than system orders will contact staff of the Division to discuss which statistics the sponsor wishes to retain and report instead.

[53] *See* Letter of ITG, at 2.

[54] See Letter of ABA, at 4; Letter of Instinet, at 10; and Letter of ITG, at 2.

[55] In the Proposing Release, the Commission solicited comments on the appropriate interval at which sponsors should file reports. See Proposing Release, supra note 3, 59 FR at 8373. No commenter addressed this issue. One commenter, however, requested that the Commission extend the time period for filing quarterly reports from 20 calendar days to 30 calendar days after the calendar quarter. See Letter of Instinet, at 11. The Rule has been modified accordingly.

[56] The Commission has determined that summary trading information filed pursuant to Part II of Form 17A–23 are not critical to the SROs' routine oversight of BDTSs, although such information is useful for the Commission for the reasons discussed herein and may be useful to SROs for non-routine oversight of BDTS sponsors. Accordingly, the Commission has revised the Rule to require BDTS sponsors to file reports pursuant to Part II of Form 17A–23 routinely with the Commission and to make such reports available to the appropriate SRO upon request.

[57] See Letter of ABA, at 4–5 and Letter of Instinet, at 12–13.

[58] See Letter of ABA, at 4–5.

obligations.[59] The Commission believes that information contained in reports filed pursuant to the Rule will be critical to appropriately tailoring SRO examination and oversight of BDTS sponsors to reflect the distinctive characteristics and concerns of automated trading systems. Accordingly, the Rule continues to make such information available to SROs designated as a BDTS's examining authority. In order to address potential competitive issues, the Rule provides for filing of Rule 17a-23 reports directly with surveillance personnel designated by the examining SRO. The Commission notes that access to information made available to an SRO in its regulatory capacity should be rigorously restricted to those personnel who require it for surveillance and regulatory oversight purposes only. The Commission strongly urges SROs to carefully assess, and revise where necessary, their internal policies and procedures for protecting the confidentiality of sensitive information obtained in the course of fulfilling SRO regulatory responsibilities.

3. Confidentiality of Reports

Two commenters requested that the Commission discuss whether reports filed pursuant to the Proposed Rule may be exempt from public disclosure under the Freedom of Information Act.[60] The Commission notes that reports filed pursuant to the Rule will be deemed to be confidential. The Commission considers such reports to be exempt from disclosure under the Freedom of Information Act ("FOIA").[61] The Commission will protect the confidentiality of reports filed pursuant to the Rule accordingly.[62]

E. Form 17A-23

Proposed Form 17A-23 would have required sponsors to report "lists of securities trading in the system," and to state whether it offers services that allow system participants to trade with entities outside of the United States. Commenters requested clarification that sponsors may comply with the Form by identifying the categories of securities that have actually traded in the system during the period covered by the report.[63] After reviewing the comments, the Commission believes that the information required pursuant to Part I of Form 17A-23 is sufficient to provide summary information regarding the categories of securities trading, and that submission of lists identifying individual securities in the quarterly filings under Part II of Form 17A-23 would not be useful. Accordingly, the Commission has deleted this requirement from the Form. The Commission also has modified Parts I and II of Form 17A-23 to clarify that sponsors must report whether entities located outside of the United States have access to the system, and describe the nature of such access and foreign participation in the system in reports filed pursuant to Part I of the Form. Finally, the Commission has modified Part I of the Form and paragraph (d)(1) of the Rule to require system sponsors to update the information filed in Part I of the Form at least 20 days prior to implementing a material change to system operation, or, where it is commercially impracticable to do so, as soon as possible thereafter when the sponsor determines that it will implement such material change (and in any event no later than 10 calendar days following the implementation of such change).

IV. Implementation Date

The Rule will become effective on June 1, 1995. The Commission has modified the Rule to allow sponsors of systems currently operating to submit the information required by Part I of Form 17A-23 no later than July 1, 1995 (one month following the effective date), to provide sponsors of existing systems adequate time to prepare this filing.[64]

As discussed above, certain BDTS sponsors are subject to staff no-action letters that require those sponsors to provide operation and trading information to the Division that is comparable to that required in Form 17A-23.[65] These staff no-action letters do not affect the obligation of any BDTS sponsor to comply with the Rule. Prior to effectiveness of the Rule, the Division will revise the conditions of no-action in each letter granted to a sponsor of an operating system that would be subject to the Rule, to eliminate duplicative reporting requirements. Sponsors of BDTSs subject to no-action letters that have further questions on complying with the Rule and conditions of no-action should contact the Division.

V. Competition Findings

Section 23(a)(2) of the Act[66] requires the Commission, in adopting rules under the Act, to consider the anti-competitive effects of such rules, if any, and to balance any impact against the regulatory benefits gained in terms of furthering the purposes of the Act. As discussed above, several commenters raised concerns regarding the competitive implications of the Proposed Rule. The Commission has considered the Rule in light of the comments and the standard cited in Section 23(a)(2). The Rule's establishment of reporting and recordkeeping requirements will not impose a significant burden on competition. All BDTSs will be subject to the same requirements, and the reporting and recordkeeping requirements, which are similar to those currently imposed on registered brokers and dealers, should not be unduly burdensome. In addition, the Commission has specifically considered competitive concerns relating to SRO access to such information.[67] For the reasons discussed above, the Commission believes that adoption of the Rule will not impose any burden on competition not necessary or appropriate in furtherance of the Act.

VI. Summary of Final Regulatory Flexibility Analysis and Paperwork Reduction Act

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA") regarding Rule 17a-23, in accordance with 5 U.S.C. § 604. No public comment was received in response to the initial regulatory flexibility analysis. The FRFA notes the potential costs of operation and procedural changes that may be necessary to comply with the Rule. As more fully explained above, however, the Commission has determined that the proliferation of broker-dealer automated trading systems requires increased oversight to promote investor protection and to assess the impact of these systems on the securities markets. The Commission finds that the benefits of Rule 17a-23 outweigh the costs incurred by industry participants in complying with the Rule. A copy of the FRFA may be obtained by contacting Elaine M. Darroch, Attorney-Advisor, Office of Automation and International

[59] See, e.g., Exchange Act Section 15A(b), 15 U.S.C. 78o-3(b).

[60] See Letter of ABA, at 4; Letter of M&S, at 3.

[61] Such reports constitute examination, operating or condition reports of a financial institution, and, as such, are exempt from disclosure under FOIA pursuant to 5 U.S.C. § 552(b)(8).

[62] In addition, other exemptions from FOIA may be available, including the exemption provided by Section 552(b)(4) for trade secrets and commercial or financial information obtained from a person and privileged or confidential. The availability of this exemption depends upon a factual analysis which may require substantiation by the sponsor of the reporting BDTS.

[63] See Letter of Instinet, at 11 and Letter of ITG, at 2.

[64] Sponsors of existing BDTSs must submit a system description that is current as of the date of filing.

[65] See note 12, *supra*.

[66] 15 U.S.C. 78w(a)(2).

[67] See Availability of Reports to SROs, *supra*.

Markets, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W. (Mail Stop 5–1), Washington, D.C. 20549.

No public comment was received in response to proposed Rule 17a–23 with respect to the Paperwork Reduction Act of 1980, 44 U.S.C. §§ 3501 et seq.

VII. Statutory Basis

The rules and regulations of the Commission are amended as follows, pursuant to the Securities Exchange Act of 1934 and particularly Sections 2, 3, 11A, 15(c), 17, and 23(a) thereof, 15 U.S.C. §§ 78b, 78c, 78k–1, 78o(c), 78q, and 78w(a).

List of Subjects in 17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

Text of Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations 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 citation:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

Section 240.17a–23 also issued under 15 U.S.C. 78b, 78c, 78o, 78q, and 78w(a);

* * * * *

2. Section 240.17a–23 is added to read as follows:

§ 240.17a–23 Recordkeeping and Reporting Requirements relating to Broker-Dealer Trading Systems.

(a) *Scope of section.* This section shall apply to any registered broker or dealer that acts as the sponsor of a broker-dealer trading system.

(b) *Definitions.* For purposes of this section:

(1) The term *registered broker or dealer* shall have the meaning ascribed to it in Section 3(a)(48) of the Act.

(2) The term *broker-dealer trading system* means any facility that provides a mechanism, automated in full or in part, for:

(i) Collecting, receiving, disseminating, or displaying system orders; and

(ii) Matching, crossing, or executing system orders, or otherwise facilitating agreement to the basic terms of a purchase or sale of a security between system participants, or between a system participant and the system sponsor, through use of the system or through the system sponsor.

(3) The term *sponsor* means any entity that organizes, operates, administers, or otherwise directly controls a broker-dealer trading system; and, if the system operator of such broker-dealer trading system is not a registered broker or dealer, any registered broker or dealer that, pursuant to contract, affiliation, or other agreement with the system operator, is involved materially on a regular basis with executing transactions in connection with use of the broker-dealer trading system, other than solely for its own account or as a participant in the broker-dealer trading system.

(4) The term *system order* means any order or other communication or indication submitted by any system participant for entry into a trading system announcing an interest in purchasing or selling a security. The term "system order" does not include inquiries or indications of interest that are not entered into a trading system.

(5) The term *system participant* means any person that is provided access to a trading system (whether through computer terminal, access codes, or other means) by a system sponsor for the purpose of effecting the purchase or sale of securities through use of such system.

(c) *Recordkeeping.* Every registered broker or dealer subject to this section pursuant to paragraph (a) of this section shall:

(1) Make and keep current the following records relating to the broker-dealer trading system:

(i) A record of participants in the broker-dealer trading system (identifying any affiliations between system participants and the system sponsor);

(ii) Daily summaries of trading in the broker-dealer trading system, including:

(A) Securities for which transactions have been executed through use of such system;

(B) Transaction volume (separately stated for trading occurring during hours when consolidated trade reporting facilities are and are not in operation), expressed with respect to stock in trades, shares and in dollar value, and expressed with respect to other securities in trades, number of units of securities and in par value, dollar value, or other appropriate commonly used measure of value of such securities; and

(C) Number of system orders, or other identifiable indicator that accurately reflects participant trading interest, as appropriate in light of configuration of the broker-dealer trading system (expressed separately for priced and unpriced orders, if applicable in light of system configuration);

(iii) Time-sequenced records of each transaction effected through the broker-dealer trading system, including date and time executed, price, size, security traded, counterparty identification information, and method of execution (if broker-dealer trading system allows alternative means or locations for execution, such as routing to another market, matching with limit orders, or executing against the system sponsor's quotations); and

(2) Preserve, for a period of not less than three years, the first two years in an easily accessible place, the following records relating to the broker-dealer trading system:

(i) All records required to be made pursuant to paragraph (c)(1) of this section; and

(ii) All notices provided by the system sponsor to system participants generally (or to one or more classes of system participant), whether written or communicated through the broker-dealer trading system or other automated means, including, but not limited to, notices addressing hours of system operations, system malfunctions, changes to system procedures, maintenance of hardware and software, instructions pertaining to access to the broker-dealer trading system.

(d) *Reporting.* (1) Every registered broker or dealer subject to this section pursuant to paragraph (a) of this section shall:

(i) File the information required by Part I of Form 17A–23 (§ 249.636 of this chapter) at least 20 calendar days prior to operating a broker-dealer trading system, or, if the sponsor is operating the broker-dealer trading system on June 1, 1995, no later than July 1, 1995;

(ii) During the operation of a broker-dealer trading system of which the broker or dealer is the sponsor, file the information described in Part IA of Form 17A–23 (§ 249.636 of this chapter) regarding a material change to operation of the broker-dealer trading system as described in any filing previously made with the Commission pursuant to paragraph (d)(1)(i) of this section, at least 20 calendar days prior to implementing such material change, or, where it is commercially impracticable to do so, as soon as possible thereafter when the sponsor determines that it will implement such material change, and in any event no later than 10 calendar days following the implementation of such change;

(iii) During the operation of a broker-dealer trading system of which the broker or dealer is the sponsor, file the information described in Part II of Form 17A–23 (§ 249.636 of this chapter) within 30 calendar days after the end of each calendar quarter in which the broker-dealer trading system has operated after July 1, 1995; and

(iv) Within 10 calendar days after a broker-dealer trading system of which the broker or dealer is the sponsor ceases to operate, file the notice described in Part III of Form 17A–23 (§ 249.636 of this chapter).

(2) The reports provided for in paragraph (d) of this section shall be considered filed upon receipt at the Commission's principal office in Washington, DC. Duplicate originals of the reports provided for in paragraphs (d)(1)(i), (ii), and (iv) of this section must be filed with surveillance personnel designated as such by the self-regulatory organization that is the designated examining authority for the broker or dealer pursuant to § 240.17d-1 simultaneously with filing with the Commission. Duplicates of the reports required by paragraphs (d)(1)(iii) of this section must be provided to such surveillance personnel of such self-regulatory authority upon request. All reports filed pursuant to this paragraph (d) shall be deemed to be confidential.

(e) *Maintenance of records in alternative form.* The records required to be maintained and preserved pursuant to this section may be produced, reproduced and maintained pursuant to the provisions of § 240.17a-4(f).

(f) *Compliance with other recordkeeping and reporting rules.* Nothing in this section obviates the need for any broker or dealer to comply with any other applicable recordkeeping or reporting requirement in the Act and the rules and regulations thereunder. If the information in a record required to be made pursuant to this section is preserved in a record made pursuant to § 240.17a-3 or § 240.17a-4, or otherwise preserved by the sponsor (whether in summary or other form), paragraph (c) of this section shall not require the sponsor to maintain such information in a separate file, provided that the sponsor can promptly sort and retrieve the information as if it had been kept in a separate file as a record made pursuant to this section, and preserves the information in accordance with the time periods specified in paragraph (c)(2) of this section.

(g) *Maintenance of records by others.* The records required to be maintained and preserved pursuant to this section may be prepared or maintained by a service bureau, depository, or other recordkeeping service on behalf of the sponsor of a broker-dealer trading system, provided such entity complies with the provisions of § 240.17a-4(i). Agreement with such an entity shall not relieve the sponsor of a broker-dealer trading system from the responsibility to prepare and maintain records as specified in this section.

(h) *Furnishing copies of records.* Every broker or dealer subject to this section pursuant to paragraph (a) of this section shall furnish to any representative of the Commission promptly upon request, legible, true and complete copies of those records of the sponsor that are required to be preserved under this section.

(i) *Exemption from this section.* The Commission, by rule or order, may exempt any sponsor of a broker-dealer trading system from all or any of the provisions of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such exemption is consistent with the public interest or the protection of investors.

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a, *et seq.*, unless otherwise noted;

*   *   *   *   *

4. Section 249.636 and Form 17A–23 are added to read as follows:

Note: The text of Form 17A–23 appears as Appendix A to this document and will not appear in the Code of Federal Regulations.

§ 249.636 Form 17A–23, information required of certain broker and dealer sponsors of broker-dealer trading systems pursuant to section 17 of the Securities Exchange Act of 1934 and § 240.17a–23 of this chapter.

This form shall be used by every registered broker and dealer that is required to file reports under § 240.17a–23 of this chapter.

By the Commission.

Dated: December 20, 1994.

Margaret H. McFarland,

Deputy Secretary.

BILLING CODE 8010–01–P

Official Use Only

APPENDIX A

OMB Approval
OMB No.: 3235-0442
Expires: 4-30-97

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 17A-23

Information Required of Registered Broker or Dealer Sponsor of Broker-Dealer Trading System Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-23 Thereunder

READ ALL INSTRUCTIONS PRIOR TO COMPLETING FORM

FORM 17A-23 Page 1	Indicate if this Report is submitted pursuant to: Part I _____ Part IA _____ Part II _____ Part III _____ If submitted pursuant to Part II or Part III, state period covered by Report: ________________ (mm/dd/yy) through ________________ (mm/dd/yy)

SPONSOR INFORMATION

NAME OF BROKER-DEALER TRADIN ; SYSTEM:		
NAME OF REGISTERED BROKER OR DEALER SPONSOR OF SYSTEM: FIRM CRD NO. ____________________		
NAME OF SYSTEM OPERATOR: (If different from Registered Broker or Dealer Sponsor of System)		
ADDRESS OF PRINCIPAL PLACE OF BUSINESS OF REGISTERED BROKER OR DEALER SPONSOR: (Do not use P.O. Box No.)		
(No. and Street)		
(City)	(State)	(Zip Code)
NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT WITH REGARD TO THIS REPORT:		

EXECUTION

The registered broker or dealer sponsor submitting this form and the executing official hereby represent that all the information contained herein is true, correct and complete.

Manual signature of Official responsible for form:	Title:
Name of Official responsible for form:	Date executed (Month/Day/Year):

FORM 17A–23 Page 2	READ ALL INSTRUCTIONS PRIOR TO COMPLETING FORM

PART I: INITIAL OPERATION REPORT
(To be filed at least 20 calendar days prior to operation)

Provide the following information:

1. State the date the sponsor (or system operator, if other than sponsor) intends to begin operating the system.

2. State the securities or types of securities eligible for trading on or through the facilities of the system, including whether securities of foreign private issuers will be eligible for trading on or through the system.

3. State the name and address of any entity that will be involved in the operation of the system, or will execute, clear or settle transactions on behalf of the sponsor or system participants in connection with operation of the system (other than system sponsor). Briefly describe the nature of such involvement and the responsibilities of such entity with respect to operation of the system and/or execution, clearance, or settlement of transactions in connection with operation of the system.

4. Briefly describe the sponsor's criteria for granting access to the system, and the manner of operation of the system, including the procedures governing entry of quotations and orders into the system; access to the system; execution, reporting, clearance and settlement of transactions in connection with the system; and procedures for ensuring participant compliance with system usage guidelines. Attach copy of system user's manual, if available.

5. Briefly describe the sponsor's procedures for reviewing system capacity, and security and contingency planning procedures.

6. If any entity other than the sponsor will hold or safeguard participant funds or securities on a regular basis, briefly describe the controls that will be implemented to ensure the safety of those funds and securities.

7. State whether entities located outside the United States will have access to the system. If so, describe the nature of such access and the extent to which such entities may participate in the system.

PART IA: MATERIAL CHANGE TO OPERATION OF SYSTEM
(To be filed at least 20 calendar days prior to implementation of a material change to system operation, if commercially practicable)

Describe any material changes to the information previously filed by sponsor with the Commission pursuant to Part I of this Form.

PART II: QUARTERLY REPORT
(To be filed within 30 calendar days after end of calendar quarter)

Provide the following information:

1. Total volume and average daily volume of transactions effected through the system during the period covered by this report and year–to–date aggregates of these numbers, expressed in (a) number of units of securities (for transactions in stock, number of shares); (b) number of transactions; and (c) monetary value (for transactions in stock, dollar value; for transactions in securities other than stock, dollar value or other appropriate commonly used measure of value of such securities). Provide separate unit, transaction, and monetary volume and average daily volume information for the period covered by the report reflecting: (a) system activity in securities listed on a registered national securities exchange, if applicable; (b) system activity in securities quoted on the National Association of Securities Dealers' Nasdaq service, if applicable; (c) system activity occuring during regular trading hours of the primary market for type of securities trading on system (for stock, the New York Stock Exchange), and (d) system activity occurring outside regular trading hours of the primary market for type of securities trading on system (for stock, the New York Stock Exchange). Identify the primary market and hours for items (c) and (d).

2. Total number of system orders, or other identifiable indicator that accurately reflects participant trading interest, as appropriate in light of system configuration (expressed separately for priced and unpriced orders, if applicable in light of system configuration).

PART III: REPORT OF CEASING TO OPERATE OR SPONSOR SYSTEM
(To be filed within 10 calendar days after sponsor ceases to operate or sponsor System)

Provide the following information:

1. State the date the sponsor ceased to operate or sponsor the system. State whether another entity will continue to operate or sponsor the system, and provide the name, address, and telephone number of such entity, if available.

2. Provide information requested in Part II for the period beginning on the day after the period covered by the most recent Form 17A–23, Part II filing, and ending on the date stated in item 1 of this Part (date sponsor ceased to operate or sponsor the system).

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

INSTRUCTIONS FOR COMPLETING FORM 17A-23

I. Terms

Unless the context clearly indicates otherwise, terms used in this Form have the meaning ascribed to them in the Securities Exchange Act of 1934 and Rule 17a-23 thereunder.

II. Who Must File; When to File

Rule 17a-23 requires that every registered broker or dealer that acts as the sponsor of a broker-dealer trading system: file Part I of Form 17A-23 at least 20 calendar days prior to operating or sponsoring a broker-dealer trading system; file Part IA of Form 17A-23 regarding regarding a material change to operation of the system as described in any filing previously made with the Commission pursuant to Part I of Form 17A-23 at least 20 calendar days prior to implementing such material change, or, where it is commercially impracticable, as soon as possible thereafter when the sponsor determines that it will implement such material change (but in any event, no later than 10 calendar days following the implementation of such change); file Part II of Form 17A-23 within 20 calendar days after the end of each calendar quarter during which the sponsor operates or sponsors a broker-dealer trading system; and file Part III of Form 17A-23 within 10 calendar days after the sponsor ceases to operate or sponsor a broker-dealer trading system.

III. Number of Copies; How and Where to File

File the original and one copy of each Form 17A-23 filing with the SEC at Office of Automation and International Markets, Division of Market Regulation, 450 5th Street, N.W., Washington, DC 20549. Simultaneously with the filing of the original with the SEC, file one duplicate copy of each Part I, Part IA, and Part III Form 17A-23 filing with surveillance personnel designated by the self-regulatory organization that is the designated examining authority for the sponsor pursuant to Rule 17d-1. The sponsor must keep an exact copy of the filing for its records. All copies must be legible. The filing date of any Form 17A-23 filing is the date of its actual receipt by the SEC, provided that the filing complies with applicable requirements.

IV. Format of Filing

A sponsor may use the printed Form 17A-23 or a reproduction of it. In either case, complete page 1 of Form 17A-23 in the format provided. Number each page following page 1 consecutively, give the name of the broker-dealer trading system and the date at the top of each page, and identify the Part to which the information on that page relates.

V. Completing Form

If the sponsor of a broker-dealer trading system has not previously filed a Form 17A-23 with respect to the system, complete page 1 and Part I. If the sponsor has previously completed Part I in a Form 17A-23 filed with respect to the system, and continues to operate or sponsor the system: complete page 1 and Part IA only, if filing Form 17A-23 as required prior to implementing a material change to system operation; complete page 1 and Part II only, if filing Form 17A-23 as required quarterly. If the sponsor has ceased to operate or sponsor the system, complete page 1 and Part III only. Provide information required by each Part of the Form by typing or printing the text of each item followed by the response thereto. Numerical information required by Parts II and III (Item 2) may be provided in chart form. For numerical responses, clearly indicate the information each number represents and the item number in the Form which requests such information. Print or type all items and responses. If sponsor intends to provide a number other than the number of system orders in response to Item 2, Part II, contact the Office of Automation and International Markets, Division of Market Regulation, prior to filing. If the information requested by any item is available in printed form, the printed material may be attached as an exhibit and referenced in the response to the item.

VI. Sponsors that Operate More Than One Broker-Dealer Trading System

Sponsors that operate more that one broker-dealer trading system may file reports on Form 17A-23 relating to one or more systems. In each filing of Form 17A-23 that relates to more than one system operated by the sponsor, provide the required information separately for each system.

[FR Doc. 94-31656 Filed 12-27-94; 8:45 am]
BILLING CODE 8010-01-C

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 2

[Docket No. RM93–25–000]

Use of Reserved Authority in Hydropower Licenses to Ameliorate Cumulative Impacts; Policy Statement

Issued December 14, 1994.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Policy Statement.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is adopting a policy statement with respect to the use of reserved authority in licenses for hydropower projects to ameliorate cumulative impacts of such projects in the same river basin. The policy statement says that if it is not possible to explore all aspects of the cumulative environmental impact of a project at relicensing, the Commission will reserve the right to address them at a later date. The Commission will define the reserved authority as narrowly and precisely as possible. Licensees will be provided notice of any proposed use of the reserved authority and an opportunity for a hearing before the Commission acts.

EFFECTIVE DATE: January 27, 1995.

FOR FURTHER INFORMATION CONTACT: Barry Smoler, Office of the General Counsel, Federal Energy Regulatory Commission, 825 N. Capitol Street, N.E., Washington, D.C. 10426, (202) 208–1269.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the **Federal Register**, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this documents during normal business hours in Room 3104, 941 North Capitol Street, N.E., Washington, D.C. 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 208–1397. To access CIPS, set your communications software to 19200, 14400, 12000, 9600, 7200, 4800, 2400, 1200 or 300bps, full duplex, no parity, 8 data bits, and 1 stop bit. The full text of this document will be available on CIPS for 60 days from the date of issuance in ASCII and WordPerfect 5.1 format. After 60 days the document will be archived, but still accessible. The complete text on diskette in Wordperfect format may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, located in Room 3104, 941 North Capitol Street, N.E., Washington, D.C. 20426.

Before Commissioners: Elizabeth Anne Moler, Chair; Vicky A. Bailey, James J. Hoecker, William L. Massey, and Donald F. Santa, Jr.

I. Introduction

The Federal Energy Regulatory Commission (Commission) is adopting a policy statement with respect to the use of reserved authority in licenses for hydropower projects to ameliorate cumulative impacts of such projects in the same river basin.

II. Background

On September 15, 1993, the Commission issued a Notice of Proposed Policy Statement (NOPPS). [1] The NOPPS referred to a roundtable discussion held by the Commission on June 17, 1993, with a broad spectrum of organizations interested in the process for considering applications for new licenses for existing hydropower projects, the original or prior licenses for which are expiring. A number of the participants at the roundtable discussion expressed concern over cumulative impacts on the environment of multiple hydropower projects located in the same river basin.

The NOPPS noted that the Commission includes a set of standard articles, known as L-Forms, in each license that it issues. The L-Forms contain broad reservations of the Commission's authority to require alterations in the public interest to project works and operations, after notice and opportunity for hearing. [2]

In the NOPPS, the Commission recognized the importance of analyzing the potential cumulative impacts of multiple projects in the same river basin. The Commission noted, however, that the issue had now arisen in an unusual context in that, in one year (1993) 167 original licenses would expire, and the vast majority of those licensees had filed applications for a new license. The Commission thus perceived a need "to strike a reasonable balance that maximizes, to the extent feasible, taking a meaningful hard look at the cumulative impacts in a river basin without allowing the relicensing program to bog down in unacceptable delay." [3] The Commission noted in this regard that such delays could in themselves be damaging to the environment, as they would delay mitigation of adverse impacts at individual project sites.

The Commission noted in the NOPPS that it will in any event be examining cumulative impacts in its environmental assessments (EA) and environmental impact statements (EIS), and that it intended to prepare a number of multi-project EA's and EIS's that examine the cumulative impacts of related projects whose original licenses expire reasonably contemporaneously with each other. The Commission further noted that it will also include consideration of potential cumulative impacts in its environmental analysis of individual projects.

In the NOPPS, the Commission proposed several potential means of striking a reasonable balance when individual projects in the same river basin are subject to original or prior licenses that expire at fairly disparate points in time. The first option involved the project whose license does not expire for a number of years. If that project's license contained reserved authority of the kind set forth in the L-Form license articles described above, then, in coordination with the relicensing proceedings of other projects in the basin, the Commission would consider the appropriateness of using its reserved authority to reopen that project's license to address the cumulative impact issue.

The second option involved the project or projects being relicensed. The Commission might add to a new license a special article reserving the Commission's authority to address specific types of potential cumulative impacts in the future, in connection either with the relicense proceedings for other licensed projects in the basin or with any reopener proceedings that might be initiated prior to the expiration of the licenses for such other projects. The purpose of such an article would not be to narrow the Commission's ability to address an impact issue in the context of the new license, but to put the licensee on notice of the substantial likelihood that a particular issue or issues would be revisited in connection with the analysis of other specified projects in the basin. [4]

The Commission recognized the importance of providing project

[1] IV FERC Stats. & Regs. ¶ 32,501. The NOPPS was published in the **Federal Register** on September 21, 1993 (58 FR 48,994).

[2] See § 2.9 of the regulations, 18 CFR 2.9.

[3] IV FERC Stats. & Regs. at p. 32,799.

[4] The Commission noted that, although reopener clauses have been used in the past, they have not routinely been used to address cumulative impact concerns.

developers and financiers as much certainty as possible when it issues a license, and stated its intent to strive to do so. The Commission also stressed that, as is the case with any reservation of authority in a hydroelectric license, use of the reopener authority would be subject to the statutory standards of comprehensive development set forth in section 10(a)(1) of the Federal Power Act (FPA).[5] Finally, the Commission stated that it would use the reopener authority under discussion to adopt only such modifications to licenses as may be reasonably necessary to ameliorate cumulative impacts. The Commission would consider a variety of factors, including the sources and causes of the cumulative impacts, the costs of ameliorating them, and the ability of the various licensed projects to bear those costs.

The Commission invited comment on these policy proposals.

III. Comments

In response to the NOPPS, the Commission received comments and reply comments from a great many commenters, including municipal and non-municipal licensees; federal, state, and local governmental organizations; national, regional, and local environmental, trade, or other organizations and associations; and private citizens. The more substantial comments are identified in Appendix A. In addition, there was a large volume of comments in the nature of short letters. Many were from individuals (including operators of small hydro projects), and many were from local or regional organizations or local branches of national organizations.

[5] Section 10(a)(1), 16 U.S.C. § 803(a)(1), provides that all licenses issued by the Commission under Part I of the FPA shall be for projects which:

In the judgment of the Commission will be best adapted to a comprehensive plan for improving or developing a waterway or waterways for the use or benefit of interstate or foreign commerce, for the improvement and utilization of water power development, for the adequate protection, mitigation, and enhancement of fish and wildlife (including related spawning grounds and habitat), and for other beneficial public purposes, including irrigation, flood control, water supply, and recreational and other purposes referred to in section 4(e).

Section 4(e) of the FPA, 16 U.S.C. § 797(e), states, in pertinent part:

In deciding whether to issue any license under this Part for any project, the Commission, in addition to the power and development purposes for which licenses are issued, shall give equal consideration to the purposes of energy conservation, the protection, mitigation of damage to, and enhancement of, fish and wildlife (including related spawning grounds and habitat), the protection of recreational opportunities, and the preservation of other aspects of environmental quality.

A. General Comments

In general, environmental groups and licensees oppose the Commission's proposals, but for very different reasons. State and federal agencies generally support the proposals.

Environmental groups and government agencies applaud the goals of the NOPPS, but contend that it errs in perpetuating case-by-case analysis. Instead, they prefer systematic cumulative analysis of all rivers and projects in the same watershed basin, and want to have that analysis performed now, at relicensing, rather than later through reopeners.[6] Many commenters of all persuasions agree that the Commission ought to coordinate the terms of licenses for projects located in the same river basin so that in the future these licenses all will expire in the same year.[7]

The Hydropower Reform Coalition (Reform) urges the Commission to "adopt a schedule for performing watershed (basin-wide) environmental review, including impact analysis, for all watersheds that have at least one Class of 1993 relicensing and that have more than one hydro project."[8] Reform urges the Commission to commence such studies expeditiously, and to seek additional funding from Congress if necessary. Reform believes that its proposals are consistent with current federal environmental policy,[9] and that there are "sound scientific reasons to conduct cumulative impacts analyses that are based on watersheds or ecosystems, and to conduct them in a one-time, comprehensive fashion, rather than incrementally over a period of years as additional projects come up for relicensing."[10]

Reform agrees with the licensees that a system of reopening previously-issued licenses every time another project in the same river basin comes up for relicensing would be onerous and unfair to the licensees. Therefore, Reform opposes *seriatim* consideration and reconsideration of cumulative impact as each license comes up for renewal.[11]

Reform emphasizes "comprehensive" rather than "incremental" analysis of cumulative impacts. Reform advocates scoping at the outset to determine the "ecosystem boundaries" in the affected watershed, including "all past, present, and reasonably foreseeable future projects in an area, regardless of license status."[12] Reform contends that both NEPA[13] and the FPA[14] require consideration at relicensing of the cumulative impacts of a project "in the context of the relevant watershed."

[6] *See, e.g.*, the Hydropower Reform Coalition (Reform) at 5–7.

[7] *See, e.g.*, Reform at 7; National Hydropower Association (NHA) at 13–21, NHA reply comments at 3.

[8] Reform at 12–13.

[9] *Id.* at 14–17.

[10] *Id.* at 18–22.

[11] *Id.* at 23–24.

The National Hydropower Association (NHA) suggests that "the Proposed Policy runs the risk of being merely a solution in search of a problem."[15] NHA questions the Commission's legal authority to require the licensee to conduct costly studies based on unforeseen or hypothetical cumulative impacts.[16] NHA emphasizes its view that while it is appropriate to examine cumulative impacts at the time of licensing it is not appropriate to reopen that matter after the license has been issued and while it is still in effect.

NHA expresses concern that the proposed policy on reopeners changes "the fundamental economic and operational assumptions on which licensees relied" in such a manner as to threaten the continued and future viability of hydro projects.[17] NHA and the Edison Electric Institute (EEI) contend that Congress crafted the FPA to provide security of investment so as to encourage investment in hydro projects, and that the generic use of reopener clauses is inconsistent with that Congressional purpose. In this regard, they and numerous other licensee commenters contend that the license is a "contract" between the federal government and the licensee, and that the proposed policy on reopeners would violate the "contractual expectations" and "contractual reliance" created and intended by Congress.[18] In relation to this thesis, NHA, EEI, and the American Public Power Association (APPA) discuss sections 6, 10, 13, 14, 15, 21 and 28 of the FPA,[19] the legislative history of the FPA,[20] court cases,[21] and past Commission practice.[22]

NHA points out that many of the dams that cumulatively affect a river basin are beyond the Commission's jurisdiction to license. NHA contends that the proposed policy could

[12] *Id.* at 24.

[13] *Id.* at 28–32.

[14] *Id.* at 32–33.

[15] NHA at 4, 12–13.

[16] *Id.* at 6.

[17] *Id.* at 25.

[18] NHA at 25–31; EEI at 5–6, 16, 18–19.

[19] NHA at 26–29; EEI at 19–22, 26–29, 32; APPA at 11–14, 18–20. APPA's comments were submitted jointly by APPA and Certain Public Systems.

[20] NHA at 26–31; EEI at 19–22, 24–29, 33–35; APPA at 5–7.

[21] NHA at 29–30; EEI at 22–24, 32, 35–38; APPA at 9–11.

[22] NHA at 31–34; EEI at 29–32.

disproportionately shift the cost of mitigating cumulative impacts onto those projects that are licensed by the Commission.[23]

EEI questions the need for a policy statement on reopeners, contending that the Commission has not demonstrated the existence of a problem requiring a solution. EEI contends, thus, that the proposal is too broadly drawn.[24]

EEI contends that NEPA does not require the Commission to exercise reopener authority in this manner.[25] EEI contends that reopener clauses may drive up the cost of operation, discourage settlements, discourage willingness to voluntarily participate in environmental mitigation programs, impede availability of financing, and disrupt long-term system planning.[26]

APPA advocates an alternative policy consisting of voluntary coordinated activities by licensees and agencies, with appropriate incentives for licensees and applicants. APPA would hold licensees accountable for their environmental stewardship at relicensing. APPA also stresses the importance of notice and an opportunity for a hearing in reopener proceedings.[27]

The National Marine Fisheries Service (NMFS) of the U.S. Department of Commerce believes that "working discussions" would be more fruitful than notice and comment procedures. NMFS contends that "[t]he impacts of hydroelectric development cannot be accurately assessed on a project-by-project basis, but must be evaluated for an entire river basin." [28] NMFS welcomes the use of reopener clauses to conduct such inquiries on a river-wide basis. NMFS seeks clarification that the Commission will reopen licenses at the request of state and federal agencies, and wants the Commission to state its reasons in writing (i.e., in each individual case) if it declines to mandate such reopening. NMFS concludes with various suggestions for specific changes in the wording of the proposed policy statement.

The U.S. Department of the Interior (Interior) supports the Commission's efforts. Interior encourages the Commission to seek new legislative authority to reopen extant licenses that do not contain reopener clauses. Interior urges caution on inclusion of special reopener articles, stating that they may be drafted too narrowly to achieve the desired objective.

The U.S. Department of Energy (DOE) commends the Commission on its initiative. DOE suggests that the costs of mitigation be allocated in proportion to each project's impact and not be routinely divided up equally among all projects in a river basin. DOE urges the Commission to carefully balance the costs and benefits of energy production and environmental mitigation, so as to reach the most appropriate balance. DOE urges the Commission to require licensees to provide data only from their own projects and not from other licensees' projects.

The U.S. Environmental Protection Agency (EPA) supports the Commission's inclusion of reopener clauses and encourages greater use of them. EPA seeks clarification as to the circumstances that would justify reopening a license; the "avenues" available to the public to encourage the Commission to exercise reopener options; when the Commission intends to start reopening licenses; whether the reopener clauses will address water quality and aquatic habitat; and whether states will have an opportunity to issue new water quality certifications when licenses are reopened.

The Council on Environmental Quality urges the Commission to impose a moratorium on all hydropower licensing for a 10 to 15-year period, during which the Commission would prepare programmatic environmental impact statements on each watershed within the Commission's jurisdiction.

The Arizona Department of Environmental Quality, the California Department of Fish and Game, the Michigan Department of Natural Resources, the State of Vermont, and the Washington Department of Fisheries and Wildlife support the Commission's proposals. The Kentucky Department for Environmental Protection and the Wisconsin Department of Natural Resources urge basin-wide review of impacts. The California Water Resources Control Board urges the Commission to include in its cumulative impact analysis all water development projects in a river basin regardless of whether such projects fall within the scope of the Commission's licensing and exemption jurisdiction. The Maine State Planning Office supports the proposals but inquires as to how the reopening process will be coordinated with the state water quality certification program so as to ensure that the states' current standards are met when licenses are reopened.

The Adirondack Park Agency suggests use of very short-term licenses to synchronize the expiration dates of all licenses in the same river basin, but does not explain how that proposal would be consistent with the FPA.

The Columbia River Inter-Tribal Fish Commission contends that NEPA and the FPA require a comprehensive cumulative impacts analysis prior to licensing, and that this analysis can only be performed by a basin-wide approach. The Izaak Walton League contends that "biology and the law" require watershed-based cumulative effect analysis.[29]

Northrop, Devine and Tarbell, Inc., analyzed the Commission's database to determine how many different licensees hold licenses within individual river basins, how the licensed capacity within individual river basins is distributed among the licensees, and how the expiration dates of existing licenses are distributed through time within individual river basins. They report the following results:

With regard to project ownership, in 66% of the river basins, 70% or greater of the licenses are held by either a single licensee or collectively by two licensees.

With regard to project capacity, in 92% of the river basins, 70% or greater of the existing capacity is controlled by either a single licensee or collectively by two licensees; in 74% of the basins, 90% or greater of existing capacity is controlled by either a single licensee or collectively by two licensees.

With regard to license expiration time frames for projects with expiration dates between 1998 and 2015 (476 projects in 101 river basins), in 69% of the basins, all of the project licenses expire within seven years of each other; in 81% of the basins, 66% of the licenses expire within three years of each other.

From this they conclude that "over the next twenty years, on a river basin basis, the vast majority of relicensing activity will occur within a relatively short time-frame and involve at most two significant licensees." [30]

The City of Seattle contends that the expanded use of reopeners "will discourage virtually all multi-party settlement agreements." The Seattle Audubon Society contends that reliance on reopener clauses to examine cumulative impacts would improperly shift the burden of proof from the license applicants to the resource agencies, Indian tribes, and the public.[31]

Several western commenters stress the importance of considering the need to protect municipal water supplies in

[23] NHA at 34.

[24] EEI at 3–4, 6–10, 15–16.

[25] *Id.* at 10–14.

[26] *Id.* at 39–45.

[27] APPA at 3.

[28] NMFS at 1.

[29] Izaak Walton League at 1–2.

[30] Northrop, Devine and Tarbell, Inc. at 2.

[31] Seattle Audubon Society at 3.

any reopening or cumulative impact analysis.[32]

One commenter suggested limiting potential reopenings to only one reopening during the term of a license, and no earlier than ten years after its issuance.[33]

Many municipal and non-municipal operators of major projects filed extensive comments. Generally, however, those comments emphasize, elaborate, or reiterate positions articulated by NHA, EEI, and APPA which were summarized above. Some commenters relate the Commission's proposals to the facts of their particular projects.

Many environmental groups and individuals filed shorter comments. These generally reiterate and emphasize the importance of analyzing cumulative impacts on a basin-wide scale.

In its reply comments, Reform suggests that the licensees' fears are premised on the false assumption that the Commission would implement its policy in an extreme and unreasonable manner.

In its reply comments, NHA contends that no commenter has provided a methodology for implementing its proposed "watershed" or "ecosystem" approach to cumulative impact, and that those proposals would substantially delay the relicense process. NHA also contends that no commenter has demonstrated a need for the Commission's proposed policy statement, nor a legal basis in support of it.

In its reply comments, EEI suggests that the proposals to study watersheds and ecosystems go far beyond the scope of the NOPPS, and should be considered in a separate proceeding.

B. Invoking Existing Reopeners in Licenses Already Issued

NHA advocates reopening existing licenses only on a case-by-case basis, and not generically. NHA contends that excessive reliance on standard reopener clauses would discourage future investment in hydropower facilities by increasing uncertainty over project costs. Future cumulative impacts ought to be identified at relicensing, and not deferred.[34]

EEI believes licenses should be reopened only pursuant to the mutual agreement of the Commission and the licensee. The licensee should have notice and an opportunity for a hearing. The proponent of reopening should demonstrate its appropriateness. The license amendment must be reasonably necessary to address the impacts, and must be consistent with the licensee's reasonable expectations.[35]

APPA also stresses voluntary cooperation, with the focus at relicensing rather than during the term of the license.[36]

The Industrial Licensees Group (like EEI, NHA, and other licensees) contends that the Commission's legal authority to reopen a license during its term is sharply limited.[37]

C. Including Special Reopeners in New Licenses

Environmental groups express concern that inclusion of reopener reservation articles will be used as a substitute for meaningful cumulative impact analysis at relicensing, thus postponing the "hard look" required by NEPA until after the license has been issued, in derogation of both NEPA and the FPA.[38] Reform is concerned that consideration of cumulative impacts pursuant to a reopener proceeding would shift the burden of proof away from the licensee, who would have that burden if cumulative impacts were considered at relicensing.[39]

NHA does not object to the use of special reopeners as long as that use is limited to situations in which the Commission, after appropriate analysis under FPA sections 4 and 10 in the context of the first project's relicense proceeding, is genuinely unable to ascertain what mitigatory measures may be required at that first project in light of the future relicensing proceeding for the cumulatively-related second project. The first project's licensee should be given notice and an opportunity for hearing, with the issues limited to the matters raised by the second project, and with the burden of proof on the proponent of reopening. NHA prefers such specialized reopeners to more generalized reopeners because they provide better notice to the licensee and interested government agencies as to what future changes in the license the Commission might be contemplating, and when. NHA would have the Commission synchronize future license expiration dates to the extent possible so as to minimize the future need for special reopeners.[40]

As noted above, Interior is concerned that inclusion of special reopeners might narrow what it perceives to be the Commission's broad powers to reopen licenses.

IV. Discussion

The extensive comments received in response to the NOPPS have given the Commission a deeper understanding of the complexities inherent in this matter, and we have expanded and modified our policy statement accordingly.

It is beyond dispute that the Commission must deal with cumulative impacts of multiple projects in a river basin. In issuing licenses for new projects, and in issuing licenses for relicensed projects, the Commission will examine cumulative impacts carefully.

A number of commenters suggested that the Commission consider cumulative impacts in the factual context of specific cases instead of trying to establish generic rules. The point is well taken, in that decisions on cumulative impacts must necessarily consider the particular facts and circumstances in which the issues arise, and the Commission's determinations in each such individual case will necessarily be strongly shaped by the facts and circumstances presented. There are, however, several broad principles that we can state as a starting point and touchstone for the case-specific inquiries.

Our most fundamental principle is that issues of cumulative impacts ought to be examined at the time of relicensing to the fullest extent that such examination is feasible. Reservations of authority to reopen licenses at a later date for the purpose of considering cumulative impacts should be resorted to only if it is not possible to examine all such impacts during the relicensing process. Thus, the Commission will deal with cumulative impact issues as comprehensively as possible at the licensing stage. Specific license articles will be fashioned as necessary.

There will be circumstances, however, in which comprehensive analysis of all potential cumulative impacts could entail unacceptably long delays in the relicensing process. Such delays could in themselves generate harm to the environment by delaying the implementation of necessary environmentally ameliorative construction or operation pursuant to a new license. Thus, if it is not possible to fully explore all of the cumulative impacts on a timely basis, the Commission will reserve the authority necessary to revisit those issues at a later date. If the Commission foresees the need to deal with a cumulative impact issue at a future date it will

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[32] *See, e.g.*, Western Urban Water Coalition, City and County of San Francisco, and East Bay Municipal District.

[33] Pend Oreille County Public Utility District, Washington at 1.

[34] NHA at 21–24.

[35] EEI at 45–57.

[36] APPA at 18–21.

[37] Industrial Licensees Group at 6–10.

[38] *See, e.g.*, Reform at 9.

[39] Reform at 10.

[40] NHA at 13–21.

fashion specific, tailor-made license conditions to do so to the maximum extent possible. Such "reopener" authority will be defined as narrowly and specifically as possible, particularly with respect to the purpose of the reservation of such authority.

Many commenters stressed the importance of providing notice and an opportunity for hearing before exercising any reserved authority. We agree completely, and will do so. Any use of a reopener provision will have adequate procedural safeguards to protect the licensee. This will include notice and an opportunity for a hearing. Any conditioning of the license will be prospective, although it may address prior impacts.

Finally, as noted above, commenters of many persuasions urged us to coordinate the expiration dates of licenses to the maximum extent feasible. We will endeavor to do so in the licenses that come before us in the future.[41] This is consistent with, and will considerably facilitate implementation of, our overriding principle—that the cumulative impacts of projects in the same river basin ought to be considered collectively at relicensing.

Several commenters discussed the Commission's legal authority to use reservation articles in licenses. As discussed in the NOPPS, pursuant to sections 10(a)(1) and 4(e) of the FPA, all licenses issued by the Commission under Part I of the FPA shall be for projects which are best adapted to a comprehensive plan for improving or developing the waterway for beneficial public purposes, consistent with the comprehensive development standard of section 10(a)(1). The section 10(a)(1) mandate continues throughout the term of a license, and is the standard by which license amendments, whether initiated by the licensee or the Commission, are judged.[42] Under this standard, all public interest considerations, including the impact on project viability, are relevant to the Commission's decisionmaking.

As discussed in the NOPPS, the use of reopener license articles has been sustained as an appropriate means for the Commission to pursue the broad public policy objectives of section 10(a)(1) of the FPA.[43] In *Platte River Whooping Crane Critical Habitat Maintenance Trust v. FERC*,[44] the Court of Appeals quoted from the legislative history of the Electric Consumers Protection Act of 1986 (ECPA)[45] in concluding that "Congress expected FERC to exercise whatever authority it might have to introduce into existing licenses environmental protective conditions that in its judgment appear necessary."

[41] We note, in this regard, that the FPA requires that new licenses be issued for a minimum of 30 years, and that the economics of hydropower projects are frequently dependent on long-term licenses. This can be particularly significant if the new license requires the licensee to construct new project facilities (*e.g.*, fish ladders or screens) to ameliorate environmental impacts.

[42] *See, e.g.*, Trinity River Authority of Texas, 41 FERC ¶ 61,300 (1987); Pacific Gas & Electric Co., 46 FERC ¶ 61,249 (1989); Oroville-Wyandotte Irrigation District, 53 FERC ¶ 61,439 (1990).

[43] See Dept. of the Interior v. FERC, 952 F.2d 538, 546–48 (D.C. Cir. 1992); LaFlamme v. FERC, 945 F.2d 1124, 1130 (9th Cir. 1991); Pacific Gas & Electric Co. v FERC, 720 F.2d 78, 83–84 (D.C. Cir. 1983); State of California v Federal Power Commission, 345 F.2d 917, 921–25 (9th Cir. 1965).

[44] 876 F.2d 109, 118 (D.C. Cir. 1989).

[45] Pub. L. No. 99–495, 100 Stat. 1243 (Oct. 16, 1986) (codified at 16 USC 791a et seq.).

List of Subjects in 18 CFR Part 2

Administrative practice and procedure, Electric power, Natural gas, Pipelines, Reporting and recordkeeping requirements.

By the Commission.

Lois D. Cashell,

Secretary.

In consideration of the foregoing, the Commission amends Part 2, Chapter I, Title 18 of the Code of Federal Regulations as set forth below.

PART 2—GENERAL POLICY AND INTERPRETATIONS

1. The authority citation for Part 2 continues to read as follows:

Authority: 15 U.S.C. 717–717w, 3301–3432; 16 U.S.C. 792–825y, 2601–2645; 42 U.S.C. 4321–4361, 7101–7352.

2. Part 2 is amended by adding § 2.23, to read as follows:

§ 2.23 Use of Reserved Authority in Hydropower Licenses to Ameliorate Cumulative Impacts.

The Commission will address and consider cumulative impact issues at original licensing and relicensing to the fullest extent possible consistent with the Commission's statutory responsibility to avoid undue delay in the relicensing process and to avoid undue delay in the amelioration of individual project impacts at relicensing. To the extent, if any, that it is not possible to explore and address all cumulative impacts at relicensing, the Commission will reserve authority to examine and address such impacts after the new license has been issued, but will define that reserved authority as narrowly and with as much specificity as possible, particularly with respect to the purpose of reserving that authority. The Commission intends that such articles will describe, to the maximum extent possible, reasonably foreseeable future resource concerns that may warrant modifications of the licensed project. Before taking any action pursuant to such reserved authority, the Commission will publish notice of its proposed action and will provide an opportunity for hearing by the licensee and all interested parties. Hydropower licenses also contain standard "reopener" articles (see § 2.9 of this part) which reserve authority to the Commission to require, among other things, licensees of projects located in the same river basin to mitigate the cumulative impacts of those projects on the river basin. In light of the policy described above, the Commission will use the standard "reopener" articles to explore and address cumulative impacts only (except in extraordinary circumstances) where such impacts were not known at the time of licensing or are the result of changed circumstances. The Commission has authority under the Federal Power Act to require licensees, during the term of the license, to develop and provide data to the Commission on the cumulative impacts of licensed projects located in the same river basin. In issuing both new and original licenses, the Commission will coordinate the expiration dates of the licenses to the maximum extent possible, to maximize future consideration of cumulative impacts at the same time in contemporaneous proceedings at relicensing. The Commission's intention is to consider to the extent practicable cumulative impacts at the time of licensing and relicensing, and to eliminate the need to resort to the use of reserved authority.

Note: This Appendix will not be published in the Code of Federal Regulations.

Appendix A—List of Commenters

A large number of interested persons and organizations expressed their views in comments ranging in length and style from extensive analysis in a formal pleading to a brief statement of position in a letter. All of the comments were read and considered. This list includes all commenters who are governments, or agencies of governments, including states, counties, cities, and municipalities, and federal, state, and local government agencies. In addition, the list includes those commenters who filed the more comprehensive or extended comments.

Federal Agencies

Bonneville Power Administration
Council on Environmental Quality

National Marine Fisheries Service (NMFS)
U.S. Department of Energy (DOE)
U.S. Department of the Interior (Interior)
U.S. Environmental Protection Agency (EPA)
U.S. Forest Service, Huron-Manistee National Forests

State Agencies

Arizona Department of Environmental Quality
California Department of Fish and Game
California Water Resources Board
Kentucky Department for Environmental Protection
Maine Department of Inland Fisheries and Wildlife
Maine State Planning Office
Michigan Department of Natural Resources
State of Vermont
Washington Departments of Fisheries and Wildlife
Wisconsin Department of Natural Resources
State of Wyoming [46]

Associations

Adirondack Park Agency
American Forest and Paper Association
American Public Power Association and Certain Public Systems (APPA) [47]
American Rivers
Appalachian Mountain Club
California Urban Water Agencies
Columbia River Inter-Tribal Fish Council
Edison Electric Institute (EEI) [46]
Friends of the Cowlitz
Hydropower Reform Coalition (Reform) [46]
Industrial Licensee Group
Izaak Walton League
National Hydropower Association (NHA) [46]
New York Rivers United
Northrop, Devine & Tarbell, Inc.
Northwest Hydroelectric Association
Public Generating Pool
Seattle Audubon Society
Trout Unlimited
The Tulalip Tribes
Western Urban Water Coalition

Municipal Licensees

Bountiful City Light and Power
Central Nebraska Public Power and Irrigation District
Central Oregon Irrigation District
City and County of San Francisco
City of New Martinsville, West Virginia
City of Oswego, New York
City of Rocky Mount, North Carolina
City of Saint Cloud, Minnesota
City of Seattle, Washington
City of Spokane, Washington
County of Amador, California
East Bay Municipal District
El Dorado Irrigation District
Lewis County Public Utility District, Washington
Merced Irrigation District
Nebraska Public Power District
Nevada Irrigation District
Oroville-Wyandotte Irrigation District, and Tri-Dam Project
Pend Oreille County Public Utility District, Washington
Power Authority of the State of New York
Public Utility District No. 1 of Chelan County, Washington
Public Utility District No. 1 of Douglas County, Washington
Public Utility District No. 2 of Grant County, Washington
Sacramento Municipal Utility District
Tacoma Public Utilities
Turlock Irrigation District
Village of Morrisville, Vermont
Yuba County Water Agency

Non-Municipal Licensees

Adirondack Hydro Development Corporation
Alabama Power Company and Georgia Power Company
Consolidated Hydro, Inc.
Consolidated Hydro, Inc., HYDRA-CO Enterprises, Inc., Hydro Development Group, STS Hydropower, Ltd., and Synergics
Duke Power Company
Great Northern Paper, Inc.
Idaho Power Company
James River-New Hampshire Electric, Inc.
Montana Power Company
New England Power Company Niagara Mohawk Power Corporation
Northern States Power Company
Pacific Gas and Electric Company
Pacificorp
Portland General Electric Company
Public Service Company of Colorado
Puget Sound Power & Light Company
Simpson Paper Company
Southern California Edison Company
Summit Hydropower
United Energy Corporation, Mt. Hope Hydro Inc., and Liberty Power Corporation
Upper Peninsula Power Company
Washington Water Power Company [46]
Wisconsin Valley Improvement Company
Wisconsin Valley, Wisconsin Public Service Corporation, Weyerhaeuser Company, Consolidated Water Power Company, Neekosa Papers Inc., and Wisconsin River Power Company

[46] Almost all of the commenters filed initial comments. Commenters identified by this footnote filed only reply comments.

[47] Commenters identified by this footnote filed both initial and reply comments.

[FR Doc. 94-31895 Filed 12-27-94; 8:45 am]
BILLING CODE 6717-01-P

INTERNATIONAL TRADE COMMISSION

19 CFR Parts 201 and 207

Rules of General Application; Investigations of Whether Injury to Domestic Industries Results From Imports Sold at Less Than Fair Value or From Subsidized Exports to the United States

AGENCY: U.S. International Trade Commission.

ACTION: Notice of final rulemaking.

SUMMARY: The Commission is amending the rules to address concerns which have arisen relating to Commission practice. The amendments provide, in particular, for changes relating to sanctions and other actions in response to administrative protective order (APO) breaches, the procedures for conducting APO breach investigations, the filing of prehearing briefs, closed sessions of Commission hearings in title VII and other investigations, and the procedures for considering requests for exemption from disclosure under APO of business proprietary information in title VII investigations.

EFFECTIVE DATE: January 27, 1995.

FOR FURTHER INFORMATION CONTACT: Paul R. Bardos, Esq., Office of the General Counsel, U.S. International Trade Commission, telephone 202-205-3102. Hearing-impaired persons are advised that information on the matter can be obtained by contacting the Commission's TDD terminal on 202-225-1810.

SUPPLEMENTARY INFORMATION: Section 335 of the Tariff Act of 1930 (19 U.S.C. 1335) authorizes the Commission to adopt such reasonable procedures and rules and regulations as it deems necessary to carry out its functions and duties.

Commission rules ordinarily are promulgated in accordance with the rulemaking provisions of section 553 of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) (APA), which entails the following steps: (1) publication of a notice of proposed rulemaking; (2) solicitation of public comment on the proposed rules; (3) Commission review of such comments prior to developing final rules; and (4) publication of the final rules thirty days prior to their effective date. *See* 5 U.S.C. 553. Notice of proposed rulemaking was published in the **Federal Register** of April 15, 1993 (58 Fed. Reg. 19,638) and interested persons were given until May 17, 1993, to submit comments. Comments were received from the Customs and International Trade Bar Association