

**FEDERAL RESERVE BANK
OF NEW YORK**

Fiscal Agent of the United States

[Circular No. **10158**
March 3, 1987]

**PROPOSED TREASURY REGULATIONS REGARDING
GOVERNMENT SECURITIES BROKER OR DEALER ACTIVITIES**

*To All Depository Institutions, and Others Concerned,
in the Second Federal Reserve District:*

The following is quoted from the text of a statement issued by the Treasury Department:

The Treasury Department has released proposed regulations under the Government Securities Act of 1986. The regulations, which for the first time would establish a system of identification and regulation of entities that deal solely in Government securities and other exempted securities, has been published in the *Federal Register* for 30 days of public comment. Under the Government Securities Act, temporary regulations must take effect on May 26, 1987, and final regulations on July 25, 1987. The proposed regulations affect all brokers and dealers in Government securities, including those newly required to register under the Government Securities Act, registered broker-dealers, and some financial institutions.

The proposed regulations include a financial responsibility requirement for currently unregulated Government securities brokers and dealers that is based on the capital adequacy guidelines issued in May, 1985 by the Federal Reserve Bank of New York. SEC-registered broker-dealers and financial institutions would not be subject to any additional capital requirement. The proposal also would require newly registered Government securities brokers and dealers to follow SEC rules concerning possession or control of customer securities, recordkeeping and reporting, with modifications designed to enhance the knowledge and protection of all parties to repurchase transactions. Many of the repurchase agreement modifications would also apply to Government securities brokers or dealers that are registered broker-dealers or financial institutions. The proposal also includes regulations concerning the custodial holdings of Government securities by banks and other depository institutions.

Enclosed — for depository institutions in this District — is the complete text of the proposed Treasury regulations referred to in our Circular No. 10157, dated March 2, 1987, which has been reprinted from the *Federal Register* of February 25; copies will be furnished to others upon request directed to the Circulars Division of this Bank (Tel. No. 212-720-5215 or 5216). Comments on the proposal should be submitted by March 27, 1987, and may be sent directly to the Treasury, as set forth in the *Federal Register* notice.

Questions regarding this matter may be directed, at this Bank, to Don N. Ringsmuth, Associate General Counsel (Tel. No. 212-720-5007) or to Barbara L. Walter, Assistant Vice President (Tel. No. 212-720-5481).

E. GERALD CORRIGAN,
President.

Registered Federal Reserve

Wednesday
February 25, 1987

Part V

Department of the Treasury Securities and Exchange Commission Federal Reserve System

17 CFR Ch. IV

**Government Securities Act of 1986;
Implementing Regulations; Proposed Rule**

17 CFR Parts 240 and 249

**Government Securities Act of 1986;
Proposed Rule and Proposed Revision of
Form BD**

**Financial Institutions Acting as
Government Securities Brokers or
Government Securities Dealers; Notice**

DEPARTMENT OF THE TREASURY

Office of the Assistant Secretary
(Domestic Finance)

17 CFR Ch. IV

Government Securities Act of 1986;
Implementing RegulationsAGENCY: Office of the Assistant
Secretary (Domestic Finance), Treasury.

ACTION: Proposed rule.

SUMMARY: The Department of the Treasury is issuing proposed regulations as required by the Government Securities Act of 1986 (the "Government Securities Act" or "GSA"). The GSA requires the Secretary of the Treasury (the "Secretary") to adopt rules and regulations concerning the financial responsibility, protection of investor securities and funds, recordkeeping, reporting and audit of brokers and dealers in government securities. The GSA also requires the Secretary to adopt regulations relating to the custody of government securities held by financial institutions that are not government securities brokers or dealers. The proposed regulations are designed to enhance the protection of investors in government securities while maintaining a fair, honest and liquid market in such securities. Subchapter A of the proposed regulations covers government securities brokers and dealers. Subchapter B of the proposed regulations deals with custody of government securities by financial institutions.

DATES: Comments must be submitted on or before March 27, 1987. No extensions of time for comment will be provided.

ADDRESSES: Send comments to: The Government Securities Regulations Project, Department of the Treasury, Room 4417, Main Treasury Building, Washington, DC 20220.

Copies of all written comments will be available for public inspection and copying from 9:00 A.M. to 5:30 P.M. at the Treasury Department Library, Room 5030, Main Treasury Building, Washington, DC 20220.

FOR FURTHER INFORMATION CONTACT: Ellen Seidman (Special Assistant to the Under Secretary), Room 4414, Main Treasury Building, Washington, DC 20220, (202) 566-2278.

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

For information concerning possession or control of securities, contact: Virginia Rutledge (Senior Attorney for Finance), Room 2025, Main Treasury Building, Washington, DC 20220, (202) 535-4890.

SUPPLEMENTARY INFORMATION:

I. Background

The GSA establishes, for the first time, a federal system for regulation of brokers and dealers who transact business exclusively in government securities, or a government securities business combined with business in exempted securities and/or futures and other commodity interests regulated by the Commodity Futures Trading Commission ("CFTC"). The Secretary of the Treasury is to adopt rules and regulations concerning the financial responsibility, protection of investor securities and balances, recordkeeping, reporting and audit of government securities brokers and dealers.¹ Previously unregulated government securities brokers and dealers must also register with the Securities and Exchange Commission (the "SEC" or "Commission") and join a self-regulatory organization.² Enforcement of the Secretary's regulations will be carried out by the SEC and the appropriate self-regulatory organizations.³ The GSA also provides for regulation of all other brokers and dealers in government securities, all of whom must notify their principal regulatory agency of their status as government securities brokers or dealers.⁴ Enforcement of the regulations

for such entities will be carried out by the appropriate regulatory agencies.⁵

The purpose of such registration and regulation is to enhance the protection of investors in government securities by establishing and enforcing appropriate financial responsibility and custodial standards for government securities brokers and dealers. At the same time, the standards must respect and protect the integrity, liquidity and efficiency of the world's largest securities market, which is vital to the effective implementation of fiscal and monetary policy in the United States.⁶

In adopting regulations concerning those entities that are already regulated, such as brokers and dealers registered under sections 15 or 15B of the Securities Exchange Act of 1934 (the "Act") and financial institutions, the Secretary of the Treasury is to take into consideration already existing regulation with a view toward preventing overly burdensome or duplicative regulation.⁷

The proposed regulations constitute the Secretary's response to these mandates. The GSA requires that the regulations become effective as temporary regulations on May 26, 1987, and as final regulations on July 25, 1987. All government securities brokers and dealers must register or give notice by July 25, 1987, and must be in compliance with the regulations that will become final on that date.⁸ Because of the short timetable both for developing the regulations and meeting their requirements, no extensions of time for comment will be granted and it is extremely important that all those potentially affected by the regulations

⁵ Generally, the appropriate regulatory agency, for a financial institution is that institution's federal supervisory agency and is the SEC for all others, including brokers and dealers registered with the SEC under sections 15 or 15B of the Act. Section 3(a)(34)(C) [15 U.S.C. 78c(a)(34)(C)].

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

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

⁸ GSA, supra note 6, section 402. In general, the regulations are proposed to be effective July 25, 1987. However, because of the difficulties of achieving compliance with several of the regulations in the maximum of 15 days that will be available between the date for publication of the temporary regulations and June 10, 1987, the date on which entities must file registration applications with the SEC in order to assure registration before July 25, several of the regulations, in particular Part 402 relating to financial responsibility, will not become fully effective until October 25, 1987.

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

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

² Section 15C(a)(1)(A), (e) [15 U.S.C. 78o-5(a)(1)(A), (e)]. Currently unregulated entities that believe they are government securities brokers or dealers are urged to contact the appropriate self-regulatory organization, in most cases the National Association of Securities Dealers ("NASD"), for membership information, as soon as possible. The NASD has informed the Department that it will only be able to guarantee completion of membership processing before the July 25, 1987 deadline for entities that submit complete applications prior to April 15, 1987.

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

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

take the opportunity provided by this publication to analyze and comment upon the proposals, and also to prepare for implementation.⁹

In developing the proposed regulations, the Treasury has consulted extensively with the SEC and the federal supervisory agencies for financial institutions, and with the Federal Reserve Bank of New York ("FRBNY"), which has developed and published a voluntary capital adequacy guideline for brokers and dealers in government securities. The Department has met with twenty-three brokers or dealers in government securities, regulated and unregulated, large and small, financial institutions and others, and talked with a number of additional brokers and dealers by telephone. We have met with the relevant self-regulatory organizations, the National Association of Securities Dealers and the New York Stock Exchange. We have also met with trade associations, professional organizations (such as the American Institute of Certified Public Accountants), and with individual professionals serving government securities brokers and dealers. We have also been in touch with representatives of investors, including governmental entities and savings and loan associations. We have received written comments and suggestions from some of those with whom we met and from others.

As a result of this consultation and the Department's analysis, the Department has reached several conclusions concerning the Commission's existing regulations under sections 15 and 17 of the Act. First, the Department believes that in large part the existing SEC regulations that correspond to the statutory mandate of the Secretary work effectively to protect customers and insure financial integrity of brokers and dealers. In addition, almost all of the entities other than financial institutions that will be affected by the proposed regulations are familiar with many of the appropriate regulations under sections 15 and 17, either by virtue of their affiliation with a registered broker or dealer or a registered municipal securities dealer or because the principals in the firm or

professionals who service them are familiar with these regulations. Furthermore, many of these entities currently are in compliance with the SEC's regulations. Finally, with a few exceptions, the Department has concluded that regulations currently applicable to financial institutions that are government securities brokers and dealers also effectively meet the purposes of the GSA.

As a result of these conclusions, the proposed regulations, in all areas except financial responsibility, largely adopt existing regulations under sections 15 and 17 of the Act by reference, with limited modifications. Compliance by registered brokers or dealers with rules under sections 15 and 17 will, in general, be deemed compliance with these rules. With limited modifications, compliance by government securities brokers and dealers that are financial institutions with existing regulations will also be deemed compliance with these regulations. In this way, the Department intends to enable newly registered entities to rely on SEC interpretations of the rules, which are in general well-known to the industry and essential to effective enforcement of the rules. The Department is working with the other regulatory agencies to encourage them to adopt the modifications proposed in these regulations so that in time there will be only one applicable set of regulations for each entity.

In the area of financial responsibility, however, the Department determined that the capital adequacy model designed by the FRBNY,¹⁰ which effectively recognizes certain types of risks as well as risk-mitigating hedging techniques is, with modifications, better suited for brokers and dealers solely in government securities, other exempted securities, and CFTC-regulated commodity interests than SEC Rule 15c3-1.¹¹ The Department is working with the SEC toward development of a uniform rule that would allow the Treasury to accept compliance with Rule 15c3-1 by presently unregulated government securities brokers and dealers as compliance with the Treasury rule.

Regulations relating to CFTC-regulated entities. The Act requires that the SEC, in consultation with the CFTC, determine what government securities activities of a CFTC-registered entity are

"incidental" to the futures business. A CFTC-registered entity conducting only "incidental" government securities activities will not be considered a government securities broker or dealer.¹² Entities whose activities go beyond the "incidental" are required to register with the SEC and to become a member of a self-regulatory organization as defined in the Act. The SEC is scheduled to publish soon a proposed regulation defining the term "incidental" with respect to CFTC-registered entities. Based on the information available to it, the Department believes that the SEC regulation effectively removes from regulation as government securities brokers or dealers a very large number of futures commission merchants ("FCM's") and other CFTC-registered entities who limit their activities in the cash government securities market to those that are incidental to their futures-related business.

During the development period for these proposed regulations, the Department received a number of informal requests to exercise its exemptive authority to exempt FCM's and other CFTC-registered entities who transact business in government securities from, in particular, the registration and financial responsibility requirements of the Act and related regulations. The Department recognizes the potential for duplicative regulation of entities already subject to substantial federal regulation. However, the Department has not included such exemptions in the proposed rules at this time because (i) we believe that the SEC proposed regulation will eliminate the problem for all but true government securities brokers and dealers; (ii) the statutory decision to treat the CFTC differently than the SEC and the financial institution regulatory agencies suggests that, at least with respect to registration, the Department has limited authority to allow CFTC registration to substitute for SEC registration; and (iii) we have not yet been able to gather sufficient information concerning the activities, capital positions, unregulated government securities accounts for customers etc., of entities whose government securities business goes beyond the "incidental" to determine whether exemptions would be consistent with the protection of investors and the public interest.

The Department specifically invites comments concerning modified requirements for FCM's and other

⁹ Currently unregulated persons (including subsidiaries and affiliates of financial institutions) and registered brokers or dealers uncertain of their status as government securities brokers or dealers are urged to contact the Office of the Chief Counsel, Division of Market Regulation, Mail Stop 5-1, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549, as soon as possible. Financial institutions uncertain of their status should contact their appropriate regulatory agency.

¹⁰ Federal Reserve Bank of New York, Capital Adequacy Guideline for U.S. Government Securities Dealers, May 20, 1985.

¹¹ Section 240.15c3-1. Unless otherwise stated, all references to existing rules of the Commission are to sections of Title 17 of the Code of Federal Regulations.

¹² Sections 3(a)(43)(B) (government securities brokers), 3(a)(44)(D) (government securities dealers) [15 U.S.C. 78c(a)(43)(B), (a)(44)(D)].

CFTC-registered entities that are government securities brokers or dealers. In particular, we request consideration, by those entities who would not be removed from regulation through the SEC definitional rule, of (i) a financial responsibility requirement under which such an entity would be required to meet the higher of the CFTC's capital rule or the rule proposed in § 402.2;¹³ (ii) a financial responsibility requirement under which such an entity would be required to meet the higher of the CFTC's capital rule or the SEC's capital rule; and (iii) a possession or control rule that would exempt from the rules proposed in part 403 securities that were in customer segregation accounts pursuant to 17 CFR 1.20-1.30. In commenting on these and other suggestions, commenters should consider whether the suggested rules would accurately and appropriately reflect risk and adequately protect investors.

II. Section-by-Section Analysis of Proposed Regulations

A. Part 400. Rules of General Application

1. *Section 400.1.* This section notes the requirements of the Act, as amended by the GSA, for regulation, registration and notice of status. It sets forth the principle that, unless otherwise specifically provided, all regulations apply to all government securities brokers and dealers, both those who must register and those who must give notice of their status as government securities brokers or dealers to the appropriate regulatory agency. Exemptions are provided in individual parts or sections of the regulations for registered brokers or dealers and financial institutions where applicable.

The section also states the registration and notice requirements of the Act and cross-references the appropriate regulations providing for registration and notice.

2. *Section 400.2.* This section specifies the Office of the Deputy Assistant Secretary (Federal Finance) as the office within Treasury responsible for the regulations, and directs correspondence, including correspondence concerning exemptions, to that office. The section notes that the appropriate regulatory agencies (the SEC and the financial institution supervisory agencies) and the self-regulatory organizations are

responsible for enforcement of the regulations.

3. *Section 400.3.* This section sets out definitions that are applicable, except where otherwise explicitly provided, throughout the proposed regulations. Definitions contained in SEC rules referenced in the proposed regulations are applicable unless otherwise explicitly provided. These definitions are also used in this preamble.

(a) "Act" means the Securities Exchange Act of 1934, including amendments enacted as part of the GSA.

(b) "Appropriate regulatory agency" has the meaning set out in Section 3(a)(34)(G) of the Act, and in general means the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board for commercial banks and thrift institutions that are federally chartered or insured and certain foreign and District of Columbia financial institutions, and the SEC for all others. In particular, the appropriate regulatory agency for state chartered non-federally insured commercial banks and thrift institutions and for credit unions is the SEC.

(c) "Commission" or "SEC" means the Securities and Exchange Commission.

(d) "Designated examining authority" and "Examining Authority" mean, for a registered government securities broker or dealer that belongs to only one self-regulatory organization, that organization, and for a registered government securities broker or dealer that belongs to more than one self-regulatory organization, the one designated by the Commission under section 17(d) of the Act.

(e) "Financial institution" has the meaning set out in section 3(a)(46) of the Act. It includes both commercial banks and thrift institutions, both federal and state chartered. It does not include credit unions or subsidiaries or affiliates of banks and thrifts.

(f) "Government securities broker" has the meaning set out in section 3(a)(43) of the Act. As used in the proposed regulations, the term (together with the term "government securities dealer") represents the broadest classification of persons subject to the regulations. With the exceptions noted in section 3(a)(43) of the Act, the term includes registered broker-dealers and financial institutions that effect transactions in government securities for the account of others as well as registered government securities brokers.

(g) "Government securities dealer" has the meaning set out in section 3(a)(44) of the Act. As used in the proposed regulations, the term (together with the term "government securities broker") represents the broadest classification of persons subject to the regulations. With the exceptions noted in section 3(a)(44) of the Act, the term includes registered broker-dealers and financial institutions that are engaged in the business of buying and selling government securities for their own account, through a broker or otherwise, as well as registered government securities dealers.

(h) "Government securities" has the meaning set out in section 3(a)(42) of the Act. It includes securities issued or guaranteed by the Treasury or by federal agencies (including the Government National Mortgage Association), and also securities (including equity securities) issued or guaranteed by certain government-related corporations such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Student Loan Marketing Association and the Farm Credit System. (Readers are cautioned this list is not exclusive and that new organizations may be formed whose securities would also be covered by this definition.) The term also includes certain off-exchange options, puts, calls, straddles and similar privileges on other types of government securities. In general, securities that were "exempted securities" under section 3(a)(12) of the Act (prior to enactment of the GSA) because of their connection with the United States, are "government securities."

(i) "Registered broker or dealer" means a firm that is registered with the SEC under sections 15 or 15B of the Act and that is also a government securities broker or dealer.

(j) "Registered government securities broker or dealer" means a firm that effects transactions solely in government securities, other exempted securities (not including municipal securities) and/or futures and other commodity interests regulated by the CFTC, and is registered pursuant to section 15C(a)(1)(A) of the Act. This term does not include registered brokers or dealers or financial institutions.

(k) "Secretary" means the Secretary of the Treasury.

(l) "Treasury" or "Department" means the Department of the Treasury.

4. *Section 400.4.* This section requires every officer, director or manager of a government securities broker or dealer that is a financial institution not exempt

¹³ An FCM that is also a broker-dealer is currently required to meet the higher of the CFTC or SEC capital adequacy rule. 17 CFR 1.17. If such an entity were also a government securities broker or dealer, this proposal would not require consideration by the entity of the § 402.2 rule.

from these regulations under Part 401 of the proposed regulations, who is directly engaged¹⁴ in the management, supervision or performance of any activities of the financial institution as a government securities broker or dealer, as well as salespersons and traders (together "associated persons"), to file with the financial institution and keep current a disclosure form. The form will enable the financial institution and the appropriate regulatory agencies to determine whether such person is subject to a statutory disqualification as provided in section 15C(c) of the Act. Persons who already have on file with their financial institution a current Form U-4 (which is required for persons associated with a registered broker or dealer) or a Form MSD-4 (which is required for associated persons of a bank municipal securities dealer) need not file a new form.

The rule requires the financial institution to verify the information on the form and to file the form with the appropriate regulatory agency. Initially this procedure will be part of the notification required by section 15C(a)(1)(B)(i) of the Act. The requirements of this section do not apply to persons associated with financial institutions that are exempt from registration as provided in Part 401 of the proposed regulations. This section also requires the financial institution to file with its appropriate regulatory agency a notification of the termination of association with the government securities business of the financial institution of an associated person.

The requirements in section 400.4 mirror existing requirements concerning bank municipal securities dealers and are designed to increase the integrity of the entire industry by reducing the ability of persons subject to statutory disqualification to become affiliated with other government securities brokers or dealers, including financial institutions. The Department anticipates that the self-regulatory organizations will impose similar requirements on persons associated with registered government securities brokers and dealers and on registered government securities brokers and dealers.¹⁵ By

¹⁴ Directors and senior officers of the financial institution who may from time to time set broad policy guidelines affecting the financial institution as a whole that are not, directly related to the conduct of the financial institution's government securities business are not considered to be "directly engaged" in the government securities business of the financial institution.

¹⁵ With respect to registered government securities brokers and dealers who are currently registered with the CFTC, the Department is hopeful that it will be possible for the self-regulatory organizations under the Act and the self-regulatory

virtue of the exemption for those who already have filed the U-4, U-5, MSD-4 or MSD-5 forms, and the simplicity of the forms (no information is required relating to professional qualifications), the Department anticipates that the burden imposed by this section will be minimal.

5. *Section 400.5.* This section requires registered government securities brokers and dealers and registered brokers or dealers who are also government securities brokers or dealers to update and keep current with the SEC information on their registration application and notice forms, respectively. Section 400.5 also requires similar updating of notices filed by financial institutions that are government securities brokers and dealers.

6. *Section 400.6.* This section requires government securities brokers and dealers that are financial institutions (and that are not exempt from notice requirements pursuant to Part 401 of the proposed regulations) to file with their appropriate regulatory agency a notice of termination of such status. The notice is required by section 15C(a)(1)(B)(i) of the Act and is similar to the withdrawal requirements imposed on registered brokers and dealers and on bank municipal securities dealers. The withdrawal would become effective 60 days after filing, unless disciplinary action concerning the entity filing the notice had started prior to the date on which the notice was filed. Enforcement actions may, of course, be instituted after that time arising out of occurrences prior to the expiration of the 60 day period.

B. Part 401. Exemptions

Under section 15C(a)(4) of the Act, the Secretary may exempt any government securities broker, government securities dealer or class of such brokers and dealers from any provision of section 15C (a), (b) and (d) of the Act or the regulations issued under those subsections. Any exemption must be consistent with public interest, the protection of investors and the purposes of the GSA. Commenters are asked to consider whether exemptions other than those proposed are necessary or desirable and to provide information responding to the statutory standards for exemption. In particular, comments are particularly requested on whether an exemption for entities whose government securities business is limited to brokering repurchase

organizations for the futures industry to work together to minimize the paperwork burden attendant on registration.

transactions (a group the Department believes is coincident with brokers of federal funds) should be exempt from regulation as government securities brokers so long as they operate on a fully disclosed basis to both principals in all such transactions.

1. *Section 401.1.* There are thousands of organizations that handle transactions in United States Savings Bonds ("savings bonds"), whether in their capacities as qualified issuing or paying agents or in providing services to customers or employees by forwarding requested transactions to qualified issuing or paying agents or the Treasury. For many of these organizations, savings bond transactions are the only type of government securities transactions they handle. However, it is possible that under a broad interpretation of the definition of government securities broker in section 3(a)(43) of the Act, some or all of these organizations might be considered government securities brokers. The Treasury is therefore proposing, pursuant to its exemptive authority, that if an organization's activities are limited to savings bond transactions and any other activity exempt as provided in Part 401, and it would otherwise be considered a government securities broker, such organization shall be exempt from the requirements of sections 15C (a), (b) and (d) of the Act and the regulations thereunder.

Savings bonds offer terms and conditions that protect investors from risk. Savings bonds are not transferable and therefore are not eligible for trading or for pledging as collateral. Additionally, most savings bond transactions are handled by organizations that have qualified to act as savings bond issuing and paying agents pursuant to 31 CFR Part 317 and 31 CFR Part 321. These agents are governed by those regulations and by the terms and conditions of the application-agreements executed by them at the time of qualification. The remaining organizations that handle savings bond transactions are not qualified savings bond agents but may, as a service to customers or to employees participating in a payroll savings plan, forward applications or other savings bond transactions to an authorized issuing or paying agent or the Treasury. In the case of organizations that only forward savings bond transactions, the Treasury has determined that sufficient customer protection exists because of the limited involvement of these organizations and the terms and conditions of the bonds themselves.

It should be noted that the recordkeeping requirements of Part 404 do not apply to the savings bond transactions of any government securities broker or dealer. The Treasury does not consider that any other parts of these regulations are applicable to savings bond transactions.

2. *Section 401.2.* This section provides an exemption for depository institutions that submit tenders or subscriptions for purchase on original issue of U.S. Treasury securities for the account of customers. A depository institution engaging only in such transactions and other activities exempted by Part 401 of the proposed regulations, would be exempt from the provisions of section 15C (a), (b), and (d) of the Act, and the regulations thereunder.

Under the terms of Treasury securities auctions, commercial banks and certain other depository institutions may submit a tender for the account of a customer, provided the customer is identified as the purchaser on the tender form. Generally, payment for the securities also will be handled through the institution submitting the tender. Furthermore, the securities purchased may continue to be held by the customer through that same institution. The Department has concluded that where a depository institution submits tenders for customers, facilitates payment, and perhaps maintains the purchased securities in a purely custodial capacity, the customer will be adequately protected so long as the depository institution complies with the regulations for custodial depository institutions set forth in Part 450 of the proposed regulations.

Therefore, the Department proposes to exempt depository institutions whose only involvement in government securities transactions is the submission of tenders for customers and any other activity exempt from the regulations as provided in Part 401. The exemption is conditioned on the depository institution's agreement to comply with Part 450 of the proposed regulations concerning possession or control of government securities held for customers, thereby obviating a technical legal argument that a financial institution that is a government securities broker or dealer but is exempt under this part is not required to comply with the regulations under Title II of the GSA. The exemption of this section is intended to apply only as long as the depository institution submits tenders and facilitates payment solely as agent for the identified customer. It would not apply to a depository institution that

purchases securities itself on original issue and resells them to customers.

3. *Sections 401.3 and 401.4.* These sections exempt from Sections 15C (a) (b) and (d) of the Act and the regulations thereunder, financial institutions that engage in certain limited types of transactions in government securities which, under traditional interpretations of the definitions of "broker" or "dealer," might qualify them as government securities brokers or dealers. For the reasons set forth below, the Department has determined that, for these types of transactions, regulation of a financial institution as a government securities broker or dealer is not necessary for the protection of investors or to achieve the other purposes of the GSA as long as the institution complies with Part 450 of these regulations relating to custody of government securities held for customers.

Throughout the consideration of the GSA Congress cited estimates of the total number of secondary government securities dealers in the range of 200 to 500 firms, including registered brokers and dealers.¹⁶ The Department has been informed by the federal financial institution regulatory agencies that a very large percentage of the financial institutions in the country engage in the types of transactions involving government securities that are described below, primarily on a customer accommodation basis. Without an exemption for these activities, the total number of government securities brokers and dealers subject to registration or notice requirements would reach well into the thousands. The Department believes this would not be consistent with the intent of Congress.

(a) Section 401.3, relating to brokerage activities

Although the government securities market is primarily a dealer market, many financial institutions effect brokerage transactions as an accommodation for customers. Sections 401.1 and 401.2 of these regulations would exempt financial institutions whose brokerage activities are confined to transactions in United States savings bonds or submission of tenders for the account of customers in auctions for U.S. Treasury securities. The Department believes that financial institutions, including federal credit unions,¹⁷ effecting a modest number of

¹⁶ See, e.g., S. Rep. No. 99-426, 99th Cong., 2d Sess. 4 & n.5 (1986); H.R. Rep. No. 99-258, 99th Cong., 1st Sess. 13-14 & n.12 (1985).

¹⁷ Federal credit unions have extremely limited brokerage powers, which are further restricted by

other brokerage transactions or effecting such transactions on a fully disclosed basis are, through existing supervision and the requirements of Part 450 of these regulations, adequately regulated to protect investors and do not need to be regulated as government securities brokers. Financial institutions engaged in more than 500 brokerage transactions in government securities per year (other than those involving savings bonds or purchases of U.S. Treasury securities on original issue for the account of customers, but including networking transactions), unless all such transactions not exempt under §§ 401.1 or 401.2 are carried on through a "networking" arrangement involving a government securities broker or dealer not exempt under this Part, are not exempt from regulation as a government securities broker.

(b) Section 401.4, relating to dealer activities limited to repurchase transactions and a limited number of reverse repurchase transactions.

A significant number of financial institutions engage in repurchase transactions in which securities held by the Institution are sold, subject to repurchase, to entities other than registered brokers or dealers or government securities brokers or dealers. Financial institutions engage in such transactions to increase yields on their investment portfolios and in so doing to provide customers with a secured, more flexible alternative to certificates of deposit. The transactions are subject to the uniform supervisory policy on repurchase agreements adopted by all the federal financial supervisory agencies.¹⁸ Although that policy is written mainly to protect financial institutions engaging in repurchase transactions as buyers rather than sellers of securities, the policy states, among other things, that banks should obtain written agreements, conforming confirmations identifying specific securities and appropriate margin, and should mark to market term agreements. In addition, of course, the financial institutions engaging in these transactions are subject to governmental

their supervisory agency, the National Credit Union Administration ("NCUA"), to acting only on a network basis. See NCUA Interpretive Ruling and Policy Statement 85-1 (Nov. 14, 1985). The Department invites comments on whether similar supervisory safeguards are in place for state-chartered credit unions.

¹⁸ See Office of the Comptroller of the Currency, BC 210, Oct. 31, 1985; Federal Deposit Insurance Corporation, BL-43-85, Nov. 1, 1985; 50 FR 49764 (Dec. 4, 1985, Board of Governors of the Federal Reserve System); 50 FR 44940 (Dec. 6, 1985, Federal Home Loan Bank Board proposed rule).

supervision. Many financial institutions also do a small number of reverse repurchase transactions as an accommodation to customers.

Under traditional interpretations of the term "dealer," such transactions, if regarded as sales and purchases, could make the financial institution a dealer. For the reasons stated above, the Department believes such treatment is inappropriate and unnecessary in the public interest, and therefore is proposing the exemption in this section for financial institutions whose only government securities dealer activities are repurchase transactions and a limited number of reverse repurchase transactions. However, since the financial institution could be regarded as a government securities dealer, although an exempt one, the exemption is available only on the condition that the financial institution agree to comply with the custody requirements proposed as Part 450 of these regulations, which are applicable to financial institutions that are not government securities brokers or dealers. This section also exempts, as fully supervised, financial institutions whose only government securities dealer activities are in a fiduciary capacity, an exemption provided to banks in Section 3(a)(44) of the Act.

A financial institution engaging in more traditional dealer activities, such as purchasing or selling other government securities, as principal, from or to customers, participating in a selling group or underwriting government securities, carrying a dealer inventory and quoting a market in government securities, advertising itself as a government securities dealer, or otherwise holding itself out as a government securities dealer, would not be covered by this exemption.

4. *Section 401.5.* This section exempts corporate credit unions that are generally subject to examination by the National Credit Union Administration ("NCUA") from sections 15C (a), (b), and (d) of the Act and the regulations thereunder if their only government securities dealer activities are the purchase or sale, subject to resale or repurchase, of government securities to other such credit unions and other activities exempted by Part 401.

Corporate credit unions, whose members are credit unions composed of natural persons, provide a valuable service to such members and other natural person credit unions by providing secured liquidity through repurchase agreements involving government securities. The corporate credit union's sales and purchases of securities subject to repurchase and

resale might constitute government securities dealer activities under traditional interpretations of the term "dealer."¹⁹ However, both sides to the transaction are subject to federal supervision,²⁰ and the Department has concluded that the additional burden that would be placed on corporate credit unions whose transactions are so limited is unnecessary for the protection of the natural person credit union investors.

The exemption is available only on the condition that the credit union agrees to comply with the terms of Part 450 of the regulations, relating to custody of government securities by depository institutions, including credit unions.

C. Part 402. Financial Responsibility

The capital adequacy rule of these proposed regulations effectively would apply only to currently unregulated government securities brokers and dealers. The general rule, based on the capital adequacy guideline recommended by the FRBNY,²¹ is that a government securities broker's or dealer's liquid capital shall equal or exceed 120 percent of total haircuts, the measure of risk of a government securities broker's or dealer's securities holdings and related financings.

1. *Section 402.1.* The section of the proposed rule would in effect exempt government securities brokers and dealers that are directly subject to the capital requirements of another appropriate regulatory agency from the requirements of this rule. Consequently, government securities brokers and dealers which are financial institutions or registered brokers or dealers are not subject to the capital requirements of this rule if they are subject to the capital requirements contained in the other appropriate federal regulatory framework. This exemption avoids the imposition on adequately regulated entities of potentially conflicting and unduly burdensome regulations in the financial responsibility area. It is noted, however, that the exemption is not available to subsidiaries or affiliates of financial institutions or of registered

¹⁹ The natural person credit union counterparty in this situation is an investor and is not a government securities dealer.

²⁰ Although some corporate credit unions are neither federally chartered nor federally insured, all existing corporate credit unions are members of the National Credit Union Administration Central Liquidity Facility and are subject to the NCUA's authority to prescribe certain rules and regulations, 12 U.S.C. 1795f(b)(3). In practice, the NCUA examines all corporate credit unions yearly.

²¹ The Federal Reserve Bank of New York, Capital Adequacy Guideline for U.S. Government Securities Dealers (May 20, 1985).

brokers or dealers, which are not necessarily subject to independent, overlapping capital requirements and where recourse to the parent would not necessarily be available.

Although the Department believes that SEC Rule 15c3-1²² does not provide as accurate an assessment of risk for firms that transact business in government securities (alone or in combination with exempted securities and/or CFTC-related commodity interests) as the FRBNY guideline methodology, experience has shown it to be appropriate for entities with a general securities business. In making this assessment, the Department assumes that the SEC will adopt many of its recently proposed modifications to Rule 15c3-1 concerning repurchase and reverse repurchase agreement deficits.²³

Banks and bank holding companies that are subject to the supervision of the Federal Reserve Board, Comptroller of the Currency, and Federal Deposit Insurance Corporation are, in general, required to maintain a ratio of primary capital to total assets of 5.5 percent and a minimum ratio of total capital to total assets of 6.0 percent.²⁴ Thrift institutions insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation are also subject to minimum net-worth requirements.²⁵

It is the understanding of the Department that the bank capital requirements, which are designed for other purposes, when applied to a normal mix of government securities dealer activities, would be significantly higher than those proposed to be required of registered government securities brokers and dealers. Recently, the three bank regulatory agencies and the Bank of England published for comment a risk-based capital framework.²⁶ No specific risk-based capital ratio has been proposed at the present time, however, and there may also be some modifications to the risk-based capital structure. Accordingly, it is too early to make a judgment as to the effect of the new proposed risk-based capital requirements on a government securities dealer operation. The Department will monitor this situation

²² Section 240.15c3-1.

²³ Exchange Act Release No. 34-23602, 51 FR 32658 (Sept. 15, 1986).

²⁴ See 12 CFR Part 225 Appendix A (Board of Governors of Federal Reserve System); 12 CFR 3.6 (Comptroller of the Currency); 12 CFR 325.3 (Federal Deposit Insurance Corporation).

²⁵ See 12 CFR 563.13.

²⁶ See news release of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Federal Reserve Board dated January 8, 1986.

and will continue to evaluate the financial institution exemption in the light of any changed financial institution capital requirements.

Although it is unclear whether the thrift institution capital requirements would also exceed those required under this part for a thrift institution (and not a subsidiary or affiliate) that was a government securities broker or dealer, the Department believes that few, if any, thrift institutions will not be exempt under Part 401. Since all financial institutions are closely supervised and their capital levels receive the close attention of their supervisory agencies, an exemption from the capital requirements being proposed in these regulations is believed warranted. The Department specifically requests comments with respect to the thrift institution exemption, and particularly requests factual information concerning thrift institutions that believe that, under the proposed regulations, they are government securities brokers or dealers not exempt under Part 401.

Government securities brokers that come within the definition of government securities interdealer brokers are allowed to elect to follow the requirements of a provision similar to the municipal securities broker's broker rule of SEC Rule 15c3-1²⁷ rather than the capital rule of § 402.2 of the proposed regulations. The Department is considering whether this or another special rule should apply to interdealer brokers who also serve customers other than dealers, and welcomes comments and suggestions on this point.

The capital rule will be effective July 25, 1987, except that, for a three month period, newly registered government securities brokers and dealers will be required only to have and maintain liquid capital (before deduction of any haircuts) of \$50,000, except that the minimum for introducing brokers will be \$5,000. This delay is necessary to give new registrants an opportunity to put in place the systems needed for the haircut calculations required by the rule while at the same time requiring such firms to have some cushion of capital to protect investors.

2. Section 402.2. While many of the basic concepts underlying the proposed rule are the same as those contained in the SEC's Rule 15c3-1, the proposed rule is tailored for participants in the government securities market. The basic standard set out in the proposed rule is that liquid capital, defined to be equal to the SEC concept of tentative net capital with one modification for futures

contracts, must exceed measured risk (total haircuts) by at least 20 percent.

In comparison to Rule 15c3-1, the proposed rule eliminates the need to determine aggregate indebtedness. However, the Department recognizes that some government securities dealers and brokers may find the haircut calculations of the proposed rule complex. Consideration was given to allowing registered government securities brokers and dealers the option of meeting the requirements of Rule 15c3-1 rather than the requirements contained in the proposed rule.²⁸ For the reasons stated below, the Department believes that option is inappropriate for entities transacting business solely in government and other exempted securities.

For firms without a broad range of diversified activities but rather concentrated in the government securities market, the haircut calculation of the proposed rule is a more accurate measure of risk than the haircut calculations of the SEC rule.

The ratio requirement of the proposed rule, liquid capital to risk, is a simpler concept and more appropriate to these firms.

The haircut factors of the proposed rule are based on recent market conditions and will be revised as market conditions change. This not only holds for the factors applying to net positions, but also for the factors that permit a reduction in measured risk for offsetting positions in the same maturity sector or across different sectors. Consequently, the haircut factors are proposed to be a more current risk measurement than the SEC factors, which are not designed to be updated with any frequency.

The proposed haircut methodology also provides a more accurate system for recognizing the reduced risk of hedged positions than the SEC methodology, which in some cases is more generous and in other cases less generous than the proposed rule. Also, the inclusion of financings, mainly repurchase and reverse repurchase agreements, into the total haircut calculation in the proposed rule is a recognition of the importance of a major financing technique in the market and a recognition that term repurchase and reverse repurchase agreements can serve to offset the risk in the position being financed.

Linking capital requirements to aggregate indebtedness or aggregate debit items as computed in accordance with the Formula for Determination of

²⁸ Firms that wish to follow Rule 15c3-1 in effect have that option by registering with the SEC as a broker-dealer under Section 15.

Reserve Requirements for Brokers and Dealers (Exhibit A to Rule 15c3-3)²⁹ may not be appropriate in all cases for specialized firms. The activities of government securities brokers and dealers may generate very little aggregate indebtedness or aggregate debit items. Consequently, the Department believes that the direct link between liquid capital and measured risk of the proposed rule serves better to focus a government securities broker's or dealer's attention on the amount of liquid capital needed in order to undertake prudentially a given level of risk.

Comparison to the FRBNY Guideline. The proposed rule differs in two principal ways, which are related, from the FRBNY's capital adequacy guideline. The definition of liquid capital has been modified, and one category of haircut has been eliminated.

The FRBNY defined liquid capital to be net capital before haircuts on securities positions (line 3640 of SEC Form X-17A-5 or FOCUS Report) with two adjustments—omission of proprietary charges on commodities (line 3600) and the deduction for reverse repurchase agreement deficits (included in line 3612, "Other Charges and/or Deductions"). These adjustments were required because the FRBNY included haircuts on futures and forward positions and haircuts for credit exposure to counterparties. The proposed rule retains the omission of proprietary charges on commodities, since, as in the FRBNY methodology, haircuts on futures and forward positions are included in the calculation of total haircuts.

The proposed rule, however, does not omit the deduction for reverse repurchase agreement deficits because, unlike the FRBNY guideline, it does not include a "customer exposure haircut." Rather, the Department decided to retain the SEC capital charge for unsecured receivables.³⁰ In some cases, the FRBNY included both the SEC capital charge and a haircut for unsecured receivables. In order to keep the concept of liquid capital close to the SEC concept of tentative net capital, the

²⁹ Section 240.15c3-3a. Under SEC rules, aggregate indebtedness may not be greater than 15 times the amount of "net capital," the determination of which includes all securities haircuts and other deductions. For broker-dealers electing the alternative net capital requirement of Rule 15c3-1, net capital must be the greater of \$100,000 or 2 percent of aggregate debit items in the Reserve Formula. Electing the alternative has the effect of increasing the amount of funds a broker-dealer is required to maintain in a "Special Reserve Account for the Exclusive Benefit of Customers."

³⁰ Section 240.15c3-1(c)(iv)(B).

²⁷ Section 240.15c3-1(a)(8).

choice was made to retain all SEC capital charges and deductions used to determine tentative net capital, except for the charge related to "commodities." To avoid inclusion in the proposed rule of both haircuts and capital charges on unsecured receivables, the customer exposure haircut of the guideline was eliminated. Commenters are invited to address the decision to retain the SEC deductions for unsecured receivables and reverse repurchase agreement deficits and consequently not to include the customer exposure haircut of the FRBNY guideline. The proposed rule also clarifies that the deduction for aged fail to deliver contracts is based on the haircut factors of this proposed rule.

SEC Repurchase Agreement Proposal. The recent SEC proposals with respect to repurchase agreements and reverse repurchase agreements³¹ have implications for this proposed capital adequacy rule that commenters are invited to address. Specifically, are the proposed increase in the capital charge for reverse repurchase agreement deficits and the new capital charge for repurchase agreement deficits appropriate and should they be applied to government securities brokers and dealers subject to the proposed rule? Also, is it appropriate to include in this capital rule (in a fashion similar to the SEC proposal) an increase in required capital when a government securities dealer receives margin in connection with a reverse repurchase agreement in excess of 105 percent of the contract value of the agreement, or should provisions relating to such "excess" margin be included in § 403.4 of the proposed rule, relating to possession or control of customer securities?

Calculation of Risk Level. The proposed rule quantifies the risk to the portfolios of government securities brokers and dealers according to a series of haircut factors. The two major types of risk that are measured are credit risk and market risk. The sum of the credit risk haircut and the market risk haircut equals total haircuts or measured risk. Total haircuts are then compared to liquid capital to determine capital adequacy. Appendix A to this preamble is a detailed example of the calculation of capital adequacy under the proposed rule.

(a) **Credit Risk.** The credit risk haircut³² is the sum of two haircuts used to quantify credit risk—a concentration of credit haircut and a credit volatility haircut. The concentration of credit haircut is equal

to the product of a concentration of credit haircut factor of 25 percent and the amount by which the net credit exposure to a single counterparty is in excess of 15 percent of the government security broker's or dealer's liquid capital. Net credit exposure is the dollar amount of funds or securities at risk to the government securities broker or dealer in the event the counterparty defaults less the dollar amount at risk to the counterparty in the event the government securities broker or dealer were to default. There is no concentration of credit haircut for exposure to the government securities broker or dealer's principal clearing bank(s) or principal clearing broker(s).

The credit volatility haircut is assessed on high quality money market instruments which are not U.S. government or agency issues and mature in more than 45 days and futures, forwards and options thereon. A credit haircut volatility factor, set at 0.15 percent (0.0015), is applied to the larger of the gross long position or gross short position in these instruments to calculate this credit volatility haircut.

(b) **Market Risk.**³³ Portfolios of government securities are subject to changes in value due to market fluctuations. This is termed market risk.

For instruments that meet the definition of "Treasury market risk instrument" in § 402.2(e), a Treasury market risk haircut is calculated. These dollar-denominated instruments are most government securities, zero-coupon receipts or certificates based on marketable Treasury notes or bonds, short-term certificates of deposit, bankers acceptances, and high quality short-term commercial paper. Futures, forwards and options on the above instruments and on time deposits whose changes in yield are closely correlated with that of certificates of deposit are included in the definition.³⁴ Options on futures on the debt instruments listed are also Treasury market risk instruments. Excluded from the definition are mortgage-backed government securities that do not pass through to each security holder on a pro rata basis a distribution based on the monthly payments and prepayments of principal and interest on the underlying pool of mortgage collateral less fees and expenses. Consequently, government securities that are collateralized mortgage obligations, real estate mortgage investment conduits, and stripped mortgage in obligations are not

included in the Treasury market risk haircut calculation.³⁵

For positions in instruments and inventory not described above, such as most Eurobonds and foreign currency, the SEC haircut factors and methodology are used. The calculation is called the "other securities haircut." The sum of the Treasury market risk haircut and the other securities haircut is the market risk haircut.

(i) **Treasury Market Risk Haircut.**³⁶
(A) **Introduction.** The Treasury market risk haircut methodology of the proposed rule quantifies risk by placing all positions into one of twelve categories and applying three different types of haircut factors—(1) net position haircut factors, (2) offset haircut factors, and (3) hedging disallowance haircut factors—to positions grouped in the categories. Net position haircut factors reflect the price volatility of debt instruments; offset haircut factors, the imperfection inherent in any hedge within a category and the range of price volatility in that category; and hedging disallowance haircut factors, the risk inherent in hedges across categories. In addition, the imperfection of hedging with futures and options is captured with a single futures and options offset factor of 20 percent.

Section 402.2(f)(1) of the proposed rule defines the twelve categories in which Treasury market risk instruments are placed in order to calculate the Treasury market risk haircut. The first ten categories are defined in terms of periods of time, either to maturity of the instrument or to the next scheduled interest rate adjustment in the case of those instruments whose rates change periodically. The last two of these ten categories are for zero-coupon instruments with terms to maturity of ten years or more. Shorter-term zero-coupon instruments are included in the first eight categories according to different time period criteria than for conventional coupon securities. The reason for this is the greater price volatility of zero-coupon instruments than conventional coupon instruments of the same maturity. The final two categories are for fixed-rate and adjustable-rate mortgage-backed securities that are Treasury market risk instruments. These categories are the same as those in the FRBNY guideline.

Section 402.2(f)(2) shows the schedule of net position and offset haircut factors for the twelve categories. Section

³¹ Exchange Act Release No. 34-23602, 51 FR 32658 (Sept. 15, 1986).

³² See § 402.2(g)(1) of the proposed rule.

³³ The market risk haircut calculation is found in Appendix A to the proposed rule, § 402.2a.

³⁴ In particular, Eurodollar futures are included in the definition of Treasury market risk instrument.

³⁵ These securities are included in the total haircuts calculation using SEC haircut factors, § 402.2a(b) of the proposed rule.

³⁶ See § 402.2a(a) of the proposed rule.

402.2(f)(3) shows the category pair hedging disallowance haircut factors and indicates those category pairs for which a reduction in total haircuts is allowed through recognition of the reduction in risk due to cross category hedging.³⁷

³⁷ The net position haircut factors are based on the market risk implicit in price volatility as it relates to changes in yields. The sensitivity of prices to yield changes varies with the maturity of a security and the level of yields. Thus the grouping of securities, except for mortgage-backed securities, is related to maturity.

Yield volatility was measured by the observed week-to-week changes in yields, using a benchmark security in each category. Treasury's constant maturity yield series and a comparable series for zero-coupon instruments based on Treasury securities were employed for the first ten categories. Based on data for 1986, a yield change was derived for each category that would encompass approximately 99 percent of expected weekly yield changes. For mortgage-backed securities, volatility was measured directly from data on prices and compared with the price volatility of Treasury securities.

To measure price volatility in the non-mortgage-backed securities categories, benchmark securities were derived that generally correspond to the Treasury original-issue maturities. In the shortest category, there is no Treasury original-issue maturity, thus a 1-month constant maturity series was used. In the 1.5 to 3.5 year category, where there are two original-issue maturities, the data employed were the average of the 2-year and the 3-year data. In the 3.5 to 7.5 year category, where there are three original-issue maturities, the 5-year data were used. The data for the 30-year maturity were used for the 15-30 year category. Zero-coupon maturities were mapped into coupon categories of similar duration. A price for each hypothetical benchmark security was determined using average coupon data and average yield data for coupon instruments and average yield data for zero-coupon instruments for 1986. The price was then recomputed using the average yield plus the yield change that has been described above for each category. For each category, the difference in these two prices as a percent of the original (benchmark) price, when rounded is the net position haircut factor. When multiplied by the dollar net position, the result is the dollar value of potential risk exposure.

The offset haircut factors for each category are based on the difference in the price elasticity with respect to yield of the benchmark security and a hypothetical security with a maturity set at the beginning point of the maturity range of the category. This difference in elasticity is divided by the elasticity of the benchmark security, to which a constant of five percent (0.05) is added to account for changes in the shape of the yield curve and for securities that trade off the curve. The net position haircut factor multiplied by the number calculated above is the offset haircut factor for the category.

Hedging across maturity classes can reduce total risk. As the distance between maturity classes increases, however, the risk associated with the variability of the yield curve increases. Thus in the calculation of risk, the haircut on a net long position in one maturity category does not offset one for one the haircut for a net short position in another category. The hedging disallowance haircut factor determines what percent of the offset that is not permitted. The factors, which are found at § 402.2(f)(3) of the proposed rule, were derived by examining the correlations (R^2) between yield changes in different maturity categories using 1986 data. Hedging is permitted only if yield changes in the two categories are sufficiently well correlated. To compute the factor, the amount by which the

Schedules A through E, similar to those in the guideline, are presented in Appendix A to the rule and can be used to calculate haircuts and the liquid capital to total haircut ratio.³⁸

The haircut factors have been updated to reflect recent market conditions, while retaining the same twelve haircut categories as in the FRBNY guideline for security positions. The Department tentatively plans to review these haircut factors at six month intervals and plans to change them with appropriate notice if warranted by changed market conditions. Also, the mapping of zero-coupon instruments into the maturity categories may change. Commenters are invited to address this aspect of the proposal.

Commenters are also asked to address whether the calculation of risk with respect to options and futures is adequate. The proposed rule follows the FRBNY guideline in this area, but the Department recognizes that a more sophisticated treatment is possible. However, a better measure of risk in this area would substantially complicate the calculation for government securities brokers and dealers. This increased complexity does not appear to be commensurate with the resulting increase in the accuracy of the risk measurement.

(B) *Calculation of the Treasury Market Risk Haircut.*³⁹ The three haircut factors are used to calculate four different haircuts: the governments offset portion haircut, the futures and options offset haircut, the hedging disallowance haircut, and the residual net position haircut. The sum of these four haircuts is the dollar measure of market risk captured by the Treasury market risk haircut. In the process of calculating the haircuts, some interim haircuts must be calculated. These interim haircuts, unlike the final four haircuts used to determine the Treasury market risk haircut, may be positive or

movements in yields in one category do not correspond to movements in another category was determined. Another 10 percent was added to reflect the imperfections inherent in any hedge. The results were rounded and grouped into three classes determined by the percent of the hedge being disallowed.

³⁸ Schedules A through E are included in Appendix A to the proposed capital rule, § 402.2a, not necessarily as a required form that would be used in computing haircuts, but rather as a convenient reference in the computation of haircuts. The SEC or designated examining authority may, at its discretion, require adherence by the government securities broker or dealer to these schedules or to substantially similar forms. The Department requests comments on the utility of these forms and in particular invites suggestions for improving Schedule E.

³⁹ See Appendix A to this preamble for a detailed example of this calculation.

negative numbers. The final four haircuts are always positive or zero.

(i) *Net Immediate Position Interim Haircuts and Governments Offset Portion Haircut.*⁴⁰ The net immediate position interim haircuts, which are used in the determination of the residual net position haircut, and the governments offset portion haircut are calculated for each category by applying net position and offset haircut factors to immediate positions in Treasury market risk instruments and financings.

The gross long (gross short) immediate position for each category is the sum of the market values of each long (short) immediate position in Treasury market risk instruments that are placed in the category and the value of financings that provide securities (cash) to the government securities broker or dealer. Long and short immediate positions in Treasury market risk instruments are the net long or short position in such an instrument as of the trade date (as long as the time between trade date and settlement date is not longer than five business days or 30 calendar days in the case of mortgage-backed securities). Also, certain net long and short when-issued positions are included as long and short immediate positions in Treasury market risk instruments. With respect to these when-issued positions in Treasury notes and bonds, commenters are requested to address whether the rule should specifically set out a valuation methodology for such positions between announcement and auction date, i.e., before a coupon rate has been set on the Treasury note or bond, and to suggest an appropriate methodology if one is considered necessary.

Most financings, excluding subordinated debt, are included in the gross long and gross short immediate positions. The dominant forms of financing in the government market are repurchase agreements, which provide funds to government securities brokers and dealers, and reverse repurchase agreements, which provide securities. Securities lending and borrowing are included if such borrowing or lending is in effect secured by cash collateral. Financings are included in each category at contract value and according to the term to maturity or time to the next scheduled interest rate adjustment. The underlying securities are not relevant to the placement of the financing in a category. Reverse repurchase agreements and other arrangements to borrow securities against cash collateral are considered

⁴⁰ See §§ 402.2a(1), (2) of the proposed rule.

long positions, while repurchase agreements and other arrangements to borrow funds are considered short positions.

Gross long and gross short immediate positions, including financings, that are placed in Category A (under 45 days) will not contribute to the calculation of total haircuts, since there is no haircut on these positions.

The appropriate net position haircut factor is applied to the net position (gross long position minus gross short position) in each of the twelve categories. This determines the net immediate position interim haircut for each category. (In order to perform the hedging calculation between categories described below, the sign convention is that net immediate position interim haircuts on net long positions are positive, and on net short positions, negative.)

The offset haircut factor is applied to the smaller of the gross long or gross short immediate position in each category to create the governments offset portion haircut. Since offset haircuts cannot be netted, they are all positive. The sum of the offset haircuts for each category is the total governments offset portion haircut.

(i) *Futures and Options Offset Haircut and Aggregate Interim Haircuts.*⁴¹ The calculation of offset haircuts on futures and forward contracts is different from that on immediate positions. The haircuts on these contracts are calculated separately from the haircuts on immediate positions and then these futures and forward haircuts along with haircuts on options (also calculated separately as described below) are consolidated with the net immediate position interim haircuts on immediate positions by category. Schedule D can be used for this consolidation.

To calculate the futures and options offset haircut, interim haircuts on gross long and gross short futures and forward positions are determined by using the net position haircut factors that correspond to the term to maturity of the deliverable security at the time of the maturity of the futures or forward contract, which is henceforth referred to as the maturity of the underlying security. (In the case of a cash settlement contract, the term to maturity of the security or investment on which the cash settlement price is based would be used.) For example, the applicable haircut factor for futures contracts on three-month Treasury bills would be the net position haircut for Category B (45-

135 days). However, for purposes of combining these haircuts with the net immediate position interim haircuts on immediate positions, the haircut is placed in the maturity category corresponding to the sum of the remaining time to maturity of the futures contract and the maturity of the underlying security. For example, the interim haircut on a three-month Treasury bill futures contract with four months remaining to delivery would be placed in Category C (4.5-9 months), though the haircut was determined by the net position haircut factor for Category B.

As a practical matter, this shifting of maturity categories will usually be relevant only to futures and forward contracts on short-term instruments. It will, of course, not be relevant to contracts on mortgage-backed securities.

The gross futures or forward interim haircut⁴² is the product of the applicable haircut factor and the value of the futures or forward position which corresponds to the current market price of such contract. For example, a futures price of 95 on the 20-year bond futures contract on \$100,000 par value would produce a value of \$95,000. The interim haircuts on long futures and forwards are positive, and on short futures and forwards, negative.

Gross options interim haircuts⁴³ are the lesser of (1) the market value of the option or (2) the net immediate position interim haircut on the underlying cash instrument or gross futures interim haircut on the underlying futures contract. Gross options interim haircuts on purchased calls and sold puts are positive, while the interim haircuts on sold calls and purchased puts are negative. The gross options interim haircut is entered in the category in which the underlying instrument would be entered.

Net immediate position interim haircuts are combined with gross option and futures and forward interim haircuts in the same category (the categories in which these haircuts are placed is described above) to form positive and negative aggregate interim haircuts. In each category, the sum of positive interim haircuts equals the positive aggregate interim haircut, and the sum of negative interim haircuts equals the negative aggregate interim haircut. An offset haircut factor of 20 percent is applied to the smaller of the absolute values of the positive and negative

aggregate interim haircuts in each category. The sum of these resulting offset haircuts for all the categories is the total futures and options offset haircut.

(iii) *Hedging Disallowance Haircuts.*⁴⁴ To calculate these haircuts, residual position interim haircuts must be determined for each category. If there are no futures and options positions, the residual position interim haircut for each category is equal to the net immediate position interim haircut described in the section on the government offset portion haircut. If there are futures or options positions, then the positive and negative aggregate interim haircuts for each category are summed to calculate the residual position interim haircut. This interim haircut may be a positive or negative number.

The risk reduction inherent in hedges between categories where the price volatility is reasonably well correlated is reflected by netting the residual net position interim haircuts in these category pairs. Each time two residual position interim haircuts are netted, a hedging disallowance is determined. The sum of these hedging disallowances is the total hedging disallowance haircut.

Section 402.2(f)(2) of the rule shows the category pairs where such netting is allowed and the applicable hedging disallowance haircut factor for these category pairs. Schedule E can be used to calculate the hedging disallowance haircut.

Hedging disallowance haircuts are first calculated for residual position interim haircuts in those category pairs where the hedging disallowance haircut factor is smallest. For each such pair, the hedging disallowance haircut factor is applied to the smaller of the absolute values of the two residual position interim haircuts. The resulting hedging disallowance haircuts are positive. The sum of the two residual position interim haircuts is called a net residual position interim haircut and may be positive or negative.

Net residual position interim haircuts may be paired with other residual position interim haircuts or net residual position interim haircuts. For this purpose, net residual position interim haircuts as described above are considered to be in the category of the larger in absolute value of the two interim haircuts that were netted to produce it and a net residual position interim haircut of zero is placed in the other category. Of course, as before, such netting is only permitted for certain

⁴² See §§ 402.2a(a)(3)(i)(A), 402.2a(a)(3)(ii)(A) of the proposed rule.

⁴³ See §§ 402.2a(a)(3)(i)(B), 402.2a(a)(3)(ii)(B) of the proposed rule.

⁴¹ See § 402.2a(a)(3) of the proposed rule.

⁴⁴ See § 402.2a(a)(4) of the proposed rule.

category pairs. Note that each time two interim haircuts are netted, the total hedging disallowance haircut increases, while the total residual net position haircut, described below, decreases.

After all possible netting has been recognized for category pairs with the smallest hedging disallowance haircut factors, the same procedure is applied for haircuts in category pairs with higher hedging disallowance haircut factors. Once all possible (net) residual position interim haircuts have been netted, then all the hedging disallowance haircuts from each netting described above are summed to produce the total hedging disallowance haircut.

(iv) *Residual Net Position Haircut.*⁴⁵ The absolute values of the (net) residual position interim haircuts remaining for each category after the netting described above are summed to produce the total residual net position haircut.

(ii) *Other Securities Haircut.*⁴⁶ For inventory and securities that are not Treasury market risk instruments for the purpose of the Treasury market risk haircut calculation, SEC haircut factors are used. If a position in a Treasury market risk instrument is part of a hedge with an instrument that is not a Treasury market risk instrument, it is permissible to exclude this position from the Treasury market risk haircut calculation and include it in the other securities haircut calculation if such inclusion serves to reduce the other securities haircut. The value of the position taken out of the Treasury market risk haircut calculation and placed in the other securities calculation may not be larger than the position that is being offset in the SEC framework.

*Debt-Equity Requirements and Prohibition on Withdrawal of Capital.*⁴⁷ The proposed rule provides for minimum debt-equity requirements and prohibitions against withdrawal of capital for government securities brokers and dealers. These proposed requirements largely reflect the requirements of paragraphs (d) and (e) of SEC Rule 15c3-1.⁴⁸

D. Part 403. Protection of Customer Securities and Balances

The Act requires the Secretary to promulgate rules to provide safeguards with respect to "the acceptance of custody and use of customers, securities, the carrying and use of customers, deposits or credit balances, and the transfer and control of government securities subject to repurchase

agreements and in similar transactions."⁴⁹

The SEC has promulgated a number of rules designed to protect customer funds and securities held by registered brokers and dealers. The primary customer protection rules are Rules 15c3-2 and 15c3-3.⁵⁰ Rule 15c3-3 requires that brokers and dealers immediately obtain possession or control of all fully paid customer securities as well as margin securities in excess of a certain specified amount. An important function of the possession or control requirement is to assure that such customer securities are maintained free of all liens and encumbrances. The rule also requires that customers' free credit balances and certain other amounts owing to customers are set aside by a broker or dealer in a special reserve account. In addition, Rule 15c3-2 provides that a broker or dealer may not use customer free credit balances unless the customer receives regular statements indicating the amount owed to the customer and notifying the customer that the funds are not segregated from funds of the broker or dealer and may be used in its business.

These rules have two primary purposes: to protect customer assets in the event a firm requires liquidation and to prevent unwarranted expansion of a firm's business through the use of customer funds and securities. The rules have been viewed by the SEC as an effective means of customer protection. In addition, many registered brokers and dealers that effect transactions in government securities have indicated that from their perspective the rules are generally both workable and effective.

The Department has examined these rules in detail and has concluded that the SEC rules, with mostly minor modifications, will be equally effective to provide protection of customer assets in the government securities market. As a result, the Department proposes, as a general matter, to require compliance with Rule 15c3-3 and certain related rules. Certain proposed modifications to these rules are described in the section-by-section analysis of Part 403. With the exception of certain proposed requirements for control of securities subject to hold-in-custody repurchase agreements, the modifications provide language necessary to apply the SEC rules in the context of the government securities market.

The Department notes that Rule 15c3-3 establishes certain time frames in which a broker or dealer must reduce

securities to possession or control, such as the requirement in paragraph (d)(2) to take action on securities shown as "failed to receive" more than 30 calendar days.⁵¹ Although responses to inquiries by the Department did not suggest any significant abuse, some of these time frames for buying in securities to cover shortfalls may be longer than necessary, particularly in the case of transactions in book-entry securities. Comments are requested on whether the time frames should be shortened with respect to some or all classes of securities. Commenters are also requested to suggest any other modifications to Rule 15c3-3 not included in the proposed rule that would be appropriate in the context of the government securities market.

The Department has also considered whether it would be appropriate for the rule governing buy-ins to cover securities shortfalls to provide that a broker or dealer may buy in a substitute security, such as Treasury bills of the appropriate market value. The Department has not adopted this approach because it appears that it could undermine the basic rationale of the rule and because it raises at least two problems. The most important one is that the bills or other substitute securities would need to be viewed as belonging to a specific customer whose securities position had not been covered in order to accomplish customer protection in the event of liquidation of the broker or dealer. The Department is not certain this could be accomplished in these regulations. Second, it would appear that a substitution should not be permitted unless it is explicitly permitted under the terms of the agreement between the dealer or broker and its customer. If a right of substitution is agreed to, then it would not appear necessary to include additional language in the rule.

The Department also invites comments on whether "reverse repurchase surplus"—the amount by which the market value of securities purchased by a broker or dealer in a repurchase transaction exceeds the funds transferred—should be considered a credit item in the reserve calculation under Exhibit A of Rule 15c3-3.⁵² In its recent proposal concerning repurchase transactions,⁵³ the SEC noted that

⁴⁵ See § 402.2a(a)(5) of the proposed rule.

⁴⁶ See § 402.2a(b) of the proposed rule.

⁴⁷ See §§ 402.2 (h), (i) of the proposed rule.

⁴⁸ Section 240.15c3-1 (d), (e).

⁴⁹ Section 15C(b)(1)(s) [15 U.S.C. 78o-5(b)(1)(A)].

⁵⁰ Sections 240.15c3-2, .15c3-3.

⁵¹ Section 240.15c3-3(d)(2).

⁵² Section 240.15c3-3a.

⁵³ Exchange Act Release No. 34-23602, 51 FR 32658 (Sept. 15, 1986).

"some broker-dealers create leverage by obtaining the use of funds through matched repurchase agreements," and proposed an increase in required capital to take this into account. The Department notes that reverse repurchase surplus does not create additional risk to the broker or dealer, but that it creates a liability to a counterparty which might more appropriately be accounted for in the Rule 15c3-3 reserve. Comments are requested on which treatment, if any, is appropriate.

Finally, the Department notes that Part 403 deals with aspects of transactions in the government securities market that may also be affected by other proposed rules that have been published for comment by various agencies. The SEC's recently proposed amendments to rule 15c3-3 impose certain requirements with respect to securities that are the subject of repurchase transactions.⁵⁴ On November 28, 1986, the Treasury published for public comment a revised proposed rule governing the transfer of interest in Treasury book-entry securities.⁵⁵ Finally, on December 16, 1986, the Board of Governors of the Federal Reserve System published for comment a proposal to reduce payment system risk that arises in connection with, among other things, transactions in book-entry securities.⁵⁶ Commenters are asked to give particular consideration to the interaction of all these proposals with the proposed rules set forth below in both Part 403 and Part 450, which contain the rules applicable to custody of government securities held for customers by financial institutions.

1. *Section 403.1.* This section provides that registered brokers and dealers effecting transactions in government securities must comply with Rules 8c-1, 15c2-1, and 15c3-2 and with Rule 15c3-3⁵⁷ as modified by § 403.4 below. The modifications (discussed in detail in connection with § 403.4) relate primarily to repurchase and reverse repurchase transactions, and are based on the SEC's recent proposal in this area, noted above. If amendments to the SEC rules substantially similar to those in the § 403.4 modifications are adopted prior to the adoption of the final Treasury rules, the Department intends to revise § 403.1 to provide that compliance with the SEC rule constitutes compliance with this part.

2. *Sections 403.2 and 403.3.* These sections provide that every registered

government securities broker or dealer must comply with the SEC rules governing hypothecation of customer securities and the use of free credit balances.

3. *Section 403.4.* This section sets forth the basic rule that, except as otherwise provided in Section 403.1, every government securities broker or dealer must comply with Rule 15c3-3, as modified by paragraphs (a) through (i) of this section; paragraphs (j) and (k) are technical modifications applicable only to registered government securities brokers and dealers.

(a) This paragraph states that the term "broker or dealer" in Rule 15c3-3 includes government securities brokers and dealers.

(b)-(d) Rule 15c3-3 defines "fully paid securities," "margin securities," and "excess margin securities" in terms of the requirements of the accounts in which they must be carried, as set out in Regulation T of the Board of Governors of the Federal Reserve System.⁵⁸ More general definitions are included here because the provisions of Regulation T are not always applicable to government securities. The definitions set forth here are intended to describe the commonly understood meanings of the terms "fully paid securities," "margin securities," and "excess margin securities," without reference to the specific accounts in which the securities may be carried. Comments are requested on whether, in the government securities market, 140 percent of a customer's total debit balances is the appropriate cut-off between margin and excess margin securities. Under the SEC rules, a registered broker or dealer is permitted to treat securities with a market value of up to 140 percent of a customer's debit balances as margin securities because ordinarily a bank financing the purchase of such securities will lend only 75 percent of their market value. With respect to government securities, lending at a higher loan to market value ratio is common.

(e) This paragraph provides a specific rule for control of securities subject to a repurchase agreement. Repurchase agreements represent a substantial portion of the daily activity of the government securities market and provide a significant financial and cash management tool for both investors and government securities dealers.⁵⁹

Repurchase agreements may be for a specified term or for overnight investment only. Repurchase transactions may also provide investment for an indefinite period by permitting the participant to elect each day whether to continue the repurchase transaction or terminate it.

Typically, a repurchase agreement will be structured in one of three ways. The agreement may require that the securities be delivered to the purchaser or the purchaser's designated custodial bank. An alternative arrangement is for the seller, the buyer, and a third party (usually a custodial bank) to enter into a tripartite agreement under which the third party agrees to hold the securities that are the subject of the repurchase agreement for the benefit of both parties. The third alternative is that the seller of the securities may retain control of the securities and earmark them on its own books as securities subject to a specific repurchase transaction. Under this arrangement, the seller usually will also instruct its clearing bank to segregate the securities subject to repurchase from the securities in the dealer's clearing account. However, the clearing bank will not necessarily be advised of the identity of the buyer of specific repo securities, and the securities will be subject only to the control of the seller and its clearing bank.

Experience over the last several years has indicated that this last type of repurchase transaction, commonly referred to as a "hold in custody" or "letter" repurchase agreement, represents the greatest potential for loss on the part of the investors since the securities purchased remain in the control of the seller. Many of the investors that experienced significant losses in the failures of two government securities dealers, Beville, Bresler & Schulman, Inc. ("BBS") and E.S.M. Government Securities, Inc. ("ESM"), had entered into hold in custody repurchase transactions with these entities, and it is the investor losses in these cases that provided the impetus for passage of the GSA.

At the same time, as is recognized in the legislative history of the GSA, requiring actual delivery of all

The parties to a repurchase transaction may characterize and account for the transaction in either of these ways. In the discussion that follows, the parties to a transaction will be referred to as the seller and buyer for ease of reference. The use of these terms does not reflect a determination on the part of the Department that for all purposes and in all contexts repurchase transactions must be characterized as sales and repurchases and not as secured loans.

⁵⁴ Ibid.

⁵⁵ 51 FR 43027 (Nov. 28, 1986).

⁵⁶ 51 FR 45046 (Dec. 16, 1986).

⁵⁷ Sections 240.8c-1, .15c2-1, .15c3-2, .15c3-3.

⁵⁸ 12 CFR Part 220.

⁵⁹ A repurchase agreement is a transaction in which the owner of securities agrees to sell them to another and to repurchase them on a specified date at a specified price. Although the transactions generally are documented as the sale and repurchase of securities, economically the transaction has characteristics of a secured loan.

securities subject to repurchase could have a significant detrimental impact on the liquidity of the market. For example, the Senate Committee Report⁶⁰ indicates that the Committee concluded that a physical delivery requirement for overnight repurchase agreements in securities guaranteed by the Government National Mortgage Association ("GNMA") might have adverse consequences on the efficiency and liquidity of the government securities market, and that such a requirement would also be impractical for other certificated government securities. With respect to other repurchase agreements, the Committee expressed the expectation that the Secretary would adopt rules requiring physical delivery of the securities to a customer only after a determination that less expensive alternatives, such as segregation of customers' securities and procedures for credit analysis and review of counterparties, would not effectuate the purposes of the Act, and that such a requirement is feasible and justifiable given the need to protect the liquidity of the government securities market.⁶¹ The House Committee Report⁶² states that requiring the physical transfer of securities involved in repurchase transactions would impair market efficiency, but that requirements for segregating and designating securities for particular investors would help prevent fraud as well as inadvertent errors that may occur.⁶³

Many of the entities that enter into hold in custody repurchase agreements are large institutional investors that are sufficiently sophisticated and informed to make a reasonable assessment of the risks and benefits of a given transaction and a careful evaluation of the creditworthiness and stability of their counterparty. For these investors and for the dealers with whom they enter into these transactions, the hold in custody repurchase agreement provides a convenient and flexible method of financial and cash management. The Department believes that these investors should continue to have the opportunity to make the judgment that the convenience and flexibility provided outweigh any potential risk of loss. Nevertheless, the Department has also concluded that to provide adequate protection to the smaller, possibly less sophisticated investors, it is necessary to establish certain requirements for the

control of securities subject to hold in custody repurchase agreements.⁶⁴

Just prior to the enactment of the GSA, the SEC proposed amendments to several of its financial responsibility and customer protection rules that would deal explicitly with securities subject to repurchase agreements.⁶⁵ In particular, the proposed SEC rule generally would require possession or control of securities that are the subject of a hold in custody repurchase agreement. However, for repurchase agreements with a contract price of \$1,000,000 or greater, possession or control is not required during the trading day. The effect of this exception is to permit securities that are the subject of a hold in custody repurchase agreement to be commingled with the dealer's own securities during the day and to be used to facilitate deliveries of securities to third parties if necessary. Under the proposed SEC rules, the securities would be reseggregated from the dealer's own securities at the end of the trading day. Since most repurchase agreements give the dealer the right to substitute collateral, the securities that are segregated each night for a given repurchase transaction may differ from day to day.

The intraday use of securities subject to term hold in custody repurchase agreements appears to be a common practice in the government securities market, and those commenting on the SEC proposal have urged that to eliminate completely the capability of using such securities for deliveries and resubstituting collateral could seriously diminish the efficiency of the market. The amount of securities that may be committed to term repurchase agreements during any one day may be substantial. To require that these securities be monitored during the day, transaction-by-transaction, and that individual instructions to move securities to the dealer's account to facilitate a delivery and to substitute other securities that are acceptable collateral for that transaction, may require real-time operational capabilities that, at the present time, might slow a dealer's daily trading activities and increase costs to unacceptable levels. The proposed SEC rule is designed to allow sufficient flexibility in this area, but at the same

time provide adequate protection for the smaller investors who may not fully understand the operational practices of their dealer/counterparties and who therefore cannot make a reasonable assessment of the risks and benefits of a given transaction.

The Department generally agrees with the SEC approach and believes that, if certain requirements are met, the sophisticated investor should still be able to enter into hold in custody repurchase transactions in which the subject securities may not be segregated at all times. The Department further agrees with the SEC that, for the smaller investor, full protection must be afforded by requiring possession or control of the securities subject to repurchase at all times. However, the Department has chosen to vary its proposed rule from the SEC proposal in two significant respects. As noted above, in the event the SEC finally adopts a rule substantially similar to the Treasury rule as proposed, the Department contemplates exempting registered brokers or dealers from the Treasury rule and working with the SEC to resolve any variations in the two rules.

First, the Department has raised the cut-off for round-the-clock segregation from the \$1 million proposed by the SEC to \$5 million. Based on inquiries and on the size of some of the transactions involved in the BBS and ESM failures, the Department concluded that \$1 million was too low a number to reasonably assure protection of all the less-informed investors.

The Department intends the dollar amount cut-off to refer to the aggregate contract price of all outstanding repurchase agreements between a particular buyer and a particular broker or dealer. Comments are specifically invited on both the dollar limit itself and on any operational or definitional problems, such as the difficulty of ascertaining the aggregate contract amount for a given buyer and of defining what constitutes a single buyer, that may arise from permitting application of the limit to the aggregate amount of repurchase agreements between a seller and buyer.

The second way in which the Treasury's proposed rule varies from the SEC rule relates to the repurchase agreement itself. Instead of adopting the more general requirement proposed by the SEC of disclosure of the rights and liabilities of the parties to the agreement, the Department proposes that repurchase agreements must be written and must contain specific consent language if the securities may

⁶⁰ S. Rep. No. 99-428, 99th Cong., 2d Sess. (1986).

⁶¹ *Ibid.* at 16 n.34.

⁶² H.R. Rep. No. 99-258, 99th Cong., 1st Sess. (1985).

⁶³ *Ibid.* at 16-17.

⁶⁴ Similar requirements for securities that are the subject of triparty repurchase transactions or repurchase transactions involving actual delivery to the buyer are unnecessary because those transactions are structured to assure recognition of the buyer's interest in the securities and to eliminate control by the seller.

⁶⁵ Exchange Act Release No. 34-23602, 51 FR 32658 (Sept. 15, 1986).

not be segregated at all times. The Department has chosen to require written repurchase agreements and to specify the required consent language for several reasons.

First, the rights and liabilities of parties to a repurchase agreement is an unsettled area of law. Therefore, the disclosure requirement would require brokers and dealers to reach specific legal conclusions in an area in which the law itself is unclear. Second, the Department believes that any language included in a repurchase agreement should be explicit enough to put the less sophisticated investor on notice of the potential risks involved in the hold in custody repurchase transaction. Finally, in the Department's view, the practice of customarily making use of repurchase agreement securities held in custody to accomplish other deliveries committed to by a dealer as part of its ordinary trading activities is inconsistent with the fact that rights in the securities, whether as a sale or as a secured loan, have been conveyed to the repurchase agreement counterparty, unless that counterparty has consented to such use. The Department does not believe that retaining the right to substitute securities, as is done in most repurchase agreements, should be regarded as explicit enough to constitute consent by a counterparty to daily commingling and use of the securities for which it has paid.

For all of the foregoing reasons, the Department proposes to require that a repurchase agreement be written and that the dealer maintain possession or control of securities subject to repurchase at all times unless, for aggregate repurchase transactions of \$5 million or more, the buyer has consented to intraday commingling with the dealer's securities and certain other provisions. Compliance with the requirement for a written repurchase agreement may be met by use of a written master repurchase agreement under which the parties to the agreement may initiate a series of distinct repurchase transactions. It should be noted that the rule requires inclusion of the specific wording set forth in § 403.4(e)(4)(iii)(A)(i) and (ii). In these provisions, the term "seller" is used to refer to the broker or dealer that agrees to sell and subsequently repurchase securities under a repurchase agreement. This word was chosen because of its use in the standard master repurchase agreement of the Public Securities Association ("PSA") which the Department believes has gained wide acceptance in the government securities market. If a

different term is used to indicate the initial seller of securities under a specific repurchase agreement, then that term may be substituted for the word "seller." Otherwise, the repurchase agreement should include the precise wording set out in the rule.

The Department also proposes to require that the securities that are the subject of a repurchase agreement be confirmed in writing at initiation of the transaction and with each substitution.

By requiring full-time possession or control of securities subject to a repurchase agreement where the aggregate transactions with a counterparty are under \$5 million, the Department does not intend to prohibit substitutions of collateral that the counterparty may agree to pursuant to the terms of the repurchase agreement. However, the Department recognizes that because of operational constraints, substitutions that are intended to be simultaneous may not be completed until the end of the day. Therefore, for transactions with less sophisticated investors, the proposed rule also requires that whenever the aggregate repurchase transactions with a single counterparty are under \$5 million, substitutions of securities may be made only with the prior agreement of the counterparty. It is noted that the PSA standard master repurchase agreement provides that substitutions of collateral are subject to the agreement of and acceptance by the counterparty. The proposed provision is included to ensure that a similar provision is included in all repurchase agreements involving transactions aggregating less than \$5 million and to make clear that agreement to a specific substitution must be obtained prior to taking any steps toward substitution of securities.

The Department also proposes that the repurchase agreement contain a disclosure concerning coverage under the Securities Investor Protection Act of 1970.⁶⁶ Under SIPA, customers of all brokers or dealers registered with the SEC under Section 15 of the Act are eligible for coverage by the Securities Investor Protection Corporation ("SIPC") of losses up to \$500,000 in the event of the bankruptcy of such broker or dealer. However, government securities brokers and dealers registered under Section 15C of the Act may not become members of SIPC and their customers would not be eligible for SIPC coverage. Furthermore, SIPC has taken the position that the provisions of SIPA do not protect the counterparty of any

broker or dealer under a repurchase agreement. For these reasons, the Department proposes that, for all hold in custody repurchase transactions, the repurchase agreement must disclose that there may not be protection under SIPA, and that to the extent SIPA is at all applicable, the protection is limited to \$500,000.

It should be noted that, for purposes of control of securities that are the subject of a repurchase agreement, acceptable control locations are limited to those described in paragraphs (c)(1), (c)(5), and (c)(6) of Rule 15c3-3 and to the additional clearing bank control location described in paragraph (f) of this rule. Comments are specifically requested on whether additional control locations are appropriate or necessary.

(f) This section adds a new paragraph to that portion of Rule 15c3-3 that describes acceptable control locations.⁶⁷ This new paragraph describes an account maintained at a clearing bank as a permissible control location for a dealer so long as (1) the account does not include proprietary securities of the dealer, and (2) the clearing bank expressly agrees in its clearing agreement with the dealer that securities in the designated account are not subject to any lien or claim of the clearing bank.

A significant proportion of all outstanding government securities are held in uncertificated form and transfers of such securities are accomplished by means of book-entries on the books of Federal Reserve Banks or financial intermediaries. A substantial number of such securities are held by or through dealers that maintain the securities through banks that provide clearing services to the dealers including extensions of credit to finance dealer positions.

Because Rule 15c3-3 was drafted for a somewhat different environment, where securities are issued in certificated form, the language of Rule 15c3-3 does not clearly apply to securities that are issued in book-entry form only. Furthermore, none of the control locations described in the rule clearly relate to the segregation accounts maintained by dealers at clearing banks. The Department understands that the SEC has interpreted the Rule to be applicable in this situation but concluded that it would be useful to include a specific provision covering this arrangement to avoid unnecessary confusion. The Department also requests comments as to whether additional control locations not

⁶⁶ Securities Investor Protection Act of 1970, Pub. L. 91-598, 84 Stat. 1636, as amended (codified at 15 U.S.C. 78aaa-eee).

⁶⁷ § 240.15c3-3(c).

specified in the SEC rule would be appropriate or suitable in the context of the government securities market.

(g) If a bank is unable or unwilling to comply with an instruction of the broker or dealer to move securities into the segregated account, the broker or dealer must give an "early warning notice" as described in § 405.5. Such a notice was considered appropriate because a refusal of a bank to segregate securities is likely to be an indication of a situation similar to a "material inadequacy" as described in § 240.17a-5(g)(3).

(h) Rule 15c3-3 provides that nothing contained in the Rule shall be construed as affecting the absolute right of a customer to receive the physical delivery of certificates for fully-paid securities or certain margin securities.⁶⁸ This provision has been modified to include the comparable right of a customer to direct the disposition of a security held in book-entry (certificateless) form. All new U.S. Treasury bonds and notes issued after July 1986 are available only in book-entry form. U.S. Treasury bills have been available in exclusively book-entry form since 1977. This provision does not preclude the customer from agreeing in writing to restrictions on its right to dispose of securities.

(i) This paragraph provides that the provision of Rule 15c3-3⁶⁹ requiring buy-in of securities after 10 days to complete a sell order of a customer (other than a short sale) applies to government securities. The application of this rule to government securities applies to registered brokers and dealers as well as registered government securities brokers and dealers.

(j) This paragraph conforms Rule 15c3-3 to § 402.2 of these regulations to allow government securities brokers and dealers that have liquid capital that exceeds by a specified amount the liquid capital required under Part 402 and that hold small amounts of customer funds to make the required reserve computations monthly rather than weekly.

(k) This paragraph conforms a portion of the reserve calculation to the net capital rules in § 402.2 of these regulations.

4. *Section 403.5.* This section sets forth the rules for custody of customer securities that are applicable to government securities brokers or dealers that are financial institutions. As a general rule, these financial institutions are directed to comply with Part 450 with respect to custody of securities

held for customers or counterparties. For securities that are held for others by the financial institution in its capacity as a government securities broker or dealer, certain additional requirements are imposed that generally parallel the requirements of SEC Rule 15c3-3.

For example, a financial institution that is a government securities broker or dealer and that engages in repurchase transactions is required to comply with provisions that parallel the requirements of § 403.3(e) described above. In addition, the financial institution is required to make daily determinations of the amount of shortfall, if any, of securities required to be in its possession or control and to take steps to obtain securities to cover a shortfall. Section 403.5 does not, however, contain any provisions similar to the requirements of SEC Rule 15c3-2 concerning use of customer funds or SEC Rule 15c3-3 concerning a special reserve bank account for holding customer balances. Rule 15c3-2, by its terms, does not apply to supervised banking institutions and the Department concluded that the exemption should be extended to all supervised financial institutions that are government securities brokers or dealers. Furthermore, because financial institutions generally maintain customer funds as a fundamental part of their business, and because they are supervised in large part to protect their deposits, the Department concluded that it would serve no useful investor protection purpose to impose the added requirement of Rule 15c3-3(e) to require a financial institution to establish a special account for customer funds at another financial institution.

A separate rule was drafted for financial institutions that are government securities brokers or dealers primarily because neither financial institutions nor their regulatory agencies are familiar with Rule 15c3-3. However, the proposed rule is intended to parallel the relevant requirements of Rule 15c3-3. Although the requirements of the proposed rule are stated in less detail than is found in Rule 15c3-3, it is anticipated that its enforcement by the financial institutions supervisory agencies will follow, in practical effect, the Commission's rule.

E. Part 404. Recordkeeping

Section 15C(b)(1)(C) of the Act requires the Secretary to propose and adopt rules that require government securities brokers and dealers to make, keep current and preserve records relating to the operation of their businesses. Part 404 of these regulations responds to that requirement. The

proposed rules generally adopt analogous rules of the SEC, Rules 17a-3, 17a-4, 17a-7 and 17a-13.⁷⁰

1. *Section 404.1.* This section provides that, for government securities brokers and dealers that are registered brokers or dealers, compliance with applicable SEC rules, with certain modifications pertaining to books and records concerning repurchase and reverse repurchase agreements, will constitute compliance with Part 404. Specifically, registered brokers and dealers (as well as registered government securities brokers and dealers, see § 404.2 below) would be required to: (i) maintain a separate ledger reflecting assets and liabilities resulting from repurchase and reverse repurchase transactions, (ii) record separately on their securities records those securities subject to repurchase and reverse repurchase agreements, and (iii) maintain copies of confirmations they send out with regard to repurchase and reverse repurchase agreements.

These additional recordkeeping requirements will ensure that all repurchase and reverse repurchase agreements are properly reflected, thereby ensuring accountability for the cash and securities involved in such transactions. The additional records required are the records specified in recent proposed amendments to the SEC rules.⁷¹ Comments provided to the SEC on these provisions of the SEC proposal were almost unanimously favorable, with many commenters indicating that they already comply as a matter of good business practice. If the amendments to the SEC rules are adopted prior to the adoption of the final Treasury rule, § 404.1 will be modified to reflect the adoption of the amendments.

2. *Sections 404.2 and 404.3.* Under these sections, registered government securities brokers and dealers are required to make, keep current and preserve the types of records required by SEC rules 17a-3, 17a-4 and 17a-7,⁷² with limited modifications relating to the different financial responsibility rules applicable to registered government securities brokers and dealers. In addition, registered government securities brokers and dealers would be required to maintain the books and records pertaining to repurchase and reverse repurchase agreements that are described above.

The Department proposes adoption of the SEC rules with modifications because those rules are well understood

⁷⁰ §§ 240.17a-3, 17a-4, 17a-7, 17a-13.

⁷¹ Exchange Act Release No. 34-23602, 51 FR 32658 (Sept. 15, 1986).

⁷² §§ 240.17a-3, 17a-4, 17a-7.

⁶⁸ § 240.15c3-3(l).

⁶⁹ § 240.15c3-3(m).

by many government securities brokers and dealers, the audit community and the self-regulatory organizations. During the consultation process prior to issuance of these proposed rules, the Department found that many currently unregulated government securities brokers and dealers are affiliated with registered brokers or dealers that must comply with the SEC rules, or with registered municipal securities dealers that must comply with similar rules. These communities generally favored adoption of recordkeeping and record preservation rules that follow the SEC rules.

3. *Section 404.4.* This section provides that financial institutions that are government securities brokers and dealers subject to specified recordkeeping rules of their appropriate regulatory agency,⁷³ are exempt from the recordkeeping and preservation requirements of Part 404, except for two types of books and records. Specifically, such financial institutions would be required to maintain records pertaining to securities positions and to associated persons of such financial institution.⁷⁴ Both types of records are already required of bank municipal securities dealers.⁷⁵ Position records are essential if a dealer is accurately to keep track of its holdings and their locations, and are the key to any assessment by an appropriate regulatory agency of the risk of a dealer operation within a financial institution. Maintenance of associated person records is needed to protect the integrity of the market in government securities by enabling financial institutions and their regulators to locate persons whose past activities make their participation in the market as brokers or dealers questionable and to take appropriate action with respect to such persons.

This partial exemption from the recordkeeping and record retention requirements recognizes that these financial institutions are already subject to federal supervision, which explicitly includes recordkeeping requirements relating to securities activities. Requiring these institutions to follow

⁷³ See 12 CFR Part 12 (Office of the Comptroller of the Currency); 12 CFR Part 208 (Board of Governors of the Federal Reserve System); 12 CFR Part 344 (Federal Deposit Insurance Corporation). Section 404.4 provides that such regulations are to be complied with without regard to the exemptions therein for transactions in U.S. government or federal agency obligations, 12 CFR 12.7(a), 12 CFR 208.8(k)(6)(i), 12 CFR 344.7(a).

⁷⁴ See discussion of records concerning associated persons at § 400.4 above.

⁷⁵ See Municipal Securities Rulemaking Board Rule G-8; Office of the Comptroller of the Currency, Comptroller's Handbook for National Bank Examiners, § 204.1, at 6 (August 1985).

another set of recordkeeping requirements would be unduly burdensome and would not promote the purposes of the Act. Compliance with the recordkeeping requirements of the bank supervisory agencies and maintenance and preservation of records on securities positions and associated persons will protect investors and is consistent with the public interest.

4. *Section 404.5.* This section requires registered government securities brokers and dealers to comply with SEC Rule 17a-13,⁷⁶ requiring a quarterly count of all securities, verification of securities records and comparison of the count and records. Although the count portion of the rule is written in terms of physical securities, the portion relating to accounting for securities not in a dealer's possession requires the equivalent of a count of book-entry securities. The rule is an important check on the accuracy of a firm's operations and recordkeeping and as such is an important aspect of investor protection.

5. *Section 404.6.* This section requires financial institutions that are government securities brokers or dealers to conduct annual counts of book-entry and definitive government securities held for customers and to verify and reconcile records. Financial institutions hold securities for a variety of customer purposes, frequently transferring customer securities held by virtue of the dealer function to the safekeeping and trust departments. Trust department securities are, by state and federal law and examination policy, required periodically to be reconciled to customer accounts.⁷⁷

Proposed Part 450 of these regulations would impose periodic count and related requirements for custodial holdings of government securities by financial institutions that are not government securities brokers or dealers. This rule requires financial institutions that are government securities brokers or dealers not exempt from regulation pursuant to Part 401, to count, reconcile and verify annually all government securities held for customers outside of trust departments. The count of book-entry securities and of definitive securities not in the financial institution's possession should be accomplished by verifying the financial institution's records with those of the depositories, depository institutions or Federal Reserve Bank

that hold securities accounts for the financial institution.

F. Part 405. Reporting and Audit Requirements.

The reporting and audit regulation generally follows the provisions of SEC Rules 17a-5, 17a-8 and 17a-11.⁷⁸ Registered government securities brokers and dealers that clear transactions or carry customer accounts will be required to file monthly reports similar to Part I of the current SEC FOCUS report (Form X-17a-5, § 249.817 of this title) demonstrating compliance with capital adequacy requirements. All registered government securities brokers and dealers will be required to file quarterly reports containing unaudited financial statements, and an annual report certified by an independent public accountant. The accountant's report is to include, among other things, schedules concerning liquid capital and customer reserve requirements and a report on internal accounting controls, including any material inadequacies in those controls. Financial institutions that are government securities brokers or dealers will, with one exception, be exempt from reporting requirements being imposed on nonfinancial government securities brokers and dealers.

1. *Section 405.1.* Compliance with Rules 17a-5, 17a-8 and 17a-11 by registered brokers and dealers who are also government securities brokers and dealers will constitute compliance with the reporting and audit regulations. Since registered brokers or dealers will continue to be required to determine net capital according to SEC Rule 15c3-1,⁷⁹ additional reporting and audit requirements are not necessary.

The Department has determined that the additional burden that would be created by requiring financial institution government securities brokers and dealers to comply with additional reporting requirements is unnecessary. Financial institutions are subject to regular capital reporting requirements,⁸⁰ and are also subject to regular examination by supervisory agencies. Moreover, the Department proposes to exempt financial institution government securities brokers and dealers from the capital adequacy requirements of Part 402 of these regulations.⁸¹ Government

⁷⁸ Sections 240.17a-5, .17a-8, .17a-11.

⁷⁹ Section 240.15c3-1, § 402.1 of the proposed regulation.

⁸⁰ See, e.g., 12 U.S.C. 161, relating to call reports, and regulations thereunder.

⁸¹ See § 402.1(c) of the proposed regulations.

⁷⁶ Section 240.17a-13.

⁷⁷ See, e.g., Comptroller's Handbook for National Trust Examiners, § 401.4.

securities brokers and dealers that are financial institutions will be subject to the proposed regulation concerning reporting of foreign currency transactions, as are registered brokers and dealers under SEC Rule 17a-8.⁸²

The section provides that all requirements of the part, except the reporting requirements, will become effective on July 25, 1987. Therefore, for example, registered government securities brokers and dealers will be required to have engaged an independent public accountant by that date. The monthly reporting requirement is delayed until the first month within which a firm becomes subject to the capital adequacy requirements, which under this proposal will be October, 1987. Registered government securities brokers and dealers will be required to file unaudited quarterly reports for the quarter ending September 30, 1987, and will be required to file quarterly reports on the appropriate form starting with the quarter within which they first become subject to the capital adequacy rules, which under this proposal will be the quarter ending December 31, 1987.

2. *Section 405.2.* This section establishes the requirements for financial reporting by and audit of registered government securities brokers and dealers. It provides that, with limited modifications, registered government securities brokers and dealers must comply with SEC Rule 17a-5.⁸³ The Department's discussions with the SEC, the self-regulatory organizations, government securities brokers and dealers, and representatives of the accounting profession, all indicated that these requirements are appropriate to meet the purposes of the Act and feasible to implement without excessive burden. The requirement for annual certified financial statements is statutory.⁸⁴

The major provisions of Rule 17a-5, as modified, are:

(a) Registered government securities brokers and dealers that clear transactions or carry customer accounts must file monthly Part I of Form G-405⁸⁵ (§ 449.5 of this chapter), showing liquid capital and total haircuts calculations;

(b) All registered government securities brokers and dealers must file quarterly Part II or Part IIA of Form G-405, consisting largely of unaudited financial statements;

(c) All registered government securities brokers and dealers must file audited annual financial statements certified by an independent public accountant;

(d) Registered government securities brokers and dealers other than introducing brokers must send investors an annual audited statement of financial condition (including a footnote concerning capital adequacy and a statement that audited financial statements and any audit report commenting on material inadequacies are available for inspection), and an unaudited statement as of the date six months from the date of the audited statement;

(e) Registered government securities brokers and dealers must engage an independent public accountant to conduct an annual audit of the registered government securities broker or dealer, and must file a statement concerning such engagement, and, if applicable, the termination of the engagement and replacement of auditors;

(f) Annual financial statements must be audited by an independent public accountant according to generally accepted auditing principles;

(g) The audit must be sufficient to enable the auditor to comment on material inadequacies, if any, in the accounting system, internal accounting controls, procedures for safeguarding securities, and in obtaining and maintaining possession or control of customer securities; and

(h) Material inadequacies must be reported within 24 hours of the time the auditor notifies the chief financial officer of the condition.

The proposed regulation provides that the SEC may declare effective a plan by a self-regulatory organization under which filings may be made with the designated examining authority rather than the Commission. The Department anticipates that the Commission will approve such plans.

3. *Section 405.3.* This rule provides that registered government securities brokers and dealers must comply with SEC Rule 17a-11,⁸⁶ concerning early warning to the Commission and designated examining authorities of capital difficulties. The rule, as modified, provides that if a registered government securities broker's or dealer's liquid capital falls below the required level established in § 402.2 of the regulations, the firm shall give notice to the Commission and the appropriate self-regulatory organization of that fact

on the day it occurs. Within 24 hours, the registered government securities broker or dealer must also file a Part II or IIA of Form G-405.

In addition, if liquid capital falls below 150 percent of total haircuts, determined in accordance with § 402.2 of the regulation, the registered government securities broker or dealer is required to file Part II or Part IIA monthly until liquid capital stays above the 150 percent level for three consecutive months. The purpose of this regulation, in coordination with other early warning regulations that the self-regulatory organizations are expected to adopt, is to allow the registered government securities broker or dealer and the enforcement authorities an opportunity to alter the firm's business practices to bring it back into compliance, and to protect customers, without requiring a shut-down or complete liquidation of the firm's business.

Section 405.3 also requires notice to the Commission and the appropriate self-regulatory organization of failure to keep the books and records required by § 404.2 of the regulations or upon discovery or notification by an independent public accountant of a material inadequacy, as defined in Rule 17a-5(g).⁸⁷

4. *Section 405.4.* This section requires registered government securities brokers and dealers and government securities brokers and dealers that are financial institutions to comply with the requirements of 31 CFR Part 103, concerning currency and foreign transactions. The effect of this requirement, which parallels Rule 17a-8⁸⁸ for registered brokers or dealers, is that the regulations are enforceable under the Act as well as under the Currency and Foreign Transactions Reporting Act (the Bank Secrecy Act).⁸⁹

G. Part 450. Custodial Holdings of Government Securities by Depository Institutions

Part 450 sets out regulations applicable to depository institutions that hold government securities for customer accounts, whether directly or through correspondent banks, trust companies, Federal Reserve Banks, or other custodial arrangements, but do not fall within the definition of a government securities broker or dealer. These regulations provide custody, recordkeeping, and other requirements

⁸² Section 240.17a-8.

⁸³ Section 240.17a-5.

⁸⁴ Section 15C(b)(1)(B) [15 U.S.C. 78o-5(b)(1)(B)].

⁸⁵ The version of the SEC FOCUS Report applicable to registered government securities brokers and dealers.

⁸⁶ Section 240.17a-11.

⁸⁷ Section 240.17a-5(g).

⁸⁸ Section 240.17a-8.

⁸⁹ Pub. L. No. 91-508, Title II, § 4 Stat. 1118, as amended (31 U.S.C. 5311-23).

applicable to government securities held for customers, including those purchased or sold subject to resale or repurchase. Depository institutions that are exempt from the requirements of Section 15C of the Act under Part 401 of these regulations, as well as certain depository institutions that are government securities brokers or dealers (see § 463.5) would also be subject to the Part 450 regulations.

Depository institutions often provide custody or safekeeping services involving the purchase of government securities for a customer. Depending on the size and geographic location of the depository institution, these securities may be held in a custody account maintained at a correspondent bank for the depository institution. If the securities are issued only in book-entry form, then the depository institution or its correspondent will generally maintain such securities in a securities account on the books of a Federal Reserve Bank.

There currently is no explicit regulatory or supervisory framework governing the practices of depository institutions providing custodial or safekeeping services for customers except where securities are held in a fiduciary capacity. Without such standards, there is the potential for inadvertent or other actions that can harm customers. The development and increasing use of certain types of transactions involving these securities, such as due bills, suggests the potential for problems may be increasing. The GSA therefore mandates promulgation of more explicit standards of conduct which will help the supervisory agencies assure that all institutions conform to good business practices in this area. The Department believes that the proposed regulations largely codify existing practices of responsible financial institutions.

1. *Section 450.1.* This section states that the Part 450 regulations apply to all depository institutions that hold government securities for customers, including in particular those who are exempt from regulation as government securities brokers or dealers under Part 401 of the proposed regulations. Unlike the regulations under subchapter A, the regulations under part 450 apply to credit unions.

2. *Section 450.2.* This section defines the terms "appropriate regulatory agency," "customer," "depository institution," "fiduciary capacity" and "government securities" for the purposes of this subchapter. The definition of appropriate regulatory agency makes explicit the statutory determination that, except in the case of

federally-chartered or federally-insured credit unions for which the NCUA is the appropriate regulatory agency, where another agency is not explicitly designated in section 3(a)(34)(G) of the Act, the SEC is the appropriate regulatory agency. This would be the case with respect to state-chartered non-federally insured banks, thrift institutions, and credit unions. References to the NCUA in Title II of the GSA as an agency whose standards might substitute for the Secretary's make it clear that, for the purposes of Title II, NCUA was meant to be considered an appropriate regulatory agency. The definition also reflects the fact that the Federal Home Loan Bank Board will act on behalf of the Federal Savings and Loan Insurance Corporation.

The customer definition is meant to ensure that repurchase agreement counterparties that are investors, rather than brokers or dealers, are protected by the provisions of this part. The definition of fiduciary capacity, which in essence requires that the depository institution have the power to exercise discretion, is substantially the same as the definition of "fiduciary" in 12 CFR 9.1, concerning fiduciary powers of national banks. The definition of "government securities" notes that, for purposes of Part 450, off-exchange puts, calls, straddles, options or privileges on government securities are not themselves government securities.

3. *Section 450.3.* This section provides an exemption from the regulations of Part 450 for government securities held in a fiduciary capacity by certain depository institutions or in a trust department in such an institution. The GSA provides that, prior to adopting regulations under Title II, the Secretary shall determine whether the rules and standards of the appropriate regulatory agencies and the National Credit Union Administration Board adequately protect government securities held for customers by depository institutions subject to their jurisdiction. The Department was not able to make such a determination with regard to custodial holdings generally. As described below, however, it appears that holdings of government securities in a fiduciary capacity by depository institutions are adequately regulated by depository institutions subject to the supervision of certain of the appropriate regulatory agencies. This determination does not extend to the rules and standards of the National Credit Union Administration Board, since credit unions generally do not exercise trust powers, and the Board does not generally regulate fiduciary activities.

Based on the information provided by the appropriate regulatory agencies and on the Department's own analysis, the Department has determined that holdings of government securities in a fiduciary capacity by depository institutions under the regulatory jurisdiction of the appropriate regulatory agencies are adequately regulated.⁹⁰ Such depository institutions are generally subject either to state or federal laws and regulations governing the safekeeping of fiduciary assets. They are also subject to examination procedures that generally require (i) review of the institution's systems and procedures to ensure that assets are adequately protected; (ii) review of applicable laws, regulations, and fiduciary principles governing the safeguarding of assets; (iii) review of the institution's accounting system to insure that records are accurate and reliable; and (iv) review of the adequacy of the institution's audit program. Accordingly, such depository institutions are exempt from § 450.4 with regard to their fiduciary holdings of government securities, provided they adhere to the applicable requirements imposed by their appropriate regulatory agencies. This exemption also extends to holdings of government securities for customers in a custodial capacity by such depository institutions, as long as such holdings are within the trust department and the depository institution agrees, with respect to such custodial holdings, to adhere to the rules applicable to securities held in a fiduciary capacity.

The Department does not anticipate that subsequent modifications of the applicable rules and standards will make this exemption inappropriate. However, the Department expects the regulatory agencies to inform the Department of any material revisions of such rules and standards.

4. *Section 450.4.* Section 450.4 sets out basic requirements for custodial holdings of government securities by depository institutions. The most fundamental of these safeguards, set out

⁹⁰ Letter from A. David Meadows, Associate Director, Division of Bank Supervision, Federal Deposit Insurance Corporation to William J. Bremner, Deputy Assistant Secretary (Federal Finance), Treasury Department (Jan. 28, 1987); Letter from Owen Carney, Director, Investment Securities Division, Office of the Comptroller of the Currency to William J. Bremner (Jan. 17, 1987); Letter from Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System to William J. Bremner (Jan. 16, 1987); Letter from Robert S. Plotkin to Mary Ann Gadziala, Assistant General Counsel (Banking & Finance), Treasury Department (Dec. 22, 1986); Memorandum from Owen Carney to Mary Ann Gadziala (Nov. 28, 1986).

at §§ 450.4(a) and (b), are the requirements that customers' securities be kept separate from those of the depository institution, that the depository institution maintain possession or control of customers' securities and that customers' securities be kept free of all liens unless expressly agreed to in writing by the customer. This requirement applies both to securities maintained in definitive (physical) form and securities maintained in book-entry form. In the case of physical securities, this might be accomplished by safekeeping in a separate part of the depository institution's vault or by delivery to another institution. In the case of book-entry securities, a depository institution would need to maintain on its own records separate securities accounts for each customer, on the one hand, and separate accounts for securities owned by the depository institution on the other. Similar account separation would also be necessary for each level in any chain of correspondent relationships through which government securities are being maintained. Where government securities are being maintained for customers at a Federal Reserve Bank, a correspondent bank or other custodian, the depository institution would need to instruct such entity to maintain possession or control of such securities free of any charge, lien, or claim of any kind in favor of the correspondent or other custodian or any persons claiming through them. To the extent it has received such an instruction, the correspondent bank or other custodian would be required to comply with Part 450 with respect to its custody of those securities held for customers of the depository institution, as well as securities held directly for customers of the correspondent.

Section 450.4(c) imposes a number of recordkeeping requirements on depository institutions holding securities for customers. Correspondent banks and other custodians of both proprietary government securities of a depository institution as well as government securities belonging to customers of that depository institution could comply with these requirements by maintaining separate sets of records, one reflecting securities held for the depository institution's own account and another reflecting securities held for the account of the depository institution's customers. The depository institution would be responsible for maintaining records identifying the interests of each customer in the securities so held.

Section 450.4(d) requires periodic counts of government securities held for

customers in both physical and book entry form. For definitive securities not in the possession of the depository institution and for all book-entry securities, the count would be accomplished by verifying the depository institution's records with those of the custodial entities on whose books the depository institution has a securities account. Such entities include depositories, correspondent banks, and Federal Reserve Banks.

The frequency of the required counts should be determined by the scope of the depository institution's custodial operations, the volume of its holdings, and the frequency of delivery and receipt of cash or securities. For example, a small bank holding government securities for a few relatively inactive customers might conduct annual counts. On the other hand, a bank that safekeeps government securities for active traders might need to conduct counts weekly or more frequently.

The requirements set forth in § 450.4 are similar to, but less burdensome than, the requirements imposed on trust departments through the regulatory and examination process. Compliance with these requirements should not add significantly to the cost of providing custodial services.

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

Section 402 of the GSA requires that these proposed regulations be published within 120 days of the date of enactment of that act.⁹¹ Therefore, the Department's opportunity to determine the effect of these proposed regulations on the economy, on small entities and on competition, has been very limited. However, based on discussions with government securities brokers and dealers, including those currently subject to federal regulation and those that are not, it is the Department's view that the proposed regulations will not impose any significant cost on those affected or affect the economy in a manner other than that explicitly required by the GSA. In addition, the Department believes that the proposed regulations will not have an unnecessary or inappropriate differential impact on classes of government securities brokers or dealers such as to create a burden on competition.

In particular, the Department believes the following decisions minimize the regulatory burden to that required by the statute:

(a) To limit any additional burden on registered brokers or dealers by deeming compliance with existing rules under Section 15 of the Act to be compliance with the proposed rules, with modifications related solely to anticipation of the SEC's proposed rulemaking concerning repurchase agreements;⁹²

(b) To minimize additional burdens on financial institutions by (1) providing exemptions for activities deemed not to be within the contemplation of the statute and (2) largely accepting compliance with existing financial institution regulation as compliance with the proposed rules;

(c) To adopt in large part the possession or control, reporting and audit regulations of the SEC, with which many currently unregulated government securities brokers and dealers are familiar;

(d) To adopt in large part the recordkeeping regulation of the SEC, with which many currently unregulated government securities brokers and dealers are familiar and, in many cases, already in compliance; and

(e) To treat dealers in all types of government securities similarly and, in particular, not to distinguish between U.S. Treasury and agency securities (except for certain mortgage backed securities in which principal and interest do not flow through to all holders on a pro rata basis) for purposes of market risk haircuts in the capital adequacy requirement.

In addition, the Department believes that the impact of these regulations will be minimized because a large number of potential registrants do not hold customer securities and/or funds. Finally, Florida's recently enacted requirement that government securities brokers and dealers in that state register with the Commission under section 15 of the Act,⁹³ as well as information obtained from entities thought to be unregistered government securities brokers and dealers, suggest that many of these entities are registering under section 15 or are merging government securities operations into already registered brokers or dealers. Once an entity has registered under section 15, the proposed regulations will have minimal additional impact.

Accordingly, the Department has concluded that the proposed regulations do not constitute a major regulation for purposes of Executive Order 12291 and that a regulatory impact analysis is not

⁹² Exchange Act Release No. 23802, 51 FR 32658 (Sept. 15, 1986).

⁹³ Fla. Stat. § 517.12(16) (Supp. 1986).

⁹¹ GSA, supra note 6, § 402.

required. Similarly, it is hereby certified that the proposed regulations, if adopted, will not have a significant economic impact on a substantial number of small entities. However, the Department invites comments on these determinations, particularly with respect to the following:

(a) What entities will be affected by the proposed regulations, and what compliance costs will be incurred? Commenters should consider the statutory requirements and distinguish among the sections of the proposed regulations, particularly distinguishing between the cost of being required to have additional capital (if that would be the result of compliance with the capital adequacy requirement) and the cost of developing and implementing systems to comply with the regulations.

(b) What will be the effect on the integrity, efficiency and liquidity of the government securities market of requiring government securities brokers and dealers to maintain effective possession or control of customer securities? In particular, comments are invited on the requirements in proposed § 403.4 that repurchase agreements be entered into only pursuant to written agreement and that brokers or dealers maintain intraday control of securities that are the subject of term repurchase transactions of under \$5,000,000 per customer.

(c) Will a substantial number of small entities be affected by the regulations, and if so to what extent? Commenters should consider not only the potential regulatory burden on small entities that are government securities brokers or dealers but also the potential benefits to small investors that may arise from the proposed regulations.

(d) Will the proposed regulations have differential impacts on classes of government securities brokers or dealers such that they would have an unnecessary or inappropriate burden on competition?

(e) Does the format of the regulations, using cross-references to SEC regulations for most rules applicable to registered government securities brokers and dealers and thereby adopting all SEC interpretations, enhance the ability of firms, particularly those already familiar with SEC rules, to comply?

If, on the basis of comments received and further investigation by the Department, the Department determines that the regulations constitute a major rule or are likely to have a significant economic impact on a substantial number of small entities, the Department

will prepare and make available the required Regulatory Impact or Regulatory Flexibility Analysis.

The collection of information requirements contained in this proposed rule have been submitted to the Office of Management and Budget pursuant to section 3504(h) of the Paperwork Reduction Act (44 U.S.C. 3504(h)). Comments on these requirements should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Attention Desk Officer for the Department of the Treasury, Washington, D.C. 20503, and

to the Department of the Treasury at the address previously specified.

Appendix A—Example of Capital Computation

Example (1). On October 31, 1986 firm A's proprietary position contains a long position of Treasury notes due November 15, 1991 with a market value of \$20 million and a short position of Treasury notes due October 15, 1990 with a market value of \$30 million. The firm would enter these holdings on schedule B,¹ "Calculation of Net Immediate Positions in Securities and Financings", in row F (3.5-7.5 year maturity category for conventional securities) as follows:

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
F 3.5-7.5 yr. (3-5.5 yr.) ..			+20	-30	+20	-30	+20	-10
Column No.	1	2	3	4	(1+3) 5	(2+4) 6	7	(5+6) 8

where the net immediate position is the sum of the positive and negative entries under "Securities and Financing Positions" and the offset portion is the lesser of the absolute values of the positive and negative entries under "Securities and Financing Positions."

Example (2). On October 31, 1986 firm A's proprietary position contains, in addition to the positions given in Example 1, a long position of Treasury bills due September 3,

1987 with a market value of \$50 million. This bill position has been financed by a \$50 million repurchase agreement terminating on August 14, 1987. The firm would enter these holdings on schedule B, "Calculation of Net Immediate Positions in Securities and Financings", in row D (9-18 month maturity category for conventional securities) as follows:

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
D 9-18 mn.		-50	+50		+50	-50	+50	0
Column No.	1	2	3	4	(1+3) 5	(2+4) 6	7	(5+6) 8

where the net immediate position is the sum of the positive and negative entries under "Securities and Financing Positions" and the offset portion is the lesser of the absolute values of the positive and negative entries under "Securities and Financing Positions."

Example (3). On October 31, 1986 firm A's proprietary position contains, in addition to the positions given in Examples 1 and 2, a long position in commercial paper which has received a rating in one of their three highest

categories from two nationally recognized statistical rating organizations and has a market value of \$70 million, and a long position in a Eurodollar certificate of deposit with a market value of \$80 million. The commercial paper matures on January 30, 1987, and the Eurodollar CD matures on

¹ Because Schedule A can only be filled out after the haircut calculations are completed, it is located in the last of these examples.

February 13, 1987. The firm's proprietary position also contains short positions in a Treasury bill maturing on November 28, 1986 with a market value of \$100 million, a domestic negotiable certificate of deposit maturing on March 31, 1987 with a market value of \$90 million, and commercial paper which has not received a rating in one of their three highest categories from at least two nationally recognized statistical rating

organizations. This commercial paper has a market value of \$40 million and matures on May 15, 1987. The firm would enter the holdings of the Treasury bill, the highly-rated commercial paper, and the domestic and Eurodollar CDs on Schedule B, "Calculation of Net Immediate Positions in Securities and Financings", in rows A, B, and C (0-44 day, 45-134 day, and 135 day-9 month maturity categories for conventional securities), as follows:

values of the positive and negative entries under "Securities and Financing Positions." The \$40 million position in commercial paper which is not rated in one of their three highest categories by at least two rating agencies is not entered on this schedule because it is not a qualified money market instrument. The haircut on this position should be calculated as specified by the Security and Exchange Commission's Rule 15c3-1 and entered on Schedule A under "Other securities (use SEC factors)."

Example (4). On October 31, 1986 firm A's proprietary position contains, in addition to the positions given in Examples 1 and 3, long positions in a coupon stripped from a U.S. Treasury bond through the STRIPS program and due November 15, 1995 with a market value of \$50 million, and a coupon physically stripped from a Treasury security in bearer form due November 15, 1988 with a market value of \$15 million. It also contains a short position in a receipt based on a single coupon or principal payment from a Treasury security. The payment is due on November 15, 2001 and has a market value of \$45 million. The firm would enter these holdings of zero-coupon securities on schedule B, "Calculation of Net Immediate Positions in Securities and Financings", in rows H, E, and I (9-12 year, 1.5-3 year, and 12-21 year maturity categories for zero-coupon instruments), respectively, as follows:

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
A 0-44 days.....				-100	0	-100	0	-100
B 45-134 days.....			+150		+150	0	0	+150
C 135 days-9 mn.....				-90	0	-90	0	-90
Column No.....	1	2	3	4	5	6	7	8

where the net immediate position is the sum of the positive and negative entries under

"Securities and Financing Positions" and the offset portion is the lesser of the absolute

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
E 1.5-3.5 yr. (1.5-3 yr.).....					+15	0	0	+15
H 15-30 yr. (9-12 yr.).....					+50	0	0	+50
I (12-21 yr.).....				-45	0	-45	0	-45
Column No.....	1	2	3	4	5	6	7	8

where the net immediate position is the sum of the positive and negative entries under "Securities and Financing Positions" and the offset portion is the lesser of the absolute values of the positive and negative entries under "Securities and Financing Positions."

Example (5). On October 31, 1986 firm A's

proprietary position contains, in addition to the positions given in Examples 1 through 4, a long position in FNMA mortgage-backed securities with a market value of \$30 million, and a short position in GNMA I adjustable rate mortgage-backed securities with a market value of \$20 million. The firm would

enter these holdings of mortgage-backed securities on schedule B, "Calculation of Net Immediate Positions in Securities and Financings", in the rows marked MB and AR (the categories for mortgage-backed and adjustable rate mortgage-backed securities), respectively, as follows:

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
MB mortgage-backed.....			+30		+30	0	0	+30
AR adjustable rate mortgage backed.....				-20	0	-20	0	-20
					(1+3)	(2+4)		(5+6)

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS—Continued

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
Column No.....	1	2	3	4	5	6	7	8

where the net immediate position is the sum of the positive and negative entries under "Securities and Financing Positions" and the offset portion is the lesser of the absolute values of the positive and negative entries under "Securities and Financing Positions."
 Example (6). On October 31, 1986 firm A's proprietary position contains, in addition to

the positions given in Examples 1 through 5, a short position in the Treasury bond due November 15, 1998 with a market value of \$30 million. The firm has partially financed the short position by borrowing \$25 million of the bonds (market value). The borrowing arrangement will terminate on April 30, 1987. The firm would enter this short position and

its financing on schedule B, "Calculation of Net Immediate Positions in Securities and Financings", in rows G and C (7.5-15 year and 4.5-9 month maturity categories for conventional securities), respectively, as follows:

SCHEDULE B.—CALCULATION OF NET IMMEDIATE POSITIONS IN SECURITIES AND FINANCINGS

[In millions of dollars]

Maturity category	Financings		Securities positions		Total securities and financing positions		Offset portions (+)	Net immediate positions (+/-)
	Long (+)	Short (-)	Long (+)	Short (-)	(+)	(-)		
C 135 days-9 mn.....	+25			-90	+25	-90	+25	-65
G 7.5-15 yr. (5.5-9 yr.).....				-30	0	-30	0	-30
Column No.....	1	2	3	4	(1+3) 5	(2+4) 6	7	(5+6) 8

where the net immediate position is the sum of the positive and negative entries under "Securities and Financing Positions" and the offset portion is the lesser of the absolute values of the positive and negative entries under "Securities and Financing Positions." The financing in category C is combined with the short position entered in category C in Example 3 to calculate the net immediate position of -\$65 million.

Schedule C

Example (7). To calculate the net

immediate position interim haircuts and the government's offset portion haircuts on the positions given in Examples 1 through 6, the offset portions and the net immediate positions are carried to Schedule C and entered in columns 7 and 8 in their respective maturity categories. The government's offset portion haircuts are determined by taking the percentage of the government's offset portions given by the corresponding government's offset portion factor. The government's offset portion haircut for

maturity category C is \$25 million x 0.08% = \$0.02 million, or \$20 thousand. The net immediate position interim haircuts are determined by taking the percentage of the net immediate positions indicated by the corresponding net immediate position factor. The net immediate position interim haircut for maturity category C is -\$65 million x 0.20% = -\$0.13 million, or -\$130 thousand. The completed Schedule C, "Governments Portion and Net Immediate Position Interim Haircuts Calculation," read as follows:

SCHEDULE C.—GOVERNMENT'S OFFSET PORTION AND NET IMMEDIATE POSITION INTERIM HAIRCUTS CALCULATION

[Dollar amounts in millions]

Maturity category	Government's offset portions			Net immediate positions		
	Amounts (+)	Factors (percent)	Haircuts (+)	Amounts (+/-)	Factors (percent)	Interim haircuts (+/-)
A 0-44 days.....	0	None	0.0000	-100	None	0.0000
B 45-134 days.....	0	0.05	0.0000	+150	0.12	+\$0.1800
C 135 days-9 mn.....	\$25	0.08	\$0.0200	-65	0.20	-\$0.1300
D 9-18 mn.....	50	0.20	0.1000	0	0.45	0.0000
E 1.5-3.5 yr. (1.5-3 yr.).....	0	0.50	0.0000	+15	1.10	+0.1650
F 3.5-7.5 yr. (3-5.5 yr.).....	20	0.45	0.0900	-10	2.20	-\$0.2200
G 7.5-15 yr. (5.5-9 yr.).....	0	0.90	0.0000	-30	3.30	-\$0.9900
H 15-30 yr. (9-12 yr.).....	0	1.55	0.0000	+50	5.00	+2.5000
I (12-21 yr.).....	0	1.50	0.0000	-45	7.75	-\$3.4875
J (over 21 yr.).....	0	2.10	0.0000	0	11.25	0.0000

SCHEDULE C.—GOVERNMENT'S OFFSET PORTION AND NET IMMEDIATE POSITION INTERIM HAIRCUTS CALCULATION—Continued

[Dollar amounts in millions]

Maturity category	Government's offset portions			Net immediate positions		
	Amounts (+)	Factors (percent)	Haircuts (+)	Amounts (+/-)	Factors (percent)	Interim haircuts (+/-)
MB mortgage-backed security.....	0	0.90	0.0000	+30	3.30	+0.9900
AR adjustable rate mortgage-backed security	0	0.50	0.0000	-20	1.10	-0.2200
Total Government's offset portion haircut			0.2100			
Column No.....	7	9	10	8	11	12

Schedule D

Example (8). On October 31, 1986 firm A's proprietary position contains, in addition to the immediate positions given in Examples 1 through 6, a short position in forward contracts in CNMA I mortgage-backed securities with a market value of \$5 million.

The forward contracts mature January 15, 1987. The gross futures and forward interim haircut would be calculated by taking the negative of 3.30% (the net position haircut factor for mortgage-backed securities) of the market value of the position, \$5 million x 3.30% = \$0.1650 million, or -\$165 thousand.

This haircut is then entered on Schedule D, "Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts," in the row marked MB (the category for mortgage-backed securities), as follows:

SCHEDULE D.—CONSOLIDATION OF NET IMMEDIATE POSITION INTERIM HAIRCUTS WITH GROSS FUTURES AND OPTIONS INTERIM HAIRCUTS

[Dollar amounts in millions]

Maturity category	Net immediate position interim haircuts (+/-)	Gross interim haircuts				Aggregate interim haircuts		Futures and options offset portions (+)	Residual position interim haircuts (+/-)
		Futures and forward		Options		(+)	(-)		
		(+)	(-)	(+)	(-)				
MB mortgage backed securities.....	+\$990.0		-\$165.0			\$990.0	-\$165.0	\$165.0	+\$825.0
Column No.....	12	13	14	15	16	17	18	19	20

where the positive aggregate interim haircut is the sum of all positive net immediate position, gross futures and forward, and gross options interim haircuts in category MB, and the negative aggregate interim haircut is the sum of all negative net immediate position, gross futures and forward, and gross options interim haircuts in category MB. The futures and options offset portion (column 19) is the smaller of the absolute values and the positive and negative aggregate interim haircuts, and the residual position interim haircut (column 20) is the sum of the positive

and negative aggregate interim haircuts. The net immediate position interim haircut is carried over from column 12 of Schedule C. Example (9). On October 31, 1986 firm A's proprietary position contains, in addition to the positions given in Examples 1 through 8, a long position of 25 futures contracts on Treasury bills with a closing price of 94.88. The futures contracts mature in March 1987. The market value of the 25 contracts is \$24.68 million. The gross futures and forward interim haircut is calculated by taking 0.12% (the net position haircut factor for maturity

category B, 45-135 days) of the market value of the position, \$24.68 million x 0.12% = \$0.296 million, or \$29.6 thousand. Since the sum of the remaining time to maturity of the futures contract and the maturity of the underlying security is about 7.5 months, this haircut is entered in row C (4.5-9 month maturity category for conventional securities) of Schedule D, "Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts," as follows:

SCHEDULE D.—CONSOLIDATION OF NET IMMEDIATE POSITION INTERIM HAIRCUTS WITH GROSS FUTURES AND OPTIONS INTERIM HAIRCUTS

[Dollar amounts in millions]

Maturity category	Net immediate position interim haircuts (+/-)	Gross interim haircuts				Aggregate interim haircuts		Futures and options offset portions (+)	Residual position interim haircuts (+/-)
		Futures and forward		Options		(+)	(-)		
		(+)	(-)	(+)	(-)				
C 135 days-9 mn.....	-\$130.0	+\$29.6				+\$29.6	-\$139.0	\$29.6	-\$100.4
Column N.....	12	13	14	15	16	17	18	19	20

where the positive aggregate interim haircut is the sum of all positive net immediate position, gross futures and forward, and gross options interim haircuts in category C, and the negative aggregate interim haircut is the sum of all negative net immediate position, gross futures and forward, and gross options interim haircuts in category C. The futures and options offset portion (column 19) is the smaller of the absolute values and the positive and negative aggregate interim haircuts, and the residual position interim haircut (column 20) is the sum of the positive and negative aggregate interim haircuts. The net immediate position interim haircut is carried over from column 12 of Schedule C.

Example (10). On October 31, 1986 firm A's proprietary position contains, in addition to the positions given in Examples 1 through 9, 25 purchased put option contracts on Treasury bill futures. The options expire in March 1987 and have an exercise price of 94.75. The closing premium on these options

for October 31 is \$0.19. The interim haircut on a purchased put is the lesser of the market value of the option contracts or the gross futures and forward interim haircut on the underlying bill futures contracts. The market value of the option contracts is found by multiplying the premium per \$100 par value times the total par value of the underlying futures contracts, $(\$0.19/\$100) \times \$25 \text{ million} = \0.475 million , or \$47.5 thousand. The gross futures and forward interim haircut on the underlying futures contract was calculated in Example 9 to be \$29.6 thousand. The interim haircut on these purchased puts is equal to the negative of the lesser of these two values, -\$29.6 thousand. This haircut is entered as follows on Schedule D, "Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts," in row C (4.5-9 month maturity category for conventional securities) as were the underlying bill futures contracts:

SCHEDULE D.—CONSOLIDATION OF NET IMMEDIATE POSITION INTERIM HAIRCUTS WITH GROSS FUTURES AND OPTIONS INTERIM HAIRCUTS

[In thousands of dollars]

Maturity category	Net immediate position interim haircuts (+/-)	Gross interim haircuts				Aggregate interim haircuts		Futures options offset portions (+)	Residual position interim haircuts (+/-)
		Futures & forward		Options		(+)	(-)		
		(+)	(-)	(+)	(-)				
C 135 days-9 mn.....	-130.0	+29.6			-29.6	+29.6	-159.6	29.6	-130.0
Column No.....	12	13	14	15	16	17	18	19	20

where the positive aggregate interim haircut is the sum of all positive net immediate position, gross futures and forward, and gross options interim haircuts in category C, and the negative aggregate interim haircut is the sum of all negative net immediate position, gross futures and forward, and gross options interim haircut in category C. The futures and options offset portion (column 19) is the smaller of the absolute values of the positive and negative aggregate interim haircuts, and the residual position interim haircut (column 20) is the sum of the positive and negative aggregate interim haircuts. The net immediate position interim haircut is carried over from column 12 of Schedule C.

Example (11). On October 31, 1986 firm A's proprietary position contains, in addition to the positions given in Examples 1 through 10, 40 purchased call option contracts on Treasury bonds due May 2016. The call options expire in December 1987 and have an exercise price of \$94. The cash price of the bond is \$95.78125. The closing premium on these options for October 31 is \$2.18 (in

64ths). The interim haircut on a purchased call is the lesser of the market value of the option contracts or the net immediate position interim haircut on the underlying bonds. The market value of the option contracts is found by multiplying the premium per \$100 par value of the bond times the total par value of the underlying bonds $(\$2.28125/\$100) \times \$4 \text{ million} = \0.09125 million , or \$91.250 thousand. The net immediate position interim haircut on the underlying bonds is found by taking 5.00% (the net position haircut factor for maturity category H, 15-30 years for conventional securities) of the market value of the position, $5.00\% \times 40 \times \$95.78125/\$100 = \191.6 thousand . The interim haircut on these purchased calls is equal to the lesser of these two values, \$91.3 thousand. This haircut is entered on Schedule D, "Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts," in row H (15-30 year maturity category for conventional securities), as follows:

SCHEDULE D.—CONSOLIDATION OF NET IMMEDIATE POSITION INTERIM HAIRCUTS WITH GROSS FUTURES AND OPTIONS INTERIM HAIRCUTS

[In thousands of dollars]

Maturity category	Net immediate position interim haircuts (+/-)	Gross interim haircuts				Aggregate interim haircuts		Futures & options offset portions (+)	Residual position interim haircuts (+/-)
		Futures & forward		Options		(+)	(-)		
		(+)	(-)	(+)	(-)				
H 15-30 yr. (9-12 yr.).....	+2,500.0			+91.3		+2,591.3	0.0	0.0	+2,591.3
Column No.....	12	13	14	15	16	17	18	19	20

where the positive aggregate interim haircut is the sum of all positive net immediate position, gross futures and forward, and gross options interim haircuts in category H, and the negative aggregate interim haircut is the sum of all negative net immediate position, gross futures and forward, and gross options interim haircuts in category H. The futures and options offset portion (column 19) is the smaller of the absolute values of the positive and negative aggregate interim haircuts, and the residual position interim haircut (column 20) is the sum of the positive and negative aggregate interim haircuts. The net immediate position interim haircut is carried over from column 12 of Schedule C.

Example (12). To calculate the total futures and options offset haircut, the futures and options offset haircut factor of 20 per cent is multiplied by the sum of all the futures and options offset portions, which have been entered in column 19. This calculation would be entered on Schedule D, "Consolidation of Net Immediate Position Interim Haircuts with Gross Futures and Options Interim Haircuts," as follows:

SCHEDULE D.—CONSOLIDATION OF NET IMMEDIATE POSITION INTERIM HAIRCUTS WITH GROSS FUTURES AND OPTIONS INTERIM HAIRCUTS

[In thousands of dollars]

Maturity category	Futures & options offset portions (+)	Residual position interim haircuts (+/-)
A 0-44 days.....	0.0	0.0
B 45-134 days	0.0	+180.0
C 135 days-9 mn.....	29.6	-130.0
D 9-18 mn	0.0	0.0
E 1.5-3.5 yr. (1.5-3 yr.).....	0.0	+165.0
F 3.5-7.5 yr. (3-5.5 yr.).....	0.0	-220.0
G 7.5-15 yr (5.5-9 yr.).....	0.0	-990.0
H 15-30 yr. (9-12 yr.)..	0.0	+2,591.3
I (12-21 yr.).....	0.0	-3,487.5
J (over 21 yr.).....	0.0	0.0
MB mortgage-backed security.....	165.0	+825.0

SCHEDULE D.—CONSOLIDATION OF NET IMMEDIATE POSITION INTERIM HAIRCUTS WITH GROSS FUTURES AND OPTIONS INTERIM HAIRCUTS—Continued

[In thousands of dollars]

Maturity category	Futures & options offset portions (+)	Residual position interim haircuts (+/-)
AR adjustable rate mortgage-backed	0.0	-220.0
Total futures and options offset portion	194.6	
Factor (percent)	×20	
Total futures and options offset haircut	38.92	
Column No.....	19	20

Schedule E

Example (13). [i] Schedule E is used to calculate the hedging disallowance haircuts, the net residual position interim haircuts, the total hedging disallowance haircut, and the residual net position haircut. The residual position interim haircut for each category is carried forward from Schedule D, column 20 to Schedule E, column 20. For firm A's positions given in Examples 1 through 11, categories E and F, with residual position interim haircuts of +\$165.0 thousand and -\$220.0 thousand, are first offset, leaving a net residual position interim haircut of -\$55.0 thousand (+\$165.0 thousand + -\$220.0 thousand) in category F and a hedging disallowance haircut of \$33.0 thousand in category E (20% × \$165.0 thousand = \$33.0 thousand). The second offset is between categories G and H, with residual position interim haircuts of -\$990.0 thousand and +\$2,591.3 thousand, leaving a net residual position interim haircut of +\$1,601.3 thousand in category H and a hedging disallowance haircut of \$198 thousand in category G. The result of these calculations would be recorded in rows E, F, G, and H of the 20 per cent disallowance

category of Schedule E, "Calculation of Hedging Disallowance Haircuts When Netting Haircuts Across Categories," as follows:

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES

[In thousands of dollars]

Maturity category	Residual position interim haircuts (+/-)	20% disallowance	
		Hedging disallowance haircuts (+)	Net residual position interim haircuts (+/-)
E 1.5-3.5 yr. (1.5-3 yr.).....	+165.0	33.0	0.0
F 3.5-7.5 yr. (3-5.5 yr.).....	-220.0	0.0	-55.0
G 7.5-15 yr. (5.9-9 yr.)..	-990.0	198.0	0.0
H 15-30 yr. (9-12 yr.)...	+2,591.3	0.0	+1,601.3
Column No...	20	21	22

[ii] With completion of offsetting of category pairs between which 20% hedging disallowance is permitted, categories between which 30% hedging disallowance is permitted are offset. Of the permissible category pairings at the 30% disallowance level, only categories B and C contain residual position interim haircuts or net residual position interim haircuts which can be offset. Category B's residual position interim haircut of +\$180 thousand is offset against category C's residual position interim haircut of -\$130 thousand, leaving a net residual position interim haircut of +\$50 thousand in category B and a hedging disallowance haircut of \$39 thousand in category C. The results of this calculation would be shown in rows B and C of Schedule E, "Calculation of Hedging Disallowance Haircuts when Netting Haircuts across Categories," as follows:

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES

[In thousands of dollars]

Maturity category	Residual position interim haircuts (+/-)	20% disallowance	
		Hedging disallowance haircuts (+)	Net residual position interim haircuts (+/-)
B 45-134 days	+180.0	0.0	+50.0
C 135 days-9 mn.....	-130.0	39.0	0.0

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES—Continued

[In thousands of dollars]

Maturity category	Residual position interim haircuts (+/-)	20% disallowance	
		Hedging disallowance haircuts (+)	Net residual position interim haircuts (+/-)
Column No.....	20	23	24

[iii] Of the permissible category pairings at the 40% disallowance level, categories F and MB contain residual position interim haircuts

or net residual position interim haircuts which can be offset. Category F's net residual interim position haircut of -\$55 thousand is offset against category MB's residual position interim haircut of +\$825 thousand, leaving a net residual position interim haircut of +\$770 thousand in category MB and a hedging disallowance haircut of \$22 thousand in category F. The second offset at the 40% level is between categories H and I, where the net residual position interim haircut of +\$1,601.3 thousand in category H is offset against the residual position interim haircut of -\$3,487.5 thousand in category I, leaving a net residual position interim haircut of -\$1,886.2 thousand in category I and a hedging disallowance haircut of \$640.5 thousand in category H. The results of these calculations would be shown in rows F, H, I, and MB of Schedule E, "Calculation of Hedging Disallowance Haircuts When Netting Haircuts Across Categories," as follows:

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES

[In thousands of dollars]

Maturity category	Residual position interim haircuts (+/-)	20% disallowance—Net Position Interim Haircuts (+/-)	40% disallowance	
			Hedging disallowance haircuts (+)	Net residual position interim haircuts (+/-)
F 3.5-7.5 yr. (3-5.5 yrs.)	-220.0	-55.0	22.0	0.0
H 15-30 yr. (9-12 yr.)	+2,591.3	+1,601.3	640.5	0.0
I (12-21 yr.)	-3,487.5	0.0	0.0	-1,886.2
MB mortgage backed security	+825.0	0.0	0.0	+770.0
Column No.	20	22	25	26

[iv] Calculation of the total hedging disallowance haircut and the residual net position haircut is shown in Schedule E in the last two columns, "Hedging Disallowance Haircuts" and "Qualified Netting Interim Haircuts," where the hedging disallowance haircut and the qualified netting interim haircut for each category are entered as follows:

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES

[In thousands of dollars]

Maturity category	Hedging disallowance haircuts	Qualified netting interim haircuts
	(+)	(+)
A 0-44 days	0.0	0.0
B 45-134 days	0.0	50.0
C 135 days-9 mn	39.0	0.0

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES—Continued

[In thousands of dollars]

Maturity category	Hedging disallowance haircuts	Qualified netting interim haircuts
	(+)	(+)
D 9-18 mn	0.0	0.0
E 1.5-3.5 yr.	33.0	0.0
(1.5-3 yr.)		
F 3.5-7.5 yr.	22.0	0.0
(3-5.5 yr.)		
G 7.5-15 yr.	198.0	0.0
(5.5-9 yr.)		
H 15-30 yr.	640.5	0.0
(9-12 yr.)		
I (12-21 yr.)	0.0	1,886.2
J (over 21 yr.)	0.0	0.0
MB mortgage-backed security	0.0	770.0

SCHEDULE E.—CALCULATION OF HEDGING DISALLOWANCE HAIRCUTS WHEN NETTING HAIRCUTS ACROSS CATEGORIES—Continued

[In thousands of dollars]

Maturity category	Hedging disallowance haircuts	Qualified netting interim haircuts
	(+)	(+)
AR adjustable rate mortgage-backed	0.0	220.0
Total hedging disallowance haircut	932.5	
Residual net position haircut		2,926.2
Column No	27	28

Schedule A

Example (14). On Schedule A, haircuts from Schedules C through E and liquid capital are entered, and the capital-to-risk ratio is calculated. On October 31, 1986, Firm A has total ownership equity of \$10,185.8 thousand and subordinated liabilities of \$2,000.0 thousand, of which \$800.3 thousand are non-allowable, or illiquid, assets. These amounts with various deductions and credits give firm A a liquid capital of \$11,335.7 thousand. With one of its customers, who is not firm A's principal clearing bank or clearing broker, firm A has a net credit exposure of \$1,780.4 thousand. This is in excess of 15 percent of firm A's liquid capital of \$11,335.7 thousand, so a concentration of credit haircut of \$20 thousand is found by multiplying the excess, \$80 thousand, by 25 percent. A credit volatility haircut of \$225 thousand is found by multiplying the larger of the qualifying long or short money market positions, \$150 million, by 0.15 percent. Since the \$40 million commercial paper position is rated in one of the four highest rating categories by two nationally recognized statistical rating organizations, it has a haircut of 2% x \$40 million = \$800 thousand according to SEC Rule 15c3-1. The haircuts and the elements making up liquid capital are entered on Schedule A, "Liquid Capital Requirement Summary Computation," as follows:

SCHEDULE A.—LIQUID CAPITAL REQUIREMENT SUMMARY COMPUTATION

[In thousands of dollars]

1. Liquid capital ¹	11,335.7
2. Haircuts on security and financing positions including contractual commitments:	
a. Total governments offset portion haircut (Schedule C)....	210.0
b. Total futures and options offset haircut (Schedule D).....	38.9
c. Total hedging disallowance haircut (Schedule E).....	932.5
d. Residual net position haircut (Schedule E).....	2,926.2
e. Other securities haircut (use SEC factors).....	800.0
3. Haircuts on credit exposure:	
a. Concentration of credit haircut.....	20.0
b. Credit volatility haircut	225.0
4. Total haircuts (lines 2+3).....	5,152.6
5. Capital-to-risk ratio (line 1/line 4)	2.2:1

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

A completed set of the remaining schedules, using firm A's positions from the examples above, follows.

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Schedule B

Calculation of Net Immediate Positions in
Securities and Financings
(\$ millions)

Maturity Category 1/	Financings		Securities Positions		Total Securities and Financing Positions		Offset Portions (+)	Net Immediate Positions (+/-)	
	Long 2/ (+)	Short 2/ (-)	Long (+)	Short (-)	(+)	(-)			
A 0-44 days				-100	0	-100	0	-100	A
B 45-134 days			+150		+150	0	0	+150	B
C 135 days- 9 months	+25			-90	+25	-90	+25	-65	C
D 9-18 months		-50	+50		+50	-50	+50	0	D
E 1.5-3.5 years (1.5-3 years)			+15		+15	0	0	+15	E
F 3.5-7.5 years (3-5.5 years)			+20	-30	+20	-30	+20	-10	F
G 7.5-15 years (5.5-9 years)				-30	0	-30	0	-30	G
H 15-30 years (9-12 years)			+50		+50	0	0	+50	H
I (12-21 years)				-45	0	-45	0	-45	I
J (21 years and over)									J
MB mortgage-backed			+30		+30	0	0	+30	MB
AR adjustable rate mortgage-backed				-20	0	-20	0	-20	AR
Column Number	1	2	3	4	5 (1+3)	6 (2+4)	7# (Note 1)	8# (5+6)	

Carry forward to Schedule C.

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

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

Schedule C

Governments Offset Portion and Net Immediate
Position Interim Haircuts Calculation
(\$ millions)

Maturity Category 1/	Governments Offset Portion			Net Immediate Positions		
	\$ Amounts (+)	Factors	Haircuts (+)	\$ Amounts (+/-)	Factors	Interim Haircuts (+/-)
A	0	None	0.0000	-100	None	0.0000
B	0	0.0005	0.0000	+150	0.0012	+0.1800
C	25	0.0008	0.0200	-65	0.0020	-0.1300
D	50	0.0020	0.1000	0	0.0045	0.0000
E	0	0.0050	0.0000	+15	0.0110	+0.1650
F	20	0.0045	0.0900	-10	0.0220	-0.2200
G	0	0.0090	0.0000	-30	0.0330	-0.9900
H	0	0.0155	0.0000	+50	0.0500	+2.5000
I	0	0.0150	0.0000	-45	0.0775	-3.4875
J	0	0.0210	0.0000	0	0.1125	0.0000
MB	0	0.0090	0.0000	+30	0.0330	+0.9900
AR	0	0.0050	0.0000	-20	0.0110	-0.2200
Total Governments Offset Portion Haircut				\$ 0.2100		
Column Number	7 (Note 1)	9	10# (7x9)	8 (Note 1)	11	12## (8x11)

Carry to Schedule A, line 2a

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

Note 1: From Schedule B.

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

Schedule D

Consolidation of Net Immediate Position Interim Haircuts
with Gross Futures and Options Interim Haircuts
(\$ thousands)

Maturity Category 1/	Net Immediate Position Interim Haircuts (+/-)	Gross Interim Haircuts				Aggregate Interim Haircuts		Futures & Options Offset Portions 2/ (+)	Residual Position Interim Haircuts (+/-)	
		Futures & Forward (+)	(-)	Options (+)	(-)	(+)	(-)			
B 45-134 days	+180.0								+180.0	B
C 135 days-9 months	-130.0	+29.6				+29.6	-159.6	29.6	-130.0	C
D 9-18 months	0.0								0.0	D
E 1.5-3.5 years (1.5-3 years)	+165.0								+165.0	E
F 3.5-7.5 years (3-5.5 years)	-220.0								-220.0	F
G 7.5-15 years (5.5-9 years)	-990.0								-990.0	G
H 15-30 years (9-12 years)	+2500.0		+91.3			+2591.3	0.0	0.0	+2,591.3	H
I (12-21 years)	-3487.5								-3,487.5	I
J (21 years and over)	0.0								0.0	J
MB mortgage-backed	+990.0		-165.0			990.0	-165.0	165.0	+825.0	MB
AR adjustable rate mortgage-backed	-220.0								-220.0	AR
								Total Futures and Options Offset Portion:	\$ 194.6	
								Factor:	x20%	
								Total Futures and Options Offset Haircut:	\$ 38.92	#
Column Number	12 (Note 1)	13	14	15	16	17	18	19 (Note 2)	20##	

Carry to Schedule A, line 2b.
Carry forward to Schedule E.

Note 1: From Schedule C.

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

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

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

Schedule E

Calculation of Hedging Disallowance Haircuts
when Netting Haircuts Across Categories 1/
(\$ thousands)

Maturity Category 2/	Residual Position Interim Haircuts (+/-)	20% Disallowance Net		30% Disallowance Net		40% Disallowance Net		Hedging Disallow- ance Haircuts (+)	Qualified Netting Interim Haircuts (+)	
		Hedging Disallow- ance Haircuts (+)	Residual Position Interim Haircuts (+/-)	Hedging Disallow- ance Haircuts (+)	Residual Position Interim Haircuts (+/-)	Hedging Disallow- ance Haircuts (+)	Residual Position Interim Haircuts (+/-)			
B 45-134 days	+180.0			0.0	+50.0			0.0	50.0	B
C 135 days- 9 months	-130.0			39.0	0.0			39.0	0.0	C
D 9-18 months	0.0							0.0	0.0	D
E 1.5-3.5 years (1.5-3 years)	+165.0	33.0	0.0					33.0	0.0	E
F 3.5-7.5 years (3-5.5 years)	-220.0	0.0	-55.0			22.0	0.0	22.0	0.0	F
G 7.5-15 years (5.5-9 years)	-990.0	198.0	0.0					198.0	0.0	G
H 15-30 years (9-12 years)	+2,591.3	0.0	+1,601.3			640.5	0.0	640.5	0.0	H
I (12-21 years)	-3,487.5					0.0	-1,886.2	0.0	1,886.2	I
J (21 years and over)	0.0							0.0	0.0	J
MB mortgage-backed	+825.0					0.0	+770.0	0.0	770.0	MB
AR adjustable rate mortgage-backed	-220.0							0.0	220.0	AR
								Total Hedging Disallowance Haircut:\$ 932.5		
								Residual Net Position Haircut:\$ 2,926.2		

Column Number	20 (Note 1)	21	22 (Note 2)	23	24 (Note 2)	25	26 (Note 2)	27# (Note 3)	28##
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Column 27 carries forward to Schedule A, line 2c.

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

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

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

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

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

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

List of subjects in 17 CFR Chapter IV

Accounting, Accountants, Banks, banking, Brokers, Credit unions, Dealers, Federal home loan banks, Government securities, Government securities brokers and dealers, Investments, National banks, Savings and loan associations, Securities.

For the reasons set out in the preamble, Chapter IV of Title 17, *Code of Federal Regulations*, is proposed to be added as set forth below.

CHAPTER IV—REGULATIONS UNDER THE GOVERNMENT SECURITIES ACT OF 1986**SUBCHAPTER A—REGULATIONS UNDER SECTION 15C OF THE SECURITIES EXCHANGE ACT OF 1934****Part**

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

SUBCHAPTER B—REGULATIONS UNDER TITLE II OF THE GOVERNMENT SECURITIES ACT OF 1986**Part**

- 450—Custodial Holdings of Government Securities by Depository Institutions

SUBCHAPTER A—REGULATIONS UNDER SECTION 15C OF THE SECURITIES EXCHANGE ACT OF 1934**PART 400—RULES OF GENERAL APPLICATION****Sec.**

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

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

§ 400.1 Scope of regulations.

(a) Title I of the Government Securities Act of 1986 (Pub. L. 99-571, 100 Stat. 3208) amends the Securities Exchange Act of 1934 (48 Stat. 881-905; 15 U.S.C. chapter 2B) ("Act") by adding section 15C, authorizing the Secretary of the Treasury to promulgate regulations concerning the financial responsibility, protection of customer securities and

balances, recordkeeping and reporting of brokers and dealers in government securities. Those regulations constitute subchapter A of this chapter. Unless otherwise explicitly provided, all regulations in this subchapter apply to all government securities brokers or dealers, including registered brokers or dealers and financial institutions.

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

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

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

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

(a) The regulations in this chapter are promulgated by the Assistant Secretary (Domestic Finance) pursuant to a delegation of authority from the Secretary of the Treasury. The office responsible for the regulations is the Office of the Deputy Assistant Secretary (Federal Finance).

(b)(1) Section 15C(a)(4) of the Act (15 U.S.C. 78o-5(a)(4)) authorizes the Secretary to exempt any government securities broker or dealer or class thereof from the requirements of registration or regulations promulgated under section 15C. In addition, section 15C(b)(3) of the Act (15 U.S.C. 78o5(b)(3)) provides for classification, by the Secretary, of government securities brokers or dealers and

authorizes the whole or partial exemption of classes from rules under section 15C or the application of different standards to different classes.

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

(c) Correspondence with the Treasury concerning the regulations, including any request for exemption, should be directed to the Deputy Assistant Secretary (Federal Finance), Department of the Treasury, Main Treasury Building, Washington, D.C. 20220. Both the envelope and the document should prominently state "Government Securities Act Request". Three copies should be provided of lengthy documents and exhibits.

§ 400.3 Definitions.

Unless otherwise explicitly provided, in this subchapter:

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

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

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

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

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

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

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

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

(i) "Registered broker or dealer" means a broker or dealer registered pursuant to section 15 or section 15B of the Act (15 U.S.C. 78o, 78o-4);

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

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

(l) "Treasury" or "Department" means the Department of the Treasury.

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

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

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

(c) For the purpose of verifying the information furnished by an associated person pursuant to paragraph (a) of this

rule, every government securities broker or dealer that is a financial institution shall make inquiry of all other employers of such associated person during the immediately preceding three years concerning the accuracy and completeness of such information.

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

(1) Obtain and, within 10 days thereafter, file with the appropriate regulatory agency, in a form acceptable to such appropriate regulatory agency, the information required by paragraphs (a) and (b) of this section; and

(2) File with the appropriate regulatory agency within 30 days after the termination of the status of an individual as an associated person a Form G-FIN-5 (§ 449.4 of this chapter), unless the financial institution is required to and has filed a Form U-5 or Form MSD-5 with respect to such person.

(e)(1) For the purposes of this part, "associated person" means a person:

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

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

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

(C) Research or investment advice, other than general economic information or advice, with respect to government securities in connection with the activities described in paragraphs (e)(1)(A) and (e)(1)(B) of this section;

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

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

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

(B) Maintenance of records involving any of the activities described in this paragraph (e)(1).

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

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

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

(a) (1) If the information contained in any application for registration as a government securities broker or dealer (other than the statements required by § 250.15Ca2-2 of this title) or in any amendment thereto, becomes inaccurate for any reason, the registered government securities broker or dealer shall file within 30 days thereafter an amendment on Form BD (§ 249.501 of this title) correcting such information, in accordance with the instructions provided therein.

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

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

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

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

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

(b) Except as provided in paragraph (c) of this section, a notice that a financial institution has ceased to act as a government securities broker or dealer shall become effective for all purposes

on the 60th day after the filing thereof with the appropriate regulatory agency or within such shorter period of time as the appropriate regulatory agency determines.

(c) If the notice described in paragraph (a) of this section is filed with the appropriate regulatory agency any time after the date of the issuance of a notice or order by the appropriate regulatory agency instituting proceedings pursuant to section 15C(c)(2)(A) of the Act (15 U.S.C. § 780-5(c)(2)(A)) to censure, suspend, limit, or bar from acting as a government securities broker or government securities dealer the entity filing such notice, or if the appropriate regulatory agency has instituted any action against the entity filing such notice pursuant to section 15C(2)(B) of the Act (15 U.S.C. § 780-5(c)(2)(B)), the notice shall become effective pursuant to paragraph (b) of this section at such time and upon such terms and conditions as the appropriate regulatory agency deems necessary to appropriate in the public interest for the protection of investors.

(d) Every notice filed pursuant to this section shall constitute a "report" within the meaning of sections 15, 15C and 32(a) of the Act (15 U.S.C. 780, 780-5, 78ff(a)).

PART 401—EXEMPTIONS

Sec.

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

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

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

401.4 Exemption for financial institutions whose government securities dealer activities consist only of repurchase and limited reverse repurchase transactions.

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

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3209 (15 U.S.C. 780-5(a)(4)).

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

An organization that handles United States Savings Bond transactions, including a qualified issuing or paying agent or an organization that accommodates customers or employees by forwarding requested transactions to

qualified issuing or paying agents or the Treasury and whose transactions in government securities are limited to these transactions and such other activities that are exempted by the regulations under this subchapter, shall be exempt from the provisions of section 15C(a), (b) and (d) of the Act (15 U.S.C. 780-5(a), (b), (d)) and the regulations of this subchapter. For the purposes of this section, the term "United States Savings Bond" means any savings-type security offered by the Treasury, including all series of the United States Savings Bonds, United States Savings Notes and United States Savings Stamps.

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

(a) Subject to the requirements of paragraph (b) of this section, a depository institution that submits tenders or subscriptions for purchase on original issue of United States Treasury securities for the account of customers on a fully disclosed basis, whose transactions in government securities are limited to such transactions and such other activities as have been exempted by regulation under this subchapter shall be exempt from the provisions of section 15C(a), (b) and (d) of the Act (15 U.S.C. 780-5(a), (b), (d)) and the regulations of this subchapter.

(b) The exemption described in paragraph (a) of this section is available only to a depository institution that agrees to comply with the regulations of Part 450 of this chapter concerning custodial holdings of government securities.

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

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

(a)(1) Subject to the requirements of paragraph (b) of this section, a financial institution shall be exempt from the provisions of Sections 15C(a), (b) and (d)

of the Act (15 U.S.C. 780-5(a), (b), (d)) and the regulations of this subchapter, unless it acts as a government securities broker by:

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

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

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

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

(ii) Effects all such transactions (other than transactions described in §§ 401.1 or 401.2) pursuant to a contractual or other arrangement with a government securities broker or dealer that is registered pursuant to section 15C(a)(1)(A) of the Act (15 U.S.C. 780-5(a)(1)(A)) or that has filed notice of its status as a government securities broker or dealer pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 780-5(a)(1)(B)) (the "transacting government securities broker or dealer") under which the transacting government securities broker or dealer will offer securities services on or off the premises of the financial institution, provided that:

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

(B) Financial institution employees perform only clerical and ministerial functions in connection with government securities transactions unless such employees are associated persons (as defined in § 400.4(e) of this chapter) or registered representatives of the transacting government securities broker or dealer;

(C) Financial institution employees do not receive compensation for government securities activities other than clerical or ministerial functions unless such employees are associated persons (as defined in § 400.4(e) of this chapter) or registered representatives of the transacting government securities broker or dealer; and

(D) Such services are provided on a basis in which all customers are fully disclosed to the transacting government securities broker or dealer.

(b) The exemption described in paragraph (a) of this section is available only to a financial institution that agrees to comply with the regulations of Part 450 of this chapter concerning custodial holdings of government securities for customers.

(c) For the purposes of this section, "financial institution" includes a federal credit union, as defined in 12 U.S.C. 1752(1).

§ 401.4 Exemption for financial institutions whose government securities dealer activities consist only of repurchase and limited reverse repurchase transactions.

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

(1) Sales or purchases in a fiduciary capacity;

(2) The sale and subsequent repurchase of government securities pursuant to a repurchase agreement;

(3) Not more than 500 transactions per year involving the purchase and subsequent resale of government securities pursuant to a reverse repurchase agreement;

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

(b) The exemption described in paragraph (a) of this section is available only to a financial institution that agrees to comply with the regulations of Part 450 of this chapter concerning custodial holdings of government securities for customers.

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

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

(2) For the purposes of this section, "corporate credit union" means a credit union whose membership consists primarily of other credit unions and that is (i) a federal credit union as defined in 12 U.S.C. 1752(1), (ii) an insured credit

union as defined in 12 U.S.C. 1752(7), or (iii) a member of the National Credit Union Administration Central Liquidity Facility.

(b) The exemption described in paragraph (a) of this section is available only to a credit union that agrees to comply with the regulations of Part 450 of this chapter concerning custodial holdings of government securities.

PART 402—FINANCIAL RESPONSIBILITY

Sec.

402.1 Application of part to registered brokers and dealers and financial institutions; effective date.

402.2 Capital requirements for registered government securities brokers and dealers.

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

402.2b [Reserved]

402.2c Appendix C—Modification of § 240.15c3-1c of this title, relating to consolidated calculations of capital, for purposes of § 402.2.

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

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

§ 402.1 Application of part to registered brokers and dealers and financial institutions; effective date.

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

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

(c) *Financial institutions.* This part does not apply to a government securities broker or dealer that is a financial institution and that is subject to the rules and regulations of its appropriate regulatory agency concerning capital requirements.

(d) *Government securities interdealer brokers.* (1) A government securities interdealer broker, as defined in paragraph (d)(2) of this section, may elect not to be subject to the limitations of this Part 402 but rather to be subject to the requirements of § 240.15c3-1 of this title (SEC Rule 15c3-1) except paragraph (c)(2)(ix) thereof, and paragraphs (d)(3), (4), and (5) of this section by filing such election in writing with its designated examining authority. A government securities interdealer broker may not revoke such election without the written consent of its designated examining authority.

(2) "Government securities interdealer broker" means a government securities broker which acts exclusively as an undisclosed agent in the purchase or sale of government securities for a registered broker or dealer or government securities broker or dealer not exempt pursuant to Part 401 of this chapter, which has no "customers" as defined in § 240.15c3-1 of this title and which does not have or maintain any government securities in its proprietary or other accounts.

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

(4) For purposes of this paragraph (d), a government securities interdealer broker shall deduct from net worth $\frac{1}{4}$ of 1% of the contract value of each government securities failed-to-deliver contract which is outstanding 5 business days or longer. Such deduction shall be increased by any excess of the contract price of the failed-to-deliver over the market value of the underlying security.

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

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

(e) The Department may, upon written application, exempt from the provisions of this part, either unconditionally or on specified terms and conditions, any registered government securities broker or dealer who satisfies the Department that, because of the special nature of its

business, its financial position, and the safeguards it has established for the protection of customers' funds and securities, it is not necessary in the public interest or for the protection of investors to subject such government securities broker or dealer to the provisions of this part.

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

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

(2) Any other registered government securities broker or dealer has and maintains liquid capital, as defined in § 402.2(d), in an amount of not less than \$50,000.

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

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

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

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

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

(1) The percentages used to calculate the deductions for failed to deliver contracts when the underlying instrument is a Treasury market risk instrument as defined in paragraph (e) of this section are the appropriate haircut factors specified in paragraph (f)(2) of this section; and

(2) The deductions from net worth required by §§ 240.15c3-1(c)(2)(vi) and (c)(2)(viii) of this title and the

adjustments to net worth set forth in § 240.15c3-1a and § 240.15c3-1b of this title (Appendices A and B to SEC Rule 15c3-1) are omitted.

(e) *Treasury market risk instruments.*

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

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

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

(iii) Certificates of deposit of less than one year to maturity;

(iv) Bankers acceptances;

(v) Commercial paper of less than one year to maturity rated in one of the three highest categories by at least two nationally recognized statistical rating organizations;

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

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

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

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

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

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

Category	Haircut factors	
	Net position haircuts (percent)	Offsets (percent)
A	None	None
B	0.12	0.05
C	0.20	0.08
D	0.45	0.20
E	1.10	0.50
F	2.20	0.45
G	3.30	0.90
H	5.00	1.55
I	7.75	1.50
J	11.25	2.10
MB	3.30	0.90
AR	1.10	0.50

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

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

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

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

(i) *Total concentration of credit haircut.* The "total concentration of credit haircut" equals the sum of the concentration of credit haircuts taken for all counterparties, except for counterparties that are principal clearing banks or principal clearing brokers, of the government securities broker or dealer.

(A) *Concentration of credit haircut.* The "concentration of credit haircut" equals the product of a concentration of credit haircut factor of 25 percent the amount by which the net credit exposure to a single counterparty, except a counterparty that is a principal clearing bank or principal clearing broker of the government securities broker or dealer, is in excess of 15 percent of the government securities broker's or dealer's liquid capital.

(B) *Net credit exposure.* For purposes of this part, the "net credit exposure" equals the dollar amount of funds or debt instruments, other securities, and other inventory at risk to the government securities broker or dealer in the event of the counterparty's default, less the amount of funds or debt instruments, other securities, and other inventory risk to the counterparty in the event of the government securities broker's or dealer's default.

(ii) *Credit volatility haircut.* The "credit volatility haircut" equals the product of a credit volatility haircut factor of 0.15 percent and the dollar amount of the larger of the gross long position or gross short position in those Treasury market risk instruments described in paragraphs (e)(1) (iii), (iv) and (v) of this section that have a term to maturity greater than 45 days, and futures, forwards and options thereon, settled on a cash or delivery basis.

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

(h) *Debt-equity requirements.* No government securities broker or dealer shall permit the total of outstanding principal amounts of its satisfactory subordination agreements as defined in § 240.15c3-1d of this title (Appendix D to SEC Rule 15c3-1) modified as provided in Appendix D to this section, § 402.2d, to exceed the allowable levels set forth in § 240.15c3-1(d) of this title.

(i) *Limitation on withdrawal of equity capital.* No equity capital of the government securities broker or dealer or a subsidiary or affiliate consolidated

pursuant to § 240.15c3-1c of this title (Appendix C to SEC Rule 15c3-1) modified as provided in Appendix C to this section, § 402.2c, may be withdrawn by action of a stockholder or partner, or by redemption or purchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor or employee if, after giving effect thereto and to any other such withdrawals, advances or loans and any Payments of Payment Obligations (as defined in § 240.15c3-1d of this title, Appendix D to SEC Rule 15c3-1, modified as provided in Appendix D to this section, § 402.2d) under satisfactory subordination agreements which are scheduled to occur within six months following such withdrawal, advance or loan, either:

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

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

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

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

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

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

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

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

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

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

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

(C) In the case of category AR, the "gross long immediate position" equals the sum of the market values of all long immediate positions in adjustable rate

mortgage-backed securities which are Treasury market risk instruments.

(ii)(A) The "gross short immediate position" for purposes of this section equals, for each category except categories MB and AR in § 402.2(f)(1), the sum of the market values of each short immediate position in Treasury market risk instruments with a term to maturity (or, in the case of a floating rate note, the time to the next scheduled interest rate adjustment or the term to maturity, whichever is less)

corresponding to such category, and the values of funds received from each financing transaction (including repurchase agreements, securities lending secured by cash collateral, and bank loans, but excluding subordinated debt which meets the requirements of § 240.15c3-1d of this title modified as provided in § 402.2d) with a term to maturity or time to the next scheduled interest rate adjustment, whichever is less, corresponding to that category.

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

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

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

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

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

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

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

(A) The net short position in a Treasury market risk instrument as of the trade date, except when the settlement date, in the case of a Treasury market risk instrument except a mortgage-backed security, is

scheduled more than five business days in the future, and, in the case of a mortgage-backed security, more than thirty calendar days in the future;

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

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

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

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

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

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

corresponding to the type of Treasury market risk mortgage-backed security.

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

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

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

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

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

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

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

corresponding to the sum of the term to maturity of the contract and the term to maturity of the underlying instrument at the time of the maturity of the contract or, in the case of a futures or forward contract on Treasury market risk mortgage-backed securities, in the category corresponding to the type of Treasury market risk mortgage-backed security.

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

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

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

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

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

(4) *Total hedging disallowance haircut.* The "total hedging disallowance haircut" equals the sum of the hedging disallowance haircuts calculated pursuant to each netting of qualified netting interim haircuts. The "hedging disallowance haircut" equals the absolute value of the product of the applicable category pair hedging disallowance haircut factor specified in § 402.2(f)(3) and the smaller in absolute value of any two qualified netting interim haircuts, netted in accordance

with the provisions of this paragraph. Schedule E of this Appendix can be used to make this calculation.

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

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

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

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

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

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

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

(1) A registered government securities broker or dealer may elect to exclude

from its calculation of the Treasury market risk haircut and include in its calculation of the other securities haircut long and short positions in Treasury market risk instruments if such positions form part of a hedge against long and short positions in securities, futures contracts, forward contracts, or options which are not Treasury market risk instruments. The value of each position in Treasury market risk instruments excluded from the calculation of the Treasury market risk haircut and included in the calculation of the other securities haircut may not exceed the value of the position which it offsets as part of a hedge.

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

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

SCHEDULE A.—LIQUID CAPITAL REQUIREMENT SUMMARY COMPUTATION

(Dollars in thousand)

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

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

Schedule B

Calculation of Net Immediate Positions in
Securities and Financings
(\$ millions)

Maturity Category 1/	Financings		Securities Positions		Total Securities and Financing Positions		Offset Portions	Net Immediate Positions	
	Long 2/ (+)	Short 2/ (-)	Long (+)	Short (-)	(+)	(-)	(+)	(+/-)	
A 0-44 days									A
B 45-134 days									B
C 135 days- 9 months									C
D 9-18 months									D
E 1.5-3.5 years (1.5-3 years)									E
F 3.5-7.5 years (3-5.5 years)									F
G 7.5-15 years (5.5-9 years)									G
H 15-30 years (9-12 years)									H
I (12-21 years)									I
J (21 years and over)									J
MB mortgage-backed									MB
AR adjustable rate mortgage-backed									AR
Column Number	1	2	3	4	5 (1+3)	6 (2+4)	7# (Note 1)	8# (5+6)	

Carry forward to Schedule C.

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

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

Schedule C

Governments Offset Portion and Net Immediate
Position Interim Haircuts Calculation
(\$ millions)

Maturity Category 1/	Governments Offset Portion			Net Immediate Positions		
	\$ Amounts (+)	Factors	Haircuts (+)	\$ Amounts (+/-)	Factors	Interim Haircuts (+/-)
A 0-44 days			None			None
B 45-134 days			0.0005			0.0012
C 135 days- 9 months			0.0008			0.0020
D 9-18 months			0.0020			0.0045
E 1.5-3.5 years (1.5-3 years)			0.0050			0.0110
F 3.5-7.5 years (3-5.5 years)			0.0045			0.0220
G 7.5-15 years (5.5-9 years)			0.0090			0.0330
H 15-30 years (9-12 years)			0.0155			0.0500
I (12-21 years)			0.0150			0.0775
J (21 years and over)			0.0210			0.1125
MB mortgage-backed			0.0090			0.0330
AR adjustable rate mortgage-backed			0.0050			0.0110

Total Governments Offset Portion Haircut \$ _____

Column Number	7 (Note 1)	9	10# (7x9)	8 (Note 1)	11	12## (8x11)
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Carry to Schedule A, line 2a

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

Note 1: From Schedule B.

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

Schedule D

Consolidation of Net Immediate Position Interim Haircuts
with Gross Futures and Options Interim Haircuts
(\$ thousands)

Maturity Category 1/	Net Immediate Position Interim Haircuts (+/-)	Gross Interim Haircuts				Aggregate Interim Haircuts (+) (-)	Futures & Options Offset Portions 2/ (+)	Residual Position Interim Haircuts (+/-)	
		Futures & Forward (+)	(-)	Options (+)	(-)				
B 45-134 days								B	
C 135 days- 9 months								C	
D 9-18 months								D	
E 1.5-3.5 years (1.5-3 years)								E	
F 3.5-7.5 years (3-5.5 years)								F	
G 7.5-15 years (5.5-9 years)								G	
H 15-30 years (9-12 years)								H	
I (12-21 years)								I	
J (21 years and over)								J	
MB mortgage-backed								MB	
AR adjustable rate mortgage-backed								AR	
Total Futures and Options Offset Portion: \$ _____									
Factor: _____									
Total Futures and Options Offset Haircut: \$ _____ #									
Column Number	12 (Note 1)	13	14	15	16	17	18	19 (Note 2)	20##

Carry to Schedule A, line 2b.

Carry forward to Schedule E.

Note 1: From Schedule C.

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

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

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

Schedule E

Calculation of Hedging Disallowance Haircuts
when Netting Haircuts Across Categories 1/
(\$ thousands)

Maturity Category 2/	Residual Position Interim Haircuts (+/-)	20% Disallowance		30% Disallowance		40% Disallowance		Hedging Disallow- ance Haircuts (+)	Qualified Netting Interim Haircuts (+)
		Hedging Disallow- ance Haircuts (+)	Residual Position Interim Haircuts (+/-)	Hedging Disallow- ance Haircuts (+)	Residual Position Interim Haircuts (+/-)	Hedging Disallow- ance Haircuts (+)	Residual Position Interim Haircuts (+/-)		
B 45-134 days									B
C 135 days- 9 months									C
D 9-18 months									D
E 1.5-3.5 years (1.5-3 years)									E
F 3.5-7.5 years (3-5.5 years)									F
G 7.5-15 years (5.5-9 years)									G
H 15-30 years (9-12 years)									H
I (12-21 years)									I
J (21 years and over)									J
MB mortgage-backed									MB
AR adjustable rate mortgage-backed									AR
Total Hedging Disallowance Haircut:\$ _____									
Residual Net Position Haircut:\$ _____									

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

Column 27 carries forward to Schedule A, line 2c.
Column 28 total carries forward to Schedule A, line 2d.
Note 1: From Schedule D (or Schedule C, if no forwards, futures, or options).
Note 2: Net of two offsetting haircuts of paired maturity categories.
Note 3: For every entry in column 20 there should be an entry in either column 27 or 28 (but never both).
1/ See Sec 402.2(f)(3) for category pair hedging disallowance haircut factors.
2/ The categories are designated in Sec. 402.2(f)(1). A category contains all securities with maturities greater than or equal to the lower of the designated maturities, but less than the higher. Maturity designations in parentheses refer to maturities of zero-coupon instruments to be placed in the category. In categories A, B, C, and D, zero-coupon instruments are to be treated in the same manner as all other instruments. A half year (.5) is always considered to be 6 months.

§ 402.2b [Reserved]**§ 402.2c Appendix C—Modification of § 240.15c3-1c of this title, relating to consolidated calculations of capital, for purposes of § 402.2.**

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

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

(b) References to "net capital" mean "liquid capital" as defined in § 402.2(d).

(c) References to "aggregate indebtedness" shall be disregarded.

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

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

"(1) If the consolidation, provided for in paragraph (a) of this section, of any such subsidiary or affiliate, results in the increase of the government securities broker's or dealer's liquid capital, as defined in § 204.2(d) of this title, or the decrease of the government securities broker's or dealer's total haircuts, as defined in § 402.2(g) of this title, and an opinion called for in paragraph (b)(2) has not been obtained, such benefits shall not be recognized in the government securities broker's or dealer's computation required by § 402.2 of this title."

(f) The reference in § 240.15c3-1c(c)(3) to "17 CFR 240.15c3-1d" means such section as modified by § 402.2d.

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

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

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

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

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

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

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

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

"(iii) The secured demand note agreement may also provide that, in lieu

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

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

"(7) A government securities broker or dealer at its option but not at the option of the lender may, if the subordination agreement so provides, make a Payment of all or any portion of the Payment Obligation thereunder prior to the scheduled maturity date of such Payment Obligation (hereinafter referred to as a "Prepayment"), but in no event may any Prepayment be made before the expiration of one year from the date such subordination agreement became effective. This restriction shall not apply to temporary subordination agreements which comply with the provisions of paragraph (c)(5) of this Appendix D. No Prepayment shall be made if, after giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding the maturities or accelerated maturities of which are scheduled to fall due within six months after the date such Prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect to such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the government securities broker or dealer, the liquid capital, as defined in § 402.2(d) of this title, of the government securities broker or dealer would be less than 150% of the government securities broker's or dealer's total haircuts, as defined in § 402.2(g) of this title. Notwithstanding the above, no

Prepayment shall occur without the prior written approval of the Examining Authority for such government securities broker or dealer."

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

"(i) The Payment Obligation of the government securities broker or dealer in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to Payment of such Payment Obligation (and to all Payments of Payment Obligations of such broker or dealer under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such Payment Obligation), either the liquid capital, as defined in § 402.2(d) of this title, of the government securities broker or dealer would be less than 150% of the government securities broker's or dealer's total haircuts, as defined in § 402.2(g) of this title, or the government securities broker's or dealer's liquid capital after deducting total haircuts would be less than 120% of the minimum dollar amount required by § 402.2(b) or § 402.2(c) of this title, as applicable. The subordination agreement may provide that if the Payment Obligation of the government securities broker or dealer thereunder does not mature and is suspended as a result of the requirement of this paragraph (b)(8) for a period of not less than six months, the government securities broker or dealer shall thereupon commence the rapid and orderly liquidation of its business but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3-1 and 240.15c3-1d."

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

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

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

"(2) *Notice of Maturity or Accelerated Maturity.* Every government securities broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to

all Payments of Payment Obligations under subordination agreements then outstanding which are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer, the liquid capital, as defined in § 402.2(d) of this title, of such government securities broker or dealer, would be less than 150% of total haircuts, as defined in § 402.2(g) of this title."

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

"(i) For the purpose of enabling a government securities broker or dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the capital requirements of § 402.2 of this title, a government securities broker or dealer shall be permitted, on no more than three occasions in any 12 month period, to enter into a subordination agreement on a temporary basis which has a stated term of no more than 45 days from the date such subordination agreement became effective. This temporary relief shall not apply to a government securities broker or dealer if, at such time, it is subject to any of the reporting provisions of § 405.3 of this title, irrespective of its compliance with such provisions or if immediately prior to entering into such subordination agreement, the liquid capital, as defined in § 402.2(d) of this title, of such broker or dealer would be less than 150% of total haircuts, as defined in § 402.2(g) of this title, or the amount of its then outstanding subordination agreements exceeds the limits specified in § 240.15c3-1(d). Such temporary subordination agreement shall be subject to all other provisions of this Appendix D."

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

"(A) After giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the government securities broker or dealer, the liquid capital, as defined in § 402.2(d) of this title, of such broker or dealer, would be less than 180% of total haircuts, as defined in § 402.2(g) of this title."

PART 403—PROTECTION OF CUSTOMER SECURITIES AND BALANCES

Sec.

- 403.1 Application of part to registered brokers and dealers.
 403.2 Hypothecation of customer securities.
 403.3 Use of customers' free credit balances.
 403.4 Customer protection—reserves and custody of securities.
 403.5 Custody of securities held by financial institutions that are government securities brokers or dealers.

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

§ 403.1 Application of part to registered brokers and dealers.

Compliance by registered brokers or dealers with §§ 240.8c-1, .15c2-1, and .15c3-2 of this title (Commission Rules 8c-1, 15c2-1 and 15c3-2), and with § 240.15c3-3 of this title (Commission Rule 15c3-3) as modified by § 403.4(a)-(i) constitutes compliance with this part.

§ 403.2 Hypothecation of customer securities.

Every registered government securities broker or dealer shall comply with the requirements of § 240.15c2-1 of this title concerning hypothecation of customer securities with the following modifications:

(a) In § 240.15c2-1(a), the words "as used in section 15(c)(1) of the Act" shall be substituted for the words "as used in section 15(c)(2) of the Act."

(b) Section 240.15c2-1(d) is modified to read as follows:

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

§ 403.3 Use of customers' free credit balances.

Every registered government securities broker or dealer shall comply with the requirement of § 240.15c3-2 of

this title concerning the use of customer free credit balances.

§ 403.4 Customer protection—reserves and custody of securities.

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

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

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

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

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

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

"(4)(i) A broker or dealer that retains custody of securities that are the subject of a repurchase agreement between the broker or dealer and a person other than another broker or dealer that is registered pursuant to section 15, 15B or 15C(a)(1)(A) of the Act (15 U.S.C. 78o, 78o-4, 78o-5(a)(1)(A)) or that has filed notice of its status as a government securities broker or dealer pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 78o-5(a)(1)(B)) shall:

"(A) Obtain the repurchase agreement in writing;

"(B) Provide in such agreement that when the contract price in the aggregate of all currently outstanding repurchase transactions with a single counterparty is less than \$5,000,000, any substitution of other securities for the securities that are the subject of any repurchase transaction, pursuant to the terms of the repurchase agreement, may be made only with the prior agreement of the counterparty to each specific substitution;

“(C) Confirm in writing the specific securities that are the subject of a repurchase transaction pursuant to such agreement at the initiation of the transaction and at the end of any day during which other securities are substituted;

“(D) Advise the counterparty in the repurchase agreement that the Securities Investor Protection Act of 1970 may not provide any protection to the counterparty with respect to the repurchase agreement, and to the extent that it is deemed applicable, the amount of protection provided may not exceed \$500,000; and

“(E) Maintain possession or control of securities that are the subject of the agreement.

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

“(iii) A broker or dealer shall not be required to maintain possession or control during the trading day if:

“(A) the repurchase agreement provides for the consent of the counterparty to limited possession or control by including the following provisions:

“(1) ‘The securities allocated to the repurchase transaction under the agreement may be segregated from the seller's own securities only at the end of each trading day.’; and

“(2) ‘While the securities are commingled with the seller's own securities during the course of a trading day, they may be subject to a clearing lien or use by the seller for deliveries on other securities transactions.’; and

“(B) The contract price of all currently outstanding repurchase agreements with that counterparty in the aggregate equals or exceeds \$5,000,000.”

(f)(1) Securities under the control of a broker or dealer, as described in § 240.15c3-3(c) of this title, shall include securities maintained by a broker or dealer in an account at a depository institution, as defined in section 19(b)(A)(i)-(vi) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)(i)-(vi)), which depository institution has a book-entry securities account at a Federal Reserve Bank through which it provides clearing services (“clearing bank”), provided the securities are maintained in a Segregated Account of the government securities broker or dealer.

(2) For purposes of this paragraph and paragraph (g) of this section, a Segregated Account is an account (other than a clearing account) of the government securities broker or dealer maintained on the books of a clearing

bank pursuant to a written clearing agreement with such clearing bank which provides that:

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

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

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

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

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

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

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

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

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

(i) For purposes of this section § 240.15c3-3(m) shall apply to government securities, notwithstanding the May 9, 1973, order of the Commission (38 FR 12103) suspending such applicability.

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

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

(k) For purposes of this section, Note E(5) of § 240.15c3-3a of this title is modified to read as follows:

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

Related accounts (e.g., the separate accounts of an individual, accounts under common control or subject to cross guarantees) shall be deemed to be a single customer's accounts for purposes of this provision."

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

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

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

(2) Comply with Part 450 and with paragraphs (c) and (d) of this section with respect to all securities held for customers or counterparties of the financial institution in its capacity as government securities broker or dealer.

(b) A financial institution shall not be in violation of the possession or control requirements of paragraphs (c) and (d) of this section if, solely as the result of normal business operations, temporary lags occur between the time when a security is first required to be in the financial institution's possession or control and the time when it is actually placed in possession or control, provided that the financial institution takes timely steps in good faith to establish prompt possession or control.

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

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

(ii) Obtain the return of any securities loaned;

(iii) Obtain possession or control of securities failed to receive for more than 30 days;

(iv) Buy in securities as necessary to the extent any shortage of securities in possession or control cannot be resolved by any of the above procedures.

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

(3) Nothing stated in this section shall be construed as affecting the absolute

right of a customer of a government securities broker or dealer, unless otherwise agreed in writing, in the normal course of business operations following demand made on the broker or dealer, to receive the physical delivery of certificates if the securities are issued in certificated form, or to direct a transfer of or otherwise to exercise control over any securities if they are:

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

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

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

(d)(1) A financial institution that retains custody of securities that are the subject of a repurchase agreement between the financial institution and a person other than another broker or dealer that is registered pursuant to section 15, 15B or 15C(a)(1)(A) of the Act (15 U.S.C. 78o, 78o-4, 78o-5(a)(1)(A)) or that has filed notice of its status as a government securities broker or dealer pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 78o-5(a)(1)(B)) shall:

(i) Obtain the repurchase agreement in writing;

(ii) Provide in such agreement that when the contract price in the aggregate of all currently outstanding repurchase transactions with a single counterparty is less than \$5,000,000, any substitution of other securities for the securities that are the subject of any repurchase transaction, pursuant to the terms of the repurchase agreement, may be made only with the prior agreement of the counterparty to such substitution;

(iii) Confirm in writing the specific securities that are the subject of a repurchase transaction pursuant to such agreement at the initiation of the transaction and at the end of any day during which other securities are substituted;

(iv) Advise the counterparty in the repurchase agreement that the funds held by the financial institution pursuant to a repurchase transaction are not a deposit and therefore are not insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation, as applicable; and

(v) Maintain possession or control of securities that are the subject of the agreement in accordance with § 450.4 (a) and (b).

(2) The financial institution shall not be required to maintain possession or control during the trading day if:

(i) The repurchase agreement provides for the consent of the counterparty to limited possession or control by including the following provisions:

(A) "The securities allocated to the repurchase transaction under the agreement may be segregated from the seller's own securities only at the end of each trading day."; and

(B) "While the securities are commingled with the seller's own securities during the course of a trading day, they may be subject to a clearing lien or use by the seller for deliveries on other securities transactions."; and

(ii) The contract price in the aggregate of all currently outstanding repurchase transactions with that counterparty equals or exceeds \$5,000,000.

PART 404—RECORDKEEPING AND PRESERVATION OF RECORDS

Sec.

404.1 Application of part to registered brokers and dealers.

404.2 Records to be made and kept current by registered government securities brokers and dealers; records of non-resident registered government securities brokers and dealers.

404.3 Records to be preserved by registered government securities brokers and dealers.

404.4 Records to be made and preserved by government securities brokers and dealers that are financial institutions.

404.5 Securities counts by registered government securities brokers and dealers.

404.6 Securities counts by government securities brokers and dealers that are financial institutions.

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

§ 404.1 Application of part to registered brokers and dealers.

Compliance by a registered broker or dealer with:

(a) Section 240.17a-3 of this title, pertaining to records to be made, modified as provided in §§ 404.2(a) (3), (4) and (5);

(b) Section 240.17a-4 of this title, pertaining to preservation of records;

(c) Section 204.17a-13 of this title, pertaining to quarterly securities counts, modified as provided in § 404.5(a)(2); and

(d) Section 240.17a-7 of this title, pertaining to records of non-resident brokers or dealers, shall constitute compliance with this part.

§ 404.2 Records to be made and kept current by registered government securities brokers and dealers; records of non-resident registered government securities brokers and dealers.

(a) Every registered government securities broker or dealer shall comply with the requirements of § 240.17a-3 of this title (Commission Rule 17a-3), with the following modifications:

(1) References to "broker or dealer" and "broker or dealer registered pursuant to Section 15 of the Act" include registered government securities brokers or dealers.

(2) References to §§ 240.17a-3, .17a-4, .17a-5, and .17a-13 mean such sections as modified by this Part and Part 405 of this chapter.

(3) Section 240.17a-3(a)(4) is revised by adding paragraph (a)(4)(vii) to read as follows:

"(vii) Repurchase and reverse repurchase agreements."

(4) Section 240.17a-3(a)(5) is modified to read as follows:

"(5) A securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping and securities that are the subjects of repurchase or reverse repurchase agreements) carried by such member, broker, or dealer for his account or for the account of his customers or partners or others and showing the location of all securities long and the offsetting position to all securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried."

(5) Section 240.17a-3(a)(8) is modified to read as follows:

"(8) Copies of confirmations of all purchases and sales of securities, including all repurchase and reverse repurchase agreements, and copies of notices of all other debits and credits for securities, cash and other items for the account of customers and partners of such member, broker or dealer."

(6) Paragraph 240.17a-3(a)(11) is modified to read as follows:

"(11) A record of the proof of money balances of all ledger accounts in the form of trial balances, and a record of the computation of liquid capital and total haircuts, as of the trial date, determined as provided in § 402.2 of this title; *provided however*, that such computation need not be made by any registered government securities broker or dealer unconditionally exempt from Part 402 of this title by § 402.1(e) of this

title. Such trial balances and computations shall be prepared currently at least once a month."

(7) Paragraph 240.17a-3(b)(1) is modified to read as follows:

"(1) This section shall not be deemed to require a government securities broker or dealer registered pursuant to section 15C(a)(1)(A) of the Act (15 U.S.C. 78o-5(a)(1)(A)) to make or keep such records of transactions cleared for such government securities broker or dealer as are customarily made and kept by a clearing broker or dealer pursuant to the requirements of §§ 240.17a-3 and 240.17a-4: *Provided*, that the clearing broker or dealer has and maintains net capital of not less than \$25,000 (or, in the case of a clearing broker or dealer that is a registered government securities broker or dealer, liquid capital less total haircuts, determined as provided in § 402.2 of this title, of not less than \$25,000) and is otherwise in compliance with § 240.15c3-1, § 402.2 of this title, or the capital rules of the exchange of which such clearing broker or dealer is a member if the members of such exchange are exempt from § 240.15c3-1 by paragraph (b)(2) thereof."

(8) The undertaking in § 240.17a-3(b)(2) is modified to read as follows:

"The undersigned hereby undertakes to maintain and preserve on behalf of [registered government securities broker or dealer] the books and records required to be maintained by [registered government securities broker or dealer] pursuant to 17 CFR §§ 404.2 and 404.3 and Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 and to permit examination of such books and records at any time or from time to time during business hours by examiners or other representatives of the Securities and Exchange Commission, and to furnish to said Commission at its principal office in Washington, DC, or at any regional office of said Commission specified in a demand made by or on behalf of said Commission for copies of books and records, true, correct, complete, and current copies of any or all, or any part, of such books and records. This undertaking shall be binding upon the undersigned, and the successors and assigns of the undersigned."

(9) Section 240.17a-3(c) is modified to read as follows:

"(c) This section shall not be deemed to require a government securities broker or dealer to make or keep such records as the required by paragraph (a) reflecting the sale and redemption of United States Savings Bonds, United States Savings Note and United States Savings Stamps."

(b)(1) Every non-resident government securities broker or dealer registered or applying for registration pursuant to section 15C of the Act shall comply with § 240.17a-7 of this title, *provided that* in such section references to "broker or dealer" shall include government securities brokers or dealers.

(2) The term "non-resident government securities broker or dealer" means (i) in the case of an individual, one who resides in or has his principal place of business in any place not subject to the jurisdiction of the United States; (ii) in the case of a corporation, one incorporated in or having its principal place of business in any place not subject to the jurisdiction of the United States; and (iii) in the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not subject to the jurisdiction of the United States.

§ 404.3 Records to be preserved by registered government securities brokers and dealers.

Every registered government securities broker or dealer shall comply with the requirements of § 240.17a-4 of this title (Commission Rule 17a-4), with the following modifications:

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

(b) References to §§ 240.17a-3, .17a-4, and .17a-5 mean such sections as modified by this part and Part 405 of this chapter.

(c) References to § 240.15c3-1, relating to net capital, and "Computation for Net Capital" thereunder mean § 402.2 of this chapter and the computation of the ratio of liquid capital to total haircuts required thereunder.

(d) References to § 240.15c3-3, relating to possession or control of customer securities and balances, mean § 403.4 of this chapter.

(e) References to Form X-17A-5 mean Form G-405 (§ 449.5 of this chapter).

(f) The computation described in § 240.17a-4(b)(8)(x) is not required.

§ 404.4 Records to be made and preserved by government securities brokers and dealers that are financial institutions.

(a) Every financial institution that is a government securities broker or dealer and that is not exempt from this part pursuant to Part 401 of this chapter shall comply with the requirements of §§ 404.2 and 404.3 unless such financial institution:

(1) Is subject to 12 CFR Part 12 (relating to national banks), 12 CFR Part

208 (relating to state member banks of the Federal Reserve System) or 12 CFR 344 (relating to state banks that are not members of the Federal Reserve System), *provided however*, that the records required to be made and kept by those regulations shall be made or kept without regard to the exemptions for transactions in U.S. government or federal agency obligations provided in 12 CFR 12.7(a), 12 CFR 208.8(k)(6)(i), and 12 CFR 344.7(a); and

(2) Makes and keeps current:

(i) A securities record or ledger reflecting separately for each government security as of the clearance dates all "long" or "short" positions (including government securities in safekeeping and government securities that are the subjects of repurchase or reverse repurchase agreements) carried by such financial institution for its account or for the account of its customers or others and showing the location of all government securities long and the offsetting position to all government securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried;

(ii) A complete and current Form G-FIN-4 (§ 449.3 of this chapter) or Form U-4 (promulgated by a self-regulatory organization) or Form MSD-4 (as required for associated persons of bank municipal securities dealers) for each associated person as defined in § 400.4(e) of this chapter; and

(iii) A Form G-FIN-5 (§ 449.4 of this chapter) or Form U-5 (promulgated by a self-regulatory organization) or Form MSD-5 (as required for associated persons of bank municipal securities dealers) for each associated person whose association has been terminated as provided in § 400.4(d)(2) of this chapter.

(b)(1) The records required by paragraph (a)(2)(i) of this section shall be preserved for not less than six years, the first two years in an easily accessible place.

(2) The records required by paragraphs (a)(2)(ii) and (iii) of this section shall be preserved for at least three years after the person who is the subject of the record has terminated his employment and any other association with the government securities broker or dealer function of the financial institution.

§ 404.5 Securities counts by registered government securities brokers and dealers.

Every registered government securities broker or dealer shall comply with the requirements of § 240.17a-13 of this title (Commission Rule 17a-13), with the following modifications:

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

(b) Sections 240.17a-13(b)(1), (2), and (3) are modified to read as follows:

"(1) Physically examine and count all securities held, including securities that are the subject of repurchase or reverse repurchase agreements;

"(2) Account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to his control or direction but not in his physical possession by examination and comparison of the supporting detail records with the appropriate ledger control accounts;

"(3) Verify all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to his control or direction but not in his physical possession, where such securities have been in said status for longer than thirty days;"

§ 404.6 Securities counts by government securities brokers and dealers that are financial institutions.

(a) Every government securities broker or dealer that is a financial institution shall, at least once in each calendar year, with respect to all government securities held by the financial institution for customers except those securities held in a fiduciary capacity or in a custodial capacity within the financial institution's trust department,

(1) Physically examine and count securities held in definitive form, including securities that are the subject of repurchase or reverse repurchase agreements;

(2) Account for securities, including securities held in book-entry form and securities subject to repurchase or reverse repurchase agreements or otherwise subject to the financial institution's control or direction but not in its physical possession, by examination and comparison of the supporting detail records and with the appropriate ledger control accounts and by verification of the records of the financial institution with those of any depository, depository institution or

Federal Reserve Bank on whose books the financial institution has securities accounts;

(3) Verify securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to the financial institution's control or direction but not in its physical possession, where such securities have been in said status for longer than thirty days;

(4) Compare the results of the counts required by paragraphs (a)(1) and (2) of this section and verification with the institution's records; and

(5) Record on the books and records of the financial institution all unresolved differences, setting forth the security involved and the date of comparison in a security count difference account no later than seven business days after the date of each required annual securities examination, count, and verification as provided in this paragraph.

(b) For the purposes of this section, "fiduciary capacity" includes trustee, executor, administrator, registrar, transfer agent, guardian, assignee, receiver, managing agent, and any other similar capacity involving the sole and shared exercise of discretion by a financial institution having fiduciary powers that is supervised by a federal or state financial institution regulator agency.

PART 405—REPORTS AND AUDIT

Sec.

405.1 Application of part to registered brokers and dealers and to financial institutions; transition rule.

405.2 Reports to be made by registered government securities brokers and dealers.

405.3 Supplemental current financial and operational reports to be made by certain registered government securities brokers and dealers.

405.4 Financial recordkeeping and reporting of currency and foreign transactions.

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

§ 405.1 Application of part to registered brokers and dealers and to financial institutions; transition rule.

(a) Compliance by registered brokers or dealers with §§ 240.17a-5, .17a-8, and .17a-11 of this title (Commission Rules 17a-5, 17a-8 and 17a-11) constitutes compliance with this part.

(b) A government securities broker or dealer that is a financial institution and is subject to financial reporting rules of its appropriate regulatory agency is

exempt from the provisions of §§ 405.2 and 405.3.

(c) This part shall be effective July 25, 1987, *provided however*,

(1) That registered government securities brokers or dealers shall first be required to file the reports required by § 240.17a-5(a), by virtue of § 405.2, for the month and the quarter during which they were first required to comply with § 402.2 of this chapter; but that

(2) For any quarter ending prior to the quarter during which they were first required to comply with § 402.2 of this chapter, registered government securities brokers or dealers shall file with the designated examining authority for such registered broker or dealer, within 17 business days after the close of the quarter, an unaudited balance sheet (with appropriate notes) for such quarter, prepared in accordance with generally accepted accounting principles.

§ 405.2 Reports to be made by registered government securities brokers and dealers.

Every registered government securities broker or dealer shall comply with the requirements of § 240.17a-5 of this title (Commission Rule 17a-5), with the following modifications:

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

(b) References to "rules of the Commission" or words of similar import include, where appropriate, the regulations contained in this chapter.

(c) References to Form X-17A-5 mean Form G-405 (§ 449.5 of this chapter).

(d) For the purpose of § 240.17a-5(a)(4) of this title, the Commission may, on the terms and conditions stated in that subparagraph, declare effective a plan with respect to Form G-405, in which case, that plan shall be treated the same as a plan approved with respect to Form X-17A-5.

(e) References to "net capital" mean "liquid capital" as defined in § 402.2(d) of this chapter.

(f) References to § 240.15c3-1, relating to net capital, mean § 402.2 of this chapter.

(g) Paragraph 240.17a-5(c)(2)(ii) is modified to read as follows:

"(ii) A footnote containing a statement of the registered government securities broker's or dealer's liquid capital, total haircuts, and ratio of liquid capital to total haircuts, determined in accordance with § 402.2 of this title. Such statement shall include summary financial statements of subsidiaries consolidated pursuant to Appendix C of § 240.15c3-1 modified as provided in § 402.2c of this title, where material, and the effect thereof on the liquid capital, total

haircuts and ratio of liquid capital to total haircuts of the registered government securities broker or dealer."

(h) References to § 240.15c3-3 and the exhibits thereto, relating to possession or control of customer securities and reserve requirements, mean § 403.4 of this chapter.

(i) The reference to § 240.15b1-2 of this title, relating to financial statements to be filed upon registration, means § 240.15Ca2-2.

(j) The supplemental report described in § 240.17a-5(e)(4) of this title, concerning the Securities Investor Protection Act, is not required.

(k) The statement described in § 240.17a-5(f)(2) of this title shall be headed "Notice Pursuant to Section 405.2," and shall be filed within 30 days following the effective date of registration as a government securities broker or dealer.

(l) References in § 240.17a-5(h)(2) of this title to § 240.17a-11 mean § 405.3 of this chapter.

§ 405.3 Supplemental current financial and operational reports to be made by certain registered government securities brokers and dealers.

Every registered government securities broker or dealer shall comply with the requirements of § 240.17a-11 of this title (Commission Rule 17a-11), with the following modifications:

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

(b) References to § 240.15c3-1, relating to net capital, mean § 402.2 of this chapter.

(c) References to "net capital" mean "liquid capital" as defined in § 402.2 of this chapter.

(d) References to § 240.15c3-1d, relating to subordination agreements, mean that section as modified by § 402.2d of this chapter.

(e) References to Form X-17A-5 mean Form G-405 (§ 449.5 of this chapter).

(f) References to § 240.17a-5, relating to reports and audit, mean § 405.2 of this chapter.

(g) Section 240.17a-11(b)(1), for the purposes of this section, is modified to read as follows:

"(1) If a computation made by a registered government securities broker or dealer pursuant to the requirements of § 402.2 of this title shows, at any point during the month, that his liquid capital is less than 150 percent of total haircuts, determined in accordance with § 402.2 of this title, such person shall file a report on Part II or Part IIA of Form G-405 (§ 449.5 of this title) as determined in accordance with the standards set forth in § 240.17a-5(a)(2) (ii) and (iii),

within 15 calendar days after the end of each month thereafter until 3 successive months shall have elapsed during which liquid capital does not fall below 150 percent of total haircuts."

(h) References to § 240.17a-3, relating to records, mean § 404.2 of this chapter.

§ 405.4 Financial recordkeeping and reporting of currency and foreign transactions.

Every government securities broker or dealer who is subject to the requirements of the Currency and Foreign Transactions Reporting Act of 1970 shall comply with the reporting, recordkeeping and record retention requirements of 31 CFR Part 103. Where 31 CFR Part 103 and § 404.3 of this chapter require the same records to be preserved for different periods of time, such records or reports shall be preserved for the longer period of time.

PART 449—FORMS, SECTION 15C OF THE SECURITIES EXCHANGE ACT OF 1934

Sec.

- 449.1 Form G-FIN, notification by financial institutions of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934.
- 449.2 Form G-FINW, notification by financial institutions of cessation of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.6 of this chapter.
- 449.3 Form G-FIN-4, notification by persons associated with financial institutions that are government securities brokers and dealers pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.
- 449.4 Form G-FIN-5, notification of termination of association with a financial institution that is a government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.
- 449.5 Form G-405, information required of registered government securities brokers and dealers pursuant to section 15C of the Securities Exchange Act of 1934 and §§ 405.2 and 405.4 of this chapter.
- 449.6 Display of OMB control numbers.

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3208 (15 U.S.C. 78o-5(a), (b)(1)(B), (b)(2)).

§ 449.1 Form G-FIN, notification by financial institutions of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934.

This form is to be used by financial institutions that are government securities brokers and dealers not exempt under Part 401 of this chapter to notify their appropriate regulatory

agency of their status. The form is promulgated by the Board of Governors of the Federal Reserve System and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.2 Form G-FINW, notification by financial institutions of cessation of status as government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.6 of this chapter.

This form is to be used by financial institutions that are government securities brokers or dealers to notify their appropriate regulatory agency that they have ceased to function as a government securities broker or dealer. The form is promulgated by the Board of Governors of the Federal Reserve System and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.3 Form G-FIN-4, notification by persons associated with financial institutions that are government securities brokers and dealers pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.

This form is to be used by associated persons of financial institutions that are government securities brokers or dealers to provide certain information to the financial institution and the appropriate regulatory agency concerning employment, education, residence, and statutory disqualification. The form is promulgated by the Department of the Treasury and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.4 Form G-FIN-5, notification of termination of association with a financial institution that is a government securities broker or dealer pursuant to section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934 and § 400.4 of this chapter.

This form is to be used by financial institutions that are government securities brokers or dealers to notify the appropriate regulatory agency of the fact that an associated person is no longer associated with the government securities broker or dealer function of the financial institution. The form is promulgated by the Department of the Treasury and is available from the Board of Governors of the Federal Reserve System, the Comptroller of the

Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board and the SEC.

§ 449.5 Form G-405, information required of registered government securities brokers and dealers pursuant to section 15C of the Securities Exchange Act of 1934 and §§ 405.2 and 405.4 of this chapter.

This form is to be used by registered government securities brokers and dealers to make the monthly, quarterly and annual financial reports required by Part 405 of this chapter. The form is promulgated by the Department of the Treasury and is available from the SEC and the designated examining authorities.

§ 449.6 Display of OMB control numbers.

The following rules promulgated by the Department of the Treasury pursuant to the Government Securities Act of 1986 containing information collection requirements are listed with the control numbers assigned by the Office of Management and Budget.

Part or section of Title 17, CFR	Currently assigned OMB control No.
§ 400.4.....	
§ 400.5.....	
§ 400.6.....	
§ 404.2.....	
§ 404.3.....	
§ 404.4.....	
§ 404.5.....	
§ 404.6.....	
§ 405.2.....	
§ 405.3.....	

SUBCHAPTER B—RULES AND REGULATIONS UNDER TITLE II OF THE GOVERNMENT SECURITIES ACT OF 1986

PART 450—CUSTODIAL HOLDINGS OF GOVERNMENT SECURITIES BY DEPOSITORY INSTITUTIONS

- Sec. 450.1 Scope of regulations; office responsible.
- 450.2 Definitions.
- 450.3 Exemption for trust holdings and holdings in trust departments.
- 450.4 Custodial holdings of government securities.
- 450.5 Display of OMB control numbers.

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3208 (15 U.S.C. 780-5(b)(1)(A), (b)(2), (b)(3)(B)); Sec. 201, Pub. L. 99-571, 100 Stat. (31 U.S.C. 3121, 9110).

§ 450.1 Scope of regulations; office responsible.

(a) This part applies to depository institutions that hold government securities as fiduciary, custodian, or otherwise for the account of a customer, and that are not government securities brokers or dealers, as defined in sections 3(a)(43) and 3(a)(44) of the

Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(43)-(44)), Depository institutions exempted under Part 401 of this chapter from the requirements applicable to government securities brokers or dealers must comply with this part. Certain depository institutions that are government securities brokers or dealers must also comply with this part, as well as with additional requirements set forth in § 403.5.

(b) The regulations in this subchapter are promulgated by the Assistant Secretary (Domestic Finance) pursuant to a delegation of authority from the Secretary of the Treasury. The office responsible for the regulations is the Office of the Deputy Assistant Secretary (Federal Finance).

§ 450.2 Definitions.

For purposes of this subchapter:

(a) "appropriate regulatory agency" has the meaning set out in section 3(a)(34)(G) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(34)(G)), except that the appropriate regulatory agency for—

(1) An institution insured by the Federal Savings and Loan Insurance Corporation is the Federal Home Loan Bank Board;

(2) A Federal credit union as defined in 12 U.S.C. 1752(1) and an insured credit union as defined in 12 U.S.C. 1752(7) is the National Credit Union Administration; and

(3) Any depository institution for whom an appropriate regulatory agency is not explicitly specified by either section 3(a)(34)(G) or this paragraph, is the SEC;

(b) "customer" includes the counterparty to a transaction pursuant to a repurchase agreement for whom the depository institution retains possession of the security sold subject to repurchase, but does not include a broker or dealer that is registered pursuant to section 15, 15B or 15C(a)(1)(A) of the Act (15 U.S.C. 780, 780-4, 780-5(a)(1)(A)) or that has filed notice of its status as a government securities broker or dealer pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 780-5(a)(1)(B)) except to the extent that a depository institution holds securities for customers of such broker or dealer;

(c) "depository institution" has the meaning stated in clauses (i) through (vi) of section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)(i)-(vi)) and also includes a foreign bank, an agency or branch of a foreign bank and a commercial lending company owned or controlled by a foreign bank (as such terms are defined in the International

Banking Act of 1978, Pub. L. 95-369, 92 Stat. 607);

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

(e) "government securities" means those obligations described in subparagraphs (A), (B), or (C) of section 3(a)(42) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(42)(A)-(C)).

§ 450.3 Exemption for trust holdings and holdings in trust departments.

(a) The Secretary has determined that the rules and standards of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation governing the holding of government securities in a fiduciary capacity by depository institutions subject thereto are adequate. Accordingly, such depository institutions are exempt from this part with respect to their holdings of government securities in a fiduciary capacity and their holdings of government securities in a custodial capacity within their trust departments, provided such institutions agree, with respect to such custodial holdings, to adhere to all requirements applicable to holdings of government securities in a fiduciary capacity imposed by their appropriate regulatory agency.

(b) The Secretary expects that each appropriate regulatory agency will notify the Department if it materially revises its rules and standards governing the holding of government securities in a fiduciary capacity.

§ 450.4 Custodial holdings of government securities.

Depository institutions that are subject to this Part shall observe the following requirements with respect to their holdings of government securities for customer accounts:

(a) All government securities held for the account of customers shall be segregated from the assets of the depository institution and shall be kept free of any charge, lien or claim of any kind, unless expressly agreed to in writing by the customer for whose account such securities are held. A safekeeping receipt or a confirmation shall be issued for every government security held for a customer.

(b) All depository institutions holding government securities for customers

shall maintain possession or control of such securities. Securities shall be deemed to be under the control of a depository institution to the extent that it has instructed a Federal Reserve Bank, correspondent bank, trust company, or other custodian, as appropriate, to maintain possession or control of such securities free of any charge, lien, or claim of any kind in favor of such correspondent bank, trust company, or other custodian or any persons claiming through them, except to the extent expressly agreed to in writing by the customer for whose account such securities are held.

(c) Records of government securities held for customers shall be kept separate and distinct from other records of the depository institution. Such records shall:

(1) Provide a system for identifying each customer and each government security held for the customer, unless the depository institution is holding securities for customers of another depository institution or of a government securities broker or dealer registered pursuant to section 15C(a)(1)(A) of the Act (15 U.S.C. 78o-5(a)(1)(A)) or a government securities broker or dealer that has filed notice of its status pursuant to section 15C(a)(1)(B) of the Act (15 U.S.C. 78o-5(a)(1)(B));

(2) Describe the customer's interest in the government security;

(3) Indicate all receipts and deliveries of government securities and all receipts and disbursements of cash in connection with such securities;

(4) Include a copy of the safekeeping receipt or a confirmation issued for each government security held; and

(5) Provide an adequate basis for audit of such information.

(d) Counts of government securities held for customers in both definitive and book-entry form shall be conducted at least annually and such counts shall be reconciled with customer account records. Counts of book-entry securities and of definitive securities held outside the possession of the depository institution shall be made by verification of the records of the depository institution with those of any depository institution, or Federal Reserve Bank on whose books the depository institution has securities accounts. The dates and results of such counts and reconciliations shall be documented with differences noted.

§ 450.5 Display of OMB control numbers.

The following rules promulgated by the Department of the Treasury pursuant to the Government Securities Act of 1986 containing information collection

requirements are listed with the control numbers assigned by the Office of Management and Budget.

Part or section of Title 17, CFR	Currently Assigned OMB Control No.
§ 450.4.....	

Dated: February 19, 1987.

Charles O. Sethness,
Assistant Secretary for Domestic Finance.
 [FR Doc. 87-3800 Filed 2-24-87; 8:45 am]
BILLING CODE 4810-25-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Rel. No. 34-24109; File No. S7-4-87]

Request for Comments on Proposed Rules and Proposed Revisions of Form BD

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rulemaking and form revision.

SUMMARY: The Commission is publishing for comment proposed rules to implement provisions of the Government Securities Act of 1986, which requires currently unregulated government securities brokers or government securities dealers to register with the Commission. Registered broker-dealers who act as government securities brokers or government securities dealers must file written notice with the Commission. The proposed rules prescribe the form and information required to be filed by government securities broker-dealers in their applications for registration with the Commission. The Commission also is publishing for comment proposed revisions to Form BD, the form used to register as a broker-dealer. The proposed revisions adapt the form for use by government securities broker-dealers and enable government securities broker-dealers currently registered or registering with the Commission to use Form BD in order to notify the Commission of their activities as government securities broker-dealers.

DATES: Comments should be submitted by March 18, 1987.

ADDRESSES: All comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Washington, DC 20549, and should refer to File No. S7-4-87. All submissions will be available for public inspection at the Commission's

Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549.

FOR FURTHER INFORMATION CONTACT:
Lynne G. Masters, Esq. at (202) 272-2848, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

Introduction

On October 28, 1986, the Securities Exchange Act of 1934 (the "Exchange Act") was amended by Pub. L. No. 99-571,¹ the Government Securities Act of 1986 (the "Act"). As amended, the Exchange Act contains a new section 15C(a) that requires government securities brokers² and government securities dealers,³ other than those already registered with the Commission or financial institutions,⁴ to register with

¹ 100 Stat. 3208.

² New section 3(a)(43) of the Exchange Act defines a government securities broker as:

Any person regularly engaged in the business of effecting transactions in government securities for the account of others, but does not include—

(A) Any corporation the securities of which are government securities under subparagraph (B) or (C) of paragraph (42) of this subsection; or

(B) Any person registered with the Commodity Futures Trading Commission, any contract market designated by the Commodity Futures Trading Commission, such contract market's affiliated clearing organization, or any floor trader on such contract market, solely because such person effects transactions in government securities that the Commission, after consultation with the Commodity Futures Trading Commission, has determined by rule or order to be incidental to such person's futures-related business.

³ New section 3(a)(44) of the Exchange Act defines a government securities dealer as:

Any person engaged in the business of buying and selling government securities for his own account, through a broker or otherwise, but does not include—

(A) Any person insofar as he buys or sells such securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business;

(B) Any corporation the securities of which are government securities under subparagraph (B) or (C) of paragraph (42) of this subsection;

(C) Any bank, unless the bank is engaged in the business of buying and selling government securities for its own account other than in a fiduciary capacity, through a broker or otherwise; or

(D) Any person registered with the Commodity Futures Trading Commission, any contract market designated by the Commission, any contract market designated by the Commodity Futures Trading Commission, such contract market's affiliated clearing organization, or any floor trader on such contract market, solely because such person effects transactions in government securities that the Commission, after consultation with the Commodity Futures Trading Commission, has determined by rule or order to be incidental to such person's futures-related business.

⁴ New section 3(a)(46) of the Exchange Act defines "financial institution" as "(A) a bank as defined in section 3(a)(6) of the Act, (B) a foreign bank, and (C) an insured institution as such term is defined in section 401 of the National Housing Act."

the Commission, by July 25, 1987.⁵ Under the Act, broker-dealers currently registered with the Commission⁶ that act as government securities brokers or government securities dealers are not required to re-register with the Commission. They are, however, required to file by July 25, 1987⁷ written notice with the Commission that they are government securities brokers or government securities dealers.⁸ Similarly, financial institutions that are government securities brokers or dealers are required to file with their appropriate regulatory agency⁹ by July

⁵ Government securities brokers and dealers registering pursuant to section 15C(a) are also required to become members of a registered securities association or a national securities exchange. See section 15C(e)(1).

⁶ These broker-dealers (hereinafter referred to as "registered broker-dealers") are broker-dealers registered under Section 15(b) of the Exchange Act and non-bank intrastate municipal securities dealers registered under Section 15B of the Exchange Act. See section 3(a)(48).

⁷ Because July 25, 1987, falls on a Saturday, registered broker-dealers required to file notice must file their notices no later than July 27, 1987. See Rule 0-3(a).

⁸ After the effective date of the amendments, all registered broker-dealers that are government securities broker-dealers are required by section 15C(a)(1)(B)(i) to file a notice with the Commission when they cease to act as a government securities broker or dealer. Section 15C(a)(1)(B) provides that a government securities broker or dealer must file a written notice with the appropriate regulatory authority when it ceases to act as a government securities broker or dealer. Although the literal language of this provision could be interpreted to apply to any government securities broker or dealer, the Commission believes that Congress intended this provision to apply only to broker-dealers registered pursuant to sections 15 and 15B and financial institutions, and not to government securities broker-dealers registered solely pursuant to section 15C(a)(1)(A).

⁹ As amended, section 3(a)(34) of the Exchange Act defines "appropriate regulatory agency" to include the following new paragraph:

(G) When used with respect to a government securities dealer, or person associated with a government securities broker or government securities dealer:

(i) The Comptroller of the Currency, in the case of a national bank, a bank in the District of Columbia examined by the Comptroller of the Currency, or a Federal branch or Federal agency of foreign bank (as such terms are used in the International Banking Act of 1978);

(ii) The Board of Governors of the Federal Reserve System, in the case of a State member bank of the Federal Reserve System, a foreign bank, a State branch or a State agency of a foreign bank, or a commercial lending company owned or controlled by a foreign bank (as such terms are used in the International Banking Act of 1978);

(iii) The Federal Deposit Insurance Corporation, in the case of a bank insured by the Federal Deposit Insurance Corporation (other than a member of the Federal Reserve System or a Federal Savings Bank);

(iv) The Federal Home Loan Bank Board, in the case of a Federal Savings and Loan Association, Federal Savings Bank, or District of Columbia savings and loan association;

(v) The Federal Savings and Loan Insurance Corporation, in the case of an institution insured by the Federal Savings and Loan Insurance

25, 1987 written notice in the form prescribed by the Board of Governors of the Federal Reserve System.

Government securities brokers and government securities dealers are subject to the rulemaking authority of the Secretary of the Treasury ("Treasury") in the areas of financial responsibility, reporting, recordkeeping, and exemptions from rulemaking. The Treasury has proposed rules in these areas, at 17 CFR 400.1-405.3.

For government securities broker-dealers required to register under section 15C(a)(1)(A) of the Exchange Act, the Act directs the Commission to prescribe the forms to be used for registration and for withdrawal from registration, as well as the information that must be filed with the required forms. In addition, the Act authorizes the Commission to establish the form to be used by registered broker-dealers that must file notice with the Commission of their status as government securities broker-dealers. In order to implement the registration, withdrawal from registration, and notice requirements of the Act, the Commission is proposing the rules described more fully below and the corresponding revisions to Form BD. Unless otherwise noted, these rules impose upon government securities broker-dealers required to register under the Act¹⁰ disclosure and filing requirements for registration and withdrawal from registration similar to those that are imposed upon other broker-dealers. The proposed revisions to Form BD are intended to adapt the form for use by government securities broker-dealers applying for registration and by registered broker-dealers notifying the Commission of their government securities activities or intention to cease such activities.

I. Discussion of Rules

1. Proposed Rule 15Cal-1. The Commission is proposing Rule 15Cal-1 to implement the requirement that

Corporation (other than a Federal Savings and Loan Association, Federal Savings Bank, or District of Columbia savings and loan association);

(vi) The Commission, in the case of all other government securities brokers and government securities dealers.

The term "District of Columbia savings and loan associations", means "any association subject to examination and supervision by the Federal Home Loan Bank Board under Section 8 of the Home Owners Loan Act of 1933."

¹⁰ The Commission will exercise its interpretive and no-action authority in determining whether registration under the Act is required. See S. Rep. No. 426, 99th Cong., 2d Sess. n.37 (1986). Requests for interpretive or no-action advice should be addressed to the Chief Counsel, Division of Market Regulation.

government securities broker-dealers already registered with the Commission pursuant to sections 15(b) or 15B(a) of the Exchange Act file written notice with the Commission that they are government securities brokers or dealers.¹¹ The Rule requires such government securities broker-dealers to file notice on Form BD that they are government securities broker-dealers by July 25, 1987. Proposed Rule 15Ca1-1 also requires a registered broker-dealer that begins government securities activities after July 25, 1987 to file written notice on Form BD with the Commission on or prior to the day it begins acting as a government securities broker-dealer. Paragraph (b) of the Rule requires a registered broker-dealer that has previously filed notice of government securities activities to file written notice on Form BD within 30 days of ceasing to act as a government securities broker-dealer.

2. Proposed Rule 15Ca2-1: Under paragraph (a) of proposed Rule 15Ca2-1, government securities broker-dealers required to register pursuant to new section 15C(a)(1)(A) would be required to apply for registration on Form BD. Form BD is the uniform application form for broker-dealer registration¹² used by the Commission, state securities regulators, and the National Association of Securities Dealers, Inc. ("NASD").¹³

¹¹ Section 15C(a)(1)(B).

¹² Form BD is the form filed by an applicant to become registered pursuant to section 15(b) of the Exchange Act. See Rule 15b1-1. In addition, intrastate nonbank municipal securities dealers required to register under Section 15B(a) file an application for registration with the Commission on Form BD. See Rule 15Ba2-2. Municipal securities dealers that are banks or separately identifiable departments or divisions of banks are not brokers or dealers because of the exception for banks contained in the section 3(a)(4) definition of broker and the section 3(a)(5) definition of dealer. These municipal securities dealers are required to register with the Commission under section 15B and file an application for registration on Form MSD. See Rule 15Ba2-1.

¹³ In 1975 the Commission adopted Form BD as a uniform form in order to enable broker-dealer applicants to file a single form for registration as a broker-dealer with the Commission, the states, and the self-regulatory organizations. See Securities Exchange Act Rel. No. 11424 (May 28, 1975), 40 FR 30634. Although the amendments facilitated the use of a single form, duplicative filing requirements remained. See Securities Exchange Act Rel. No. 20020 (July 28, 1983), 48 FR 36115. In 1983 the Commission amended Form BD to reduce those duplicative registration requirements. In addition, the revisions made Form BD and Form BDW, the form used for broker-dealer withdrawal from registration, compatible with the NASD's Central Registration Depository ("CRD"). The CRD provides a computer database that maintains current registration information for every broker-dealer that is a member of the NASD or registered with a state that participates in the CRD system. See Securities Exchange Act Rel. Nos. 20406 (Nov. 22, 1983), 48 FR 54436; 22486 (Sept. 26, 1985), 50 FR 41887 ("1985 Release"); 23646 (Sept. 26, 1986), 51 FR 35655.

Form BD requires that an applicant provide the Commission with information concerning the nature of its business, the background of its principals, its controlling persons, and its employees and is designed to permit the Commission to determine whether the applicant meets the statutory requirements to engage in the securities business.¹⁴ Because the Act requires applicants registering under section 15C(a)(1)(A) to meet substantially the same statutory requirements as other applicants for broker-dealer registration, the Commission has determined to use Form BD as the application for registration for government securities broker-dealers. Government securities broker-dealers required to register pursuant to section 15C(a)(1)(A) will be required to complete all items on the Form.

At present, Rule 15b3-1(b) requires registered broker-dealers to amend their Form BDs promptly whenever information contained in the forms becomes inaccurate.¹⁵ The proposed rules do not contain a similar provision because such amendments are deemed reports under the Act, and the Act vests the Treasury with the authority to adopt reporting requirements. However, the Treasury has proposed a rule requiring that Form BD be amended when the Form as filed becomes inaccurate.¹⁶

3. Proposed Rule 15Ca2-2: Statement of Financial Condition to be Filed with Application for Registration as a Government Securities Broker or Government Securities Dealer. Proposed Rule 15Ca2-2 requires a government securities broker-dealer applying for registration to submit as part of its application on Form BD a statement of financial condition and other information concerning the applicant's financial resources. For example, the Rule requires: (1) Disclosure of the applicant's assets, liabilities and net worth, (2) a schedule listing the applicant's securities and, if readily marketable, their market value, (3) a computation made in accordance with the capital requirements to be established by the Secretary of the Treasury,¹⁷ (4) a statement describing

¹⁴ For example, section 15C of the Exchange Act incorporates by reference the provisions of section 15(b) of the Exchange Act to permit the Commission to deny an applicant's registration if it finds that the applicant has been convicted of committing certain crimes, such as bribery, perjury or burglary within the preceding 10 years.

¹⁵ See also Rules 15Ba2-2(c) and 15Ba2-1(b).

¹⁶ 17 CFR 400.5.

¹⁷ Under the Act, the Secretary of the Treasury is to establish capital adequacy requirements for government securities broker-dealers. The proposed rule, therefore, differs from Rule 15b1-2 because it

the nature and source of capital and representing that such amount of capital has been contributed to and will continue to be devoted to the business, (5) a statement concerning establishment and maintenance of the facilities and financing required for the operation of the business, and (6) a statement for the ensuing year of operations (a) describing the arrangements made for obtaining the funds necessary to operate the business, (b) setting forth the anticipated expenses for that year, and (c) providing information as to any arrangements which have been made to obtain additional financing if it becomes necessary. The purpose of the proposed rule is to allow the Commission to determine whether the applicant has the required amount of capital and the capacity to operate as a going concern.

Many of the government securities brokers and dealers required to register under the Act have been in operation for substantial periods of time. Because these firms often have substantial inventories of securities and adequate, well-established businesses, paragraph (e) of the proposed rule provides that firms in operation for one or more years prior to July 25, 1987, the effective date of the Act, are not required to submit a schedule of securities, a detailed description of the firm's personnel and physical facility, or a detailed description of arrangements for and uses of its funds. Such firms, however, must represent that they have been acting as a government securities broker or dealer as of a date prior to July 25, 1986. In reviewing the appropriateness of this exemption, the Commission requests comment generally on the utility of the information required by this rule to the self-regulatory organizations in reviewing registration applications and admitting applicants to membership.

4. Proposed Rule 14Ca2-3: Registration of Successors. The Commission is proposing a successor rule for government securities broker-dealers similar to that already applicable to broker-dealers registered under section 15(b) of the Act.¹⁸ The rule is intended to provide for a smooth transition when one government securities broker-dealer succeeds to the business of another government

requires information concerning compliance with capital standards as established by the Secretary of the Treasury rather than the Commission.

¹⁸ See Rule 15b1-3 and Rule 15Ba2-4. Similar successor rules also apply to investment advisers. 17 CFR 275.203-1 (c) and (d). For a more complete discussion of the successor rules see 1985 Release, at 16.

securities broker-dealer that is registered pursuant to section 15C(a) of the Act. In general, a broker-dealer succeeds to and continues the business of a predecessor broker-dealer when the successor broker-dealer assumes substantially all the assets and liabilities of the predecessor¹⁹ and therefore closely resembles the predecessor registered government securities broker-dealer.

Paragraph (a) of the rule applies to most instances where a new legal entity succeeds to the business of a registered government securities broker-dealer. The successor is allowed to operate under the registration of the predecessor for 75 days if it files its own complete application for registration on Form BD within 30 days of the date of the succession.²⁰ Paragraph (b) provides special procedures for certain changes in legal status that involve the legal creation of a new entity but no practical change in the broker-dealer—changes in date or state of incorporation, form of organization,²¹ or change in the composition of a partnership. In these instances, paragraph (b) allows the new entity simply to amend the predecessor's Form BD within 30 days of the date of the succession. The amendment would include page 1 of Form BD (the execution page), page 2 (indicating that the applicant is a successor), and any other pages necessary to reflect changes in the successor government securities broker-dealer. In addition, the government securities broker-dealer would be required to comply with Rule 15Ca2-1 and file a statement of financial condition described in Rule 15Ca2-1(a).

5. Proposed Rule 15Ca2-4: Registration as Fiduciaries. The Commission is proposing to adopt for government securities broker-dealers substantially the same rule governing the registration of fiduciaries that applies to registered broker-dealers.²² The proposed rule permits a duly appointed fiduciary to assume immediate responsibility for the operation of a government securities broker-dealer's business. Under the rule, the registration of a government

securities broker-dealer is deemed to be the registration of any executor, guardian, conservator, assignee for the benefit of creditors, receiver, trustee in insolvency or bankruptcy, or other fiduciary appointed or qualified by order, judgment or decree of a court of competent jurisdiction. This enables the fiduciary to continue the business of a registered government securities broker or dealer, provided that the fiduciary files with the Commission, within 10 days after entering upon the performance of his duties, a statement setting forth substantially the same information required by Form BD.

6. Proposed Rule 15Ca2-5: Consent to Service of Process To Be Furnished by Non-Resident Government Securities Brokers or Government Securities Dealers and by Non-Resident General Partners or Managing Agents of Government Securities Brokers or Government Securities Dealers. The Commission is proposing a rule governing service of process for non-resident government securities broker-dealers that is similar to that applied to non-resident registered broker-dealers.²³ Generally, this rule provides that every non-resident government securities broker-dealer applying for registration pursuant to section 15C(a)(1)(A) must provide the Commission with a written irrevocable consent and power of attorney. This consent and power of attorney designates the Commission as an agent upon whom may be served any papers in connection with actions arising from the government securities broker or dealer's government securities business, that are subject to the jurisdiction of the United States and that accrue while the government securities broker or dealer is registered with the Commission.²⁴

²³ See Rule 15b1-5.

²⁴ Under the proposed rule, the government securities broker-dealer's consent and power of attorney relate to causes of action that accrue between the time the government securities broker or dealer becomes registered and when its registration is cancelled or revoked or when a notice to withdraw from registration (Form "BDW") becomes effective. See Rule 15Ca2-5(a). The cut-off date in proposed Rule 15Ca2-5 differs slightly from that in Rule 15b1-5 which relates to causes of action accruing up until the Commission receives a broker-dealer's Form BDW. Because a broker-dealer's withdrawal does not become effective for 60 days from the date the Form BDW is filed, or a longer time if proceedings are instituted pursuant to section 15C, the Commission believes that Rule 15Ca2-5 should provide for causes of action that may accrue between the time a government securities broker-dealer files its Form BDW and the date that notice becomes effective.

The Rule requires that the applicant stipulate to be bound by the service of process upon the Commission as if personal service had been made. Paragraph (b)(1) of the Rule provides that registered government securities broker-dealers that become non-residents must file their consent within 30 days.

Pursuant to Rule 15b1-5, the Commission prescribed a series of forms to be used by non-resident broker-dealers.²⁵ The Commission is not prescribing specific forms under Rule 15Ca2-5; nevertheless, an appropriate form to satisfy the requirements of the Rule would be one of those used for Rule 15b1-5 that is modified to apply to a government securities broker-dealer registered pursuant to section 15C(a)(1)(A).

Unlike Rule 15b1-5, proposed Rule 15Ca2-5 does not grant registered government securities brokers or dealers or those whose registrations are pending when the Rule becomes effective additional time in which to file the consents and powers of attorney.²⁶ Non-resident government securities brokers or dealers that may have already registered would have done so pursuant to section 15(b) of the Exchange Act and the rules thereunder. The consent and power of attorney would have been filed in connection with their original application for registration. Therefore, the Commission believes that these provisions are unnecessary in the proposed rule.

7. Proposed Rule 15Cc1-1: Withdrawal From Registration. Proposed Rule 15Cc1-1 provides that, in order for a government securities broker-dealer to withdraw its registration under section 15C of the Exchange Act, it must file notice of withdrawal from registration with the Commission on Form BDW.²⁷ Registered broker-dealers withdrawing from registration under other provisions of the Exchange Act are required to file the same notice.²⁸ On October 7, 1986 the Commission proposed largely technical revisions to Form BDW that are intended to simplify the form and reduce the regulatory burden on broker-dealers filing Form BDW.²⁹ The

²⁵ See Forms 7-M, 8-M, 9-M, and 10-M.

²⁶ See Rule 15b1-5(b) (1) and (2).

²⁷ Form BDW must be filed only if an entity is completely ceasing its securities business; if an entity is a registered broker-dealer and is ceasing its government securities activities but continuing other securities activities, it must file a notice on Form BD to reflect this change. See proposed Rule 15Ca1-1.

²⁸ See Rule 15b6-1 and rule 15bC-3.

²⁹ See Securities Exchange Act Rel. No. 23948 (September 28, 1986), 51 FR 35655.

¹⁹ The successor rule cannot be used by a government securities broker-dealer to eliminate a substantial liability. See 1985 Release, at 17.

²⁰ The predecessor must file a Form BDW indicating it is withdrawing from business.

²¹ Rule 15b1-3(b) as revised in 1986 contained a typographical error causing the phrase "form of organization" to read as "form or organization." The Commission intended Rule 15b1-3(b) to refer to "form of organization" and interprets the Rule in this manner.

²² See Rule 15b1-4 and 15Ba2-5 concerning broker-dealers registered pursuant to section 15(b) and section 15B, respectively.

proposed rule does not affect those proposed Form BDW revisions.

II. Proposed Revisions to Form BD.³⁰

The Commission proposes to modify Form BD for use as a registration form by government securities broker-dealers by adding a new Item 12. New Item 12 requires an applicant to indicate whether it is applying for registration solely as a government securities broker or dealer. The new Item 12 will enable the Commission, regulatory authorities, and the public to identify government securities brokers or dealers registering pursuant to section 15C(a)(1)(A). In addition, this identification will facilitate the Commission's determination of the broker-dealer's compliance with other applicable requirements.³¹

The Commission also proposes to revise Form BD so that broker-dealers registered or applying for registration pursuant to sections 15 and 15B may use it to notify the Commission of their government securities activities. These broker-dealers would file notice on Form BD by answering "yes" to new Item 13A, indicating they are acting as a government securities broker or dealer. After the effective date of the Act, broker-dealers registered pursuant to sections 15(b) and 15B that have conducted a government securities business also must notify the Commission when they cease their government securities activities.³²

³⁰ In addition to the new Items described below, the Commission is proposing amendments to the instructions page to describe the procedure for registering with the Commission as a government securities broker-dealer and for registered broker-dealers to provide notice of their government securities activities.

³¹ Under the Act, government securities brokers and dealers may be subject to different regulations than broker-dealers registered under Section 15(b). For example, a firm that conducts a business solely in government securities, and therefore registers with the Commission pursuant to section 15C(a)(1)(A), would not be a member of the Securities Investor Protection Corporation ("SIPC"). See S. Rep. No. 426, 99th Cong., 2d. Sess. 25 (1986). In addition, under section 15C(b) the Secretary of the Treasury may adopt for government securities broker-dealers rules governing their books and records and capital requirements that may differ from the rules applicable to broker-dealers generally. Finally, under section 15A(f) of the Act the NASD's rulemaking authority over transactions by government securities broker-dealers in government securities is generally limited to examining for and enforcing compliance with applicable provisions of the Act. The NASD, however, is specifically empowered to adopt rules to prohibit fraudulent, misleading, deceptive, and false advertising.

³² Section 15C(a)(1)(B).

Under the proposed amendments, notice would be filed by answering "yes" to Item 13B, indicating they are ceasing their government securities activities.

Broker-dealers registered with the Commission will have until July 25, 1987, to file this notice with the Commission. Registered broker-dealers that become government securities brokers or dealers after that date will be required pursuant to Rule 15Ca1-1 to notify the Commission on the date they begin acting as a government securities dealer and within thirty days after ceasing these activities.

Depending on their volume of government securities business, broker-dealers filing notice of government securities activities may also have to amend their Form BD to reflect a change in Item 10. Item 10 requires the applicant to check boxes indicating the types of business it is or will be engaged in if a type of business accounts for 10 percent or more of the applicant's annual revenue from the securities or advisory business. Current Item 10 provides a box only for government securities dealer activities. The Commission is proposing to add an additional box for government securities brokers.

III. Proposed Revisions to Rule 15b2-2: Inspection of Newly Registered Brokers and Dealers

Section 15(b)(2)(C) requires the Commission or the responsible self-regulatory organization to conduct an inspection of a broker-dealer³³ within six months³⁴ of granting its registration in order to determine whether the broker-dealer is operating in conformity with the federal securities laws. Pursuant to this requirement the Commission adopted Rule 15b2-2. The Commission is proposing revisions to Rule 15b2-2 to provide for the inspection of newly registered government securities broker-dealers. The Rule requires the responsible self-regulatory organization to conduct inspections of newly registered broker-dealers within six months to a year³⁵ to determine compliance with "applicable financial responsibility rules." The revisions clarify the applicability of the Rule to government securities broker-dealers registered pursuant to section 15C(a)(1)(A) and define "applicable financial responsibility rules" to include

³³ Government securities broker-dealers that are required to register pursuant to section 15C(a) are broker-dealers, and are therefore subject to the Rule.

³⁴ The Commission may delay inspection of any class of brokers or dealers for up to six months. See section 15(b)(2)(C).

³⁵ Rule 15b2-2(c) and (d).

any rule adopted by the Secretary of the Treasury pursuant to section 15C(b)(1).

Cost of Benefits. While there are no direct fees required to file Form BD with the Commission, government securities broker-dealers may incur costs associated with the proposed rules to the extent that the preparation of the required statements becomes time-consuming or requires the assistance of legal or accounting advice. These costs are difficult to estimate; therefore, the Commission solicits comments on the specific costs firms would face in complying with the proposed rules. The Commission is particularly interested in comments that identify the sources and expected amount of expenditure needed to meet the requirements of the individual rule proposals as well as suggestions for alternative, less costly methods to comply effectively with the intent of the Act.

The benefits of the proposed rules may be viewed in terms of how effectively they implement the intent of Congress to increase confidence in the government securities market and to reduce risks by having U.S. government securities brokers and dealers register or file notice with the appropriate regulatory authority.

The Commission believes that investor protection will be enhanced by the proposed registration requirements, because they should provide an adequate basis for determining whether a firm meets minimum industry standards for operating as a government securities broker or dealer. In the case of succession or withdrawal, the rules would allow for a smooth, continuous transition in management and, as with withdrawal applications, enable the Commission to determine if any further action is necessary. Another major benefit of the proposed registration procedure is that it implements the requirements of the Act while using a pre-existing method and a standard form familiar to the broker-dealer industry and that is also used by the states and the NASD.

The Commission solicits comments on the costs and benefits of the proposed rules and form changes. The Commission is particularly interested in comments addressing the identification of other sources of costs and benefits and the quantification of costs and benefits to the proposed amendments.

IV. Regulatory Flexibility Act Considerations

The Regulatory Flexibility Act establishes procedural requirements applicable to agency rulemaking that has a "significant economic impact on a

substantial number of small entities." ³⁶ The Chairman of the Commission has certified pursuant to that Act that the proposed amendments to Rule 15b2-2, if adopted, will not have a significant economic impact on a substantial number of small entities. Rule 15b2-2 provides for inspections of newly registered broker-dealers by the NASD and the exchanges. Most government securities broker-dealers will belong to the NASD, therefore, the NASD will incur most of the costs associated with the proposed amendments to Rule 15b2-2. The NASD, however, is not a small organization under § 601(4) of the Regulatory Flexibility Act because the NASD is considered "dominant in its field."

Under Rule 0-11(e) of the Exchange Act, the Commission defines a small organization, when used with reference to an exchange as any exchange that has been exempted from the reporting requirements of Rule 11Aa3-1. There is only one exchange, the Spokane Exchange, that falls within the definition of small organization. It is not expected that government securities broker-dealers will join the Spokane Exchange. Therefore, it is unlikely that there will be any economic impact on an exchange that is a small entity.

The proposed amendments to Rule 15b2-2 may result in indirect costs to government securities broker-dealers that are small entities. The costs, however, of being inspected by the NASD or the exchanges are minimal and will not have a significant economic impact on such government securities broker-dealers.

The Commission has prepared an Initial Regulatory Flexibility Analysis in accordance with 5 U.S.C. 603 regarding proposed rules 15Ca1-1, 15Ca2-1, 15Ca2-2, 15Ca2-3, 15Ca2-4, 15Ca2-5, 15Cc1-1, 15b2-2, and proposed revisions to Form BD. The Analysis notes that the

³⁶ Although section 601(b) of the Regulatory Flexibility Act defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions of the term small entity for purposes of Commission rulemaking in accordance with the Regulatory Flexibility Act. Those definitions, as relevant to this certification, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Rel. No. 18452 (January 28, 1982), 47 FR 5215. An exchange generally is a "small business" or "small organization" if it has been exempted from the reporting requirements of 17 CFR 240.11Aa3-1. See Rule 0-10(e). A broker or dealer generally is a "small business" or "small organization" if it had total capital of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a-5(d) or if not required to file such statements a broker or dealer that had total capital, net worth plus subordinated liabilities, of less than \$500,000 on the last business day of the preceding fiscal year. See Rule 0-10(c), 17 CFR 240.0-10(c).

objective of the rules is to implement the provisions of the Act. The Analysis utilized the Commission's Rule 0-10 under the Exchange Act, which defines small entities when used in reference to a broker-dealer. The Commission believes that the proposed rules will have a significant economic impact on a substantial number of small entities. The impact, however, has been minimized by requiring government securities broker-dealers to register using the same form as the form used for registration of other broker-dealers.

The intent of and the possible costs and benefits of each rule proposal is also discussed in the Analysis. Comments are solicited with respect to this initial regulatory analysis and the appropriateness of the current definition of a small broker-dealer for purposes of the Analysis.

A copy of the Initial Regulatory Flexibility Analysis may be obtained by contacting Lynne G. Masters, Esq., Division of Market Regulation, Securities and Exchange Commission, Washington, DC 20549, (202) 272-2848.

V. Statutory Authority

Pursuant to the Securities Exchange Act of 1934 and particularly sections 3, 15(b), 15C(a), and 23 thereof, 15 U.S.C. 78c, 78o(b), 78o-5(a), and 78w, the Commission proposes to adopt §§ 240.15Ca1-1, 240.15Ca2-1, 240.15Ca2-2, 240.15Ca2-3, 240.15Ca2-4, 240.15Ca2-5, 240.15Cc1-1, and to amend § 240.15b2-2 and Form BD, § 249.501 of Title 17 of the Code of Federal Regulations, in the manner set forth below.

VI. Text of Proposed Amendments

In accordance with the foregoing, it is proposed to amend 17 CFR Part 240 as follows:

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

1. The authority citation for Part 240 is amended by adding the following citations:

Authority: Sec. 23, 48 Stat. 901 as amended 15 U.S.C. 78w * * * Section 240.15b2-2, also issued under Secs. 3, 15 U.S.C. 78c, and 15, 15 U.S.C. 78o, Secs. 240.15Ca1-1, 240.15Ca2-1, 240.15Ca2-2, 240.15Ca2-3, 240.15Ca2-4, 240.15Ca2-5, 240.15Cc1-1, also issued under Secs. 3, 15 U.S.C. 78c, 15C, 15 U.S.C. 78o-5, * *

2. § 240.15b2-2 is amended by revising paragraphs (a) and (b) as follows:

§ 240.14b2-2. Inspection of newly registered brokers and dealers.

(a) *Definition*. For the purpose of this section the term "applicable financial responsibility rules" shall include: (1) Any rule adopted by the Commission pursuant to sections 8, 15(c)(3), 17(a), or 17(e)(1)(A) of the Act; (2) any rule adopted by the Commission relating to hypothecation or lending of customer securities; (3) any other rule adopted by the Commission relating to the protection of funds or securities; and (4) any rule adopted by the Secretary of the Treasury pursuant to section 15C(b)(1) of the Act.

(b) Each self-regulatory organization that has responsibility for examining a broker or dealer member (including members that are government securities brokers or government securities dealers registered pursuant to section 15C(a)(1)(A) of the Act) for compliance with applicable financial responsibility rules is authorized and directed to conduct an inspection of the member, within six months of the member's registration with the Commission, to determine whether the member is operating in conformity with applicability financial responsible rules.

* * * * *

Registration of Government Securities Brokers and Government Securities Dealers

3. By adding §§ 240.15Ca1-1, 240.15Ca2-1, 240.15Ca2-2, 240.15Ca2-3, 240.15Ca2-4, 240.15Ca2-5, 240.15Cc1-1 after the undesignated heading above as follows:

§ 240.15Ca1-1. Notice of government securities broker-dealer activities.

(a) Every government securities broker or government securities dealer that is a broker or dealer registered pursuant to sections 15 or 15B of the Act (other than a financial institution as defined in section 3(a)(46) of the Act) shall file with the Commission written notice on Form BD (§ 249.501 of this chapter) in accordance with the instructions contained therein that it is a government securities broker or government securities dealer. After July 25, 1987, every broker or dealer subject to this paragraph shall file notice that it is a government securities broker or government securities dealer prior to or on the date it begins acting as a government securities broker or government securities dealer.

(b) Every government securities broker or government securities dealer required to file notice under paragraph (a) of this section shall file with the Commission written notice on Form BD in accordance with the instructions

contained therein when it ceases to be a government securities broker or government securities dealer. Notice shall be filed within 30 days after the date the broker or dealer has ceased acting as a government securities broker or a government securities dealer.

§ 240.15Ca2-1. Application for registration as a government securities broker or a government securities dealer.

(a) An application for registration pursuant to section 15C(a)(1)(A) of the Act of a government securities broker or government securities dealer shall be filed with the Commission on Form BD (§ 249.501 of this chapter) in accordance with the instructions contained therein.

(b) Every amendment to Form BD filed by a government securities broker or government securities dealer registered pursuant to section 15C(a)(1)(A) of the Act shall constitute a "report" within the meaning of sections 15, 15C, and 32(a) of the Act.

§ 240.15Ca2-2. Statement of financial condition to be filed with application for registration as a government securities broker or government securities dealer.

(a) Every government securities broker or government securities dealer who files an application for registration on Form BD pursuant to Rule 15Ca2-1 shall file with such application a statement of financial condition as of a date no more than 30 days after the date on which such statement is filed and as of a later date reflecting any material change, if there has been a material change. Such statement of financial condition shall: (1) Be in such detail as will disclose the nature and amount of assets and liabilities and the net worth of such government securities broker or government securities dealer; (2) contain a schedule listing the securities of such government securities broker or government securities dealer or in which such government securities broker or government securities dealer has an interest and, if a ready market for the security exists, valuing the security at the market price with an indication of the market on which such valuation is made, and (3) contain a computation made in accordance with the capital requirements applicable to the business of such government securities broker or government securities dealer under the capital rules established by the Secretary of the Treasury. For purposes of this paragraph (a), if the government securities broker or government securities dealer is a sole proprietorship, the personal assets and liabilities of such government securities broker or government securities dealer shall be included in the computations of

its net worth and the Treasury capital requirements pursuant to clauses (1) and (3) hereof in testing compliance with the applicable capital rules.

(b) The schedule of securities furnished as a part of such statement of financial condition shall be deemed confidential if bound separately from the balance of such statement, except that it shall be available for official use by any official or employee of the United States or any state, by any national securities exchange or national securities association of which the person filing such statement is a member, or with whom the person is seeking to be associated, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest.

(c) Every government securities broker or government securities dealer who files an application for registration on Form BD pursuant to Rule 15Ca2-1 shall file with such application a statement that shall include the following:

(1) A representation that the capital of such government securities broker or government securities dealer has been contributed, and that such amount of capital will continue to be devoted to its business as government securities broker or government securities dealer, and a description of the nature and source of such capital, and

(2) A representation that adequate arrangements have been made by such government securities broker or government securities dealer for the establishment and maintenance of adequate facilities and financing required for the carrying on of its business as a government securities broker or government securities dealer, and an undertaking that such government securities broker or government securities dealer will continue to maintain facilities and financing adequate for its business, and a detailed statement thereof, including a discussion of the nature of such arrangements with respect to (i) personnel, (ii) physical facilities, (iii) the maintenance and preservation of books and records as required by applicable provisions of law and any applicable rules of any national securities exchange or national securities association of which such government securities broker or government securities dealer is a member, including information concerning any arrangements made for the adequate performance of these functions and duties with a bookkeeping service company or data processing service

company, or otherwise, and (iv) the methods and procedures to be employed by such government securities broker or government securities dealer for the purpose of supervising the activities of persons associated with it, and

(3) A statement describing the arrangements made for the obtaining of the funds required for the operation of its business for the first year of operations after registration, and the uses to which such funds will be put, stating in appropriate detail the expenses expected to be incurred for such first year of operations after registration; and setting forth the arrangements made, if any, for the obtaining of additional funds if such funds should become necessary.

(d) Attached to each of the statements required by this rule shall be an oath or affirmation that the information contained therein is true and correct to the best knowledge and belief of the person making such oath or affirmation. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the government securities broker or government securities dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; if a corporation, by a duly authorized officer.

(e)(1) The provisions of this rule shall not apply to a government securities broker or government securities dealer succeeding to and continuing the business of a registered government securities broker or government securities dealer, provided that such successor government securities broker or government securities dealer files with the application on Form BD a statement of financial condition as specified in paragraph (a) of this section.

(2) The information required pursuant to paragraphs (a)(2), (c)(2)(i), (c)(2)(ii), and (c)(3) of this rule shall not apply to a government securities broker or government securities dealer that has been acting continuously as a government securities broker or government securities dealer for one or more years prior to July 25, 1987, and who files with its application for registration a representation that it has been acting as a government securities broker or dealer as of a date prior to July 25, 1986.

(3) The Commission may, upon written request or upon its own motion, exempt from the provisions of this rule any government securities broker or government securities dealer, either unconditionally or on specified terms or conditions, as it deems necessary or

appropriate in the public interest or for the protection of investors.

(4) The statement of financial condition required by this rule shall be deemed a part of the application for registration within the meaning of the provisions of sections 15, 15C and 32(a) of the Act authorizing the Commission to prescribe the form of application for registration of a government securities broker or government securities dealer and prohibiting the filing of a false application.

§ 240.15Ca2-3. Registration of successor to registered government securities broker or government securities dealer.

(a) If a government securities broker or government securities dealer succeeds to and continues the business of a government securities broker or government securities dealer registered pursuant to section 15C(a)(1)(A) of the Act, the registration of the predecessor shall be deemed to remain effective as the registration of the successor for a period of 75 days after such succession, provided that an application for registration on Form BD (§ 249.501 of this chapter) is filed by such successor within 30 days after such succession.

(b) Notwithstanding the proviso to paragraph (a) of this rule, if a government securities broker or government securities dealer succeeds to and continues the business of a predecessor government securities broker or government securities dealer that is registered pursuant to section 15C(a)(1)(A) of the Act, and the succession is based solely on a change in the predecessor's date or state of incorporation, form of organization, or change in composition of a partnership, the registration of the successor may be effected by amending within 30 days of the succession the Form BD of the predecessor to reflect these changes. This amendment shall be deemed an application for registration filed by the predecessor and adopted by the successor. This successor government securities broker or government securities dealer also must file with its Form BD amendment the statements of financial condition specified in Rule 15Ca2-2.

§ 240.15Ca2-4 Registration of fiduciaries.

The registration of a government securities broker or government securities dealer pursuant to section 15C of the Act shall be deemed to be the registration of any executor, administrator, guardian, conservator, assignee for the benefit of creditors, receiver, trustee in insolvency or bankruptcy, or other fiduciary, appointed or qualified by order,

judgment, or decree of a court of competent jurisdiction to continue the business of such registered government securities broker or government securities dealer, provided that such fiduciary files with the Commission, no more than 30 days after entering upon the performance of its duties, a statement setting forth as to such fiduciary substantially the information required by Form BD.

§ 240.15Ca2-5. Consent to service of process to be furnished by non-resident government securities brokers or government securities dealers and by non-resident general partners or managing agents of government securities brokers or government securities dealers.

(a) Each non-resident government securities broker or government securities dealer applying for registration pursuant to section 15C(a)(1)(A) of the Act, each non-resident general partner of a government securities broker or government securities dealer partnership that is applying for such registration, and each non-resident managing agent of any other unincorporated government securities broker or government securities dealer that is applying for registration, shall furnish to the Commission, in a form acceptable to the Commission, a written irrevocable consent and power of attorney that: (1) designates the Securities and Exchange Commission as an agent of such government securities broker or government securities dealer upon whom may be served any process, pleadings, or other papers in any civil suit or action brought in any appropriate court in any place subject to the jurisdiction of the United States, with respect to any cause of action (i) that accrues during the period beginning when such government securities broker or government securities dealer becomes registered pursuant to section 15C(a)(1)(A) of the Act and ending either when such registration is cancelled or revoked, or when a notice filed by such government securities broker or government securities dealer to withdraw from such registration becomes effective, whichever is earlier, (ii) that arises out of any activity, in any place subject to the jurisdiction of the United States, occurring in connection with the conduct of the business of such government securities broker or government securities dealer, and (iii) that is founded, directly or indirectly, upon the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, or any

rule or regulation under any of those Acts, and (2) stipulates and agrees that any such civil suit or action may be commenced against such government securities broker or government securities dealer by the service of process upon the Commission and the forwarding of a copy thereof as provided in paragraph (c) of this section and that the service as aforesaid of any such process, pleadings or other papers upon the Commission shall be taken and held in all courts to be as valid and binding as if due personal service thereof had been made.

(b) Each government securities broker or government securities dealer registered pursuant to section 15C(a)(1)(A) of the Act that becomes a non-resident government securities broker or government securities dealer, and each general partner or managing agent of an unincorporated government securities broker or government securities dealer registered or applying for registration pursuant to section 15C(a)(1)(A) of the Act who becomes a non-resident after such registration or filing of an application for such registration, shall furnish such consent and power of attorney no more than 30 days thereafter.

(c) Service of any process, pleadings or other papers on the Commission under this rule shall be made by delivering the requisite number of copies thereof to the Secretary of the Commission or to such other person as the Commission may authorize to act in its behalf. Whenever any process, pleadings, or other papers as aforesaid are served upon the Commission, it shall promptly forward a copy thereof by registered or certified mail to the appropriate defendants at their last address of record filed with the Commission; but any failure by the Commission to forward such a copy shall have no effect on the validity of the service made upon the Commission. The Commission shall be furnished a sufficient number of copies for such purpose, and one copy for its file.

(d) For purposes of this rule the following definitions shall apply:

(1) The term "managing agent" shall mean any person, including a trustee, who directs or manages or who participates in the directing or managing of the affairs of any unincorporated organization or association that is not a partnership.

(2) The term "non-resident government securities broker or government securities dealer" shall mean: (i) In the case of an individual, one who is domiciled in or has his principal place of business in any place

not subject to the jurisdiction of the United States, (ii) in the case of a corporation, one incorporated in or having its principal place of business in any place not subject to the jurisdiction of the United States; (iii) in the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not subject to the jurisdiction of the United States.

(3) A general partner or managing agent of a government securities broker or government securities dealer shall be deemed to be a non-resident if he is domiciled in any place not subject to the jurisdiction of the United States.

§ 240.15Cc1-1. Withdrawal from registration.

(a) Notice of withdrawal from registration as a government securities broker or government securities dealer pursuant to section 15C(a)(1)(A) of the Act shall be filed on Form BDW in accordance with the instructions contained therein.

(b) Except as hereinafter provided, a notice to withdraw from registration filed by a government securities broker or government securities dealer shall become effective for all matters on the sixtieth day after the filing thereof with the Commission or within such shorter period of time as the Commission shall determine. If a notice to withdraw from registration is filed with the Commission at any time subsequent to the date of the issuance of a Commission order instituting proceedings pursuant to section 15C(c) to censure, place limitations on the activities, functions or operations of, suspend or revoke the registration of, such government securities broker or government securities dealer or if, before the effective date of the notice of withdrawal pursuant to this paragraph (b), the Commission institutes such a proceeding or a proceeding to impose terms or conditions upon such withdrawal, the notice of withdrawal shall not become effective pursuant to

this paragraph (b) except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

(c) Every notice of withdrawal filed pursuant to this section shall constitute a "report" within the meaning of sections 15, 15C, and 32(a) of the Act.

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

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

Authority: The Securities Exchange Act of 1934, 15 U.S.C. 78a. *et seq.*

5. FORM BD prescribed by § 249.501 is revised as follows: Revisions to the Instructions page, New Items 12 and 13 added, Item 10 amended. (FORM BD does not appear in the Code of Federal Regulations). The revised Form BD with the exception of Schedules A-E which are unchanged appears in the Appendix below.

By the Commission,
Shirley E. Hollis,
Assistant Secretary,
February 18, 1987.

Appendix—Form BD

Note.—This appendix will not appear in the Code of Federal Regulations.

OMB APPROVAL

OMB No. 3235-0012
Expires May 31, 1988

U.S. Securities and Exchange Commission, Washington, D.C. 20549

Special Instructions for Completing or Amending Form BD, Uniform Application for Registration as a Broker-Dealer, with the U.S. Securities and Exchange Commission.

How and Where to File

File Form BD and its schedules in triplicate with the Securities and Exchange Commission, Washington, D.C. 20549. Manually sign and notarize all three copies on the execution page.

Keep a copy. Duplicated copies may be filed if manually signed. Copies must be made on standard size white paper, in the same size as the original.

Form BD Initial Filings—Required Statements

Rule 15b1-2 and Rule 15Ca2-2 require filing with each initial Form BD application two copies of special statements of financial condition, capital contribution, facilities, and first-year funding. (See Securities Exchange Act Release No. 9594 (May 12, 1972); Securities Exchange Act Release No. 24109 (Feb. 18, 1987).)

Successor Registration

A broker-dealer that assumes substantially all the assets and liabilities of and continues the business of a predecessor broker-dealer is a successor broker-dealer. Rule 15b1-3 and Rule 15Ca2-3 require a successor broker-dealer to file a new Form BD (or, in special instances, to amend the predecessor broker-dealer's Form BD) within 30 days. The filing must indicate on page 2 of the form that the applicant is a successor and must contain the statement of financial condition required by Rule 15b1-2 or Rule 15Ca2-1 Form BD successor filings. (See Securities Exchange Act Release No. 22468, (September 26, 1985); Securities Exchange Act Release No. 24109 (Feb. 18, 1987).)

Prohibited Broker-Dealer Names

United States Code Title 18 Section 709 makes a criminal offense of using the words "National," "Federal," "United States," "reserve," or "Deposit Insurance" in the name of a person or organization in the brokerage business, unless otherwise allowed by Federal law. If these words are used in the applicant's name, include an opinion of counsel with the Form BD explaining why the words are permitted.

BILLING CODE 8010-01-M

OMB APPROVAL
OMB Number: 3235-3013
Expires: Pending Action

Instructions for Form BD

1. Updating - By law, the applicant must update the Form BD information by submitting amendments whenever the information on file changes. Complete all amended pages in full and circle the number of the item being changed.
2. Contact Employee - The individual listed on page 1 as the contact employee must be authorized to receive all compliance information, communications and mailings and be responsible for disseminating it within the applicant's organization.
3. Format
 - o Attach an execution page (page 1) with original manual signatures to the initial Form BD filing and each amendment to the form or Schedules A through D.
 - o Type all information.
 - o Give the broker-dealer and date on each page.
 - o Use only the Form BD and its Schedules or a reproduction of them.
4. Definitions
 - o Applicant - The broker-dealer applying on or amending this form.
 - o Control - The power to direct or cause the direction of the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any individual or firm that is a director, partner or officer exercising executive responsibility (or having similar status or functions) or that directly or indirectly has the right to vote 25 percent or more of the voting securities or is entitled to 25 percent or more of the profits is presumed to control that company.
 - o Jurisdiction - Any non-Federal government or regulatory body in the United States, Puerto Rico or Canada.
 - o Person - An individual, partnership, corporation or other organization.
 - o Self-regulatory organization - Any national securities or commodities exchange or registered securities association, or registered clearing agency.
5. Schedule A, B and C - Individuals not required to have a Form U-4 (individual registration) in the Central Registration Depository (CRD) who are listed on Schedules A, B or C must attach page 2 of Form U-4. The applicant broker-dealer must appear in Form U-4 Item 19 or 20. Signatures are not required.
6. Schedule D - Schedule D provides additional space for explaining "Yes" answers to Form BD items, but not for continuing Schedules A, B or C. To continue Schedules A, B or C, use copies of the Schedule being continued.
7. Schedule E - Schedule E Amendments to report changes in Branch Offices may be submitted without an execution page.
8. Federal Information Law and Requirements - The Securities Exchange Act of 1934, Sections 15, 15C, 17(a) and 23(a), authorize the SEC to collect the information on this form from applicants for registration as a broker or dealer (and persons associated with applicants). The information is used for regulatory purposes, including deciding whether to grant registration. The SEC maintains files of the information on this form and makes it publicly available. Only the Social Security Number information, which aids in identifying the applicant, is voluntary.
9. Government Securities Activities
 - A. Section 15C of the Exchange Act requires government securities broker-dealers to register with the SEC. To do so, use Form BD and answer "yes" to Item 12 if conducting only a government securities business.
 - B. Broker-dealers registered or applicants applying for registration under Section 15(b) or 15B of the Exchange Act that conduct (or intend to conduct) a government securities business in addition to other broker-dealer activities (if any) must file a notice on Form BD by answering "yes" to Item 13A.
 - C. Broker-dealers registered under Section 15(b) or 15B of the Exchange Act that cease to conduct a government securities business must file notice when ceasing their activities in government securities. To do so, file an amendment to Form BD and answer "yes" to Item 13B.

FORM 8D PAGE 1 <small>(Execution Page) Revised 1/86</small>	UNIFORM APPLICATION FOR BROKER-DEALER REGISTRATION	OFFICIAL USE
<p>WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as a broker-dealer would violate the Federal securities laws and the laws of the jurisdictions and may result in disciplinary, administrative, injunctive or criminal action. INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.</p>		
<input type="checkbox"/> APPLICATION <input type="checkbox"/> AMENDMENT FIRM CRD NO.: _____		
<p>1 Exact name, principal business address, mailing address, if different, and telephone number of applicant:</p> <p>A. Full name of applicant (If sole proprietor, state last, first, and middle name) B. IRS Empl. Ident. No.:</p> <p>_____</p> <p>C. Name under which business is conducted, if different:</p> <p>_____</p> <p>D. If name of business is hereby amended, state previous name:</p> <p>_____</p> <p>E. Firm main address:</p> <p>_____ (Number and Street) _____ (City) _____ (State) _____ (Zip Code)</p> <p>Mailing Address, if different:</p> <p>_____</p> <p>F. Telephone Number:</p> <p>_____ (Area Code) _____ (Telephone Number)</p> <p>G. CONTACT EMPLOYEE:</p> <p>_____</p>		
<p>EXECUTION. For the purpose of complying with the laws of the State(s) I have designated in Item 2 relating to either the offer or sale of securities or commodities, I hereby certify that the applicant is in compliance with applicable state surety bonding requirements and irrevocably appoint the administrator of each of those State(s), or such other person designated by law, and the successors in such office, my attorney in said State(s) upon whom may be served any notice, process or pleading in any action or proceeding against me arising out of or in connection with the offer or sale of securities or commodities, or out of the violation or alleged violation of the laws of those State(s) and I do hereby consent that any such action or proceeding against me may be commenced in any court of competent jurisdiction and proper venue within said State(s) by service of process upon said appointee with the same effect as if I were a resident in said State(s) and had lawfully been served with process in said State(s).</p> <p>The undersigned, being first duly sworn, deposes and says that he has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including exhibits attached hereto and other information filed herewith, all of which are made a part hereof, are current, true, and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended, such information is currently accurate and complete.</p> <p>_____ Date _____ Name of Applicant</p> <p>By _____ Signature and Title</p> <p>Subscribed and sworn before me this _____ day of _____, 19____ by _____</p> <p>My commission expires _____ County of _____ State of _____</p> <p style="text-align: center;"><i>This page must always be completed in full with original, manual signature and notarization. To amend, circle item(s) being amended.</i></p>		
DO NOT WRITE BELOW THIS LINE FOR OFFICIAL USE ONLY		

To amend, circle question numbers amended and file with a completed Execution page (Page 1).

FORM 8D Page 2	Applicant Name: _____ Date: _____ Firm CRD No.: _____	OFFICIAL USE																																																																			
<p>2. To be registered with the following: (designate: "1" Initial Registration, "2" Pending, "3" Already Registered. If any license, registration or membership listed herein is of a restricted nature, explain fully on Schedule D.)</p> <p style="text-align: center;"><input type="checkbox"/> SECURITIES & EXCHANGE COMMISSION</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 5%; text-align: center;">S E C</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> ASE</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> BSE</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> CBOE</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> CSE</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> MSE</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> NASD</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> NYSE</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> PHLX</td> <td style="width: 5%; text-align: center;"><input type="checkbox"/> PSE</td> <td style="width: 5%; 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<p>3. Date of formation: _____ Place of filing: _____ for</p> <p><input type="checkbox"/> Corporation Complete Schedule A <input type="checkbox"/> Partnership Complete Schedule B <input type="checkbox"/> Sole Proprietorship Complete Schedule C</p> <p><input type="checkbox"/> Other (specify) _____ Complete Schedule C</p>																																																																					
<p>4. If applicant is a sole proprietor, state full residence address and social security number</p> <p>_____ (Number and Street) _____ (City) _____ (State) _____ (Zip Code)</p> <p style="text-align: right;">Social Security No. _____</p>																																																																					
<p>5. Is applicant a successor to a registered broker dealer? YES NO</p> <p>If yes, explain on Schedule D. _____ <input type="checkbox"/> <input type="checkbox"/></p> <p>If yes, state _____</p> <p>A. Date of Succession: _____</p> <p>B. Full name, IRS Empl Ident No, SEC File No, and Firm CRD No of predecessor broker-dealer</p> <p>Name: _____</p> <p>IRS Empl Ident No: _____ FIRM CRD No: _____</p> <p>SEC File Number: _____</p>																																																																					
<p>6. A. Does any person not named in Item 1 or Schedules A, B or C, directly or indirectly through agreement or otherwise, exercise or have the power to exercise control over the management or policies of applicant? YES NO</p> <p>(If yes, state on Schedule D the exact name of each person (if individual, state last, first, and middle names) and describe the agreement or other basis through which such person exercises or has the power to exercise control.) <input type="checkbox"/> <input type="checkbox"/> 1</p> <p>B. Is the business of applicant wholly or partially financed, directly or indirectly, by any person not named in Item 1 or Schedules A, B or C, in any manner other than by (1) a public offering of securities made pursuant to the Securities Act of 1933; (2) credit extended in the ordinary course of business by suppliers, banks and others, or a satisfactory subordination agreement, as defined in Rule 15c3.1 under the Securities Exchange Act of 1934 (17CFR 240.15c3-1)? YES NO</p> <p>(If yes, state on Schedule D the exact name (last, first, middle) of each person and describe the agreement or arrangement through which such financing is made available, including the amount thereof.) <input type="checkbox"/> <input type="checkbox"/> 2</p>																																																																					

To amend, circle question numbers amended and file with a completed Execution page (Page 1).

FORM BD Page 3	OFFICIAL USE
Applicant Name _____	
Date _____ Firm CRD No. _____	
7 Definitions	
<ul style="list-style-type: none"> ● Control affiliate — An individual or firm that directly or indirectly controls, is under common control with, or is controlled by the applicant. Included are any employees identified in Schedules A, B or C of this form as exercising control. Excluded are any employees who perform clerical, administrative, support or similar functions; or who, regardless of title, perform no executive duties or have no senior policy making authority ● Investment or investment-related — Pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, futures sponsor, bank, or savings and loan association). ● Involved — Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act. 	
A. In the past ten years has the applicant or control affiliate been convicted of or pleaded guilty or nolo contendere ("no contest") to:	
(1) a felony or misdemeanor involving investment or an investment-related business, fraud, false statements or omissions, wrongful taking of property, or bribery, forgery, counterfeiting or extortion?	YES <input type="checkbox"/> NO <input type="checkbox"/> 3
(2) any other felony?	YES <input type="checkbox"/> NO <input type="checkbox"/> 4
B Has any court	
(1) In the past ten years enjoined the applicant or a control affiliate in connection with any investment-related activity?	YES <input type="checkbox"/> NO <input type="checkbox"/> 5
(2) ever found that the applicant or a control affiliate was involved in a violation of investment-related statutes or regulations?	YES <input type="checkbox"/> NO <input type="checkbox"/> 6
C Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever	
(1) found the applicant or a control affiliate to have made a false statement or omission?	YES <input type="checkbox"/> NO <input type="checkbox"/> 7
(2) found the applicant or a control affiliate to have been involved in a violation of its regulations or statutes?	YES <input type="checkbox"/> NO <input type="checkbox"/> 8
(3) found the applicant or a control affiliate to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked, or restricted?	YES <input type="checkbox"/> NO <input type="checkbox"/> 9
(4) entered an order denying, suspending or revoking the applicant's or a control affiliate's registration or otherwise disciplined it by restricting its activities?	YES <input type="checkbox"/> NO <input type="checkbox"/> 10
D Has any other Federal regulatory agency or any state regulatory agency	
(1) ever found the applicant or a control affiliate to have made a false statement or omission or been dishonest, unfair, or unethical?	YES <input type="checkbox"/> NO <input type="checkbox"/> 11
(2) ever found the applicant or a control affiliate to have been involved in a violation of investment regulations or statutes?	YES <input type="checkbox"/> NO <input type="checkbox"/> 12
(3) ever found the applicant or a control affiliate to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked, or restricted?	YES <input type="checkbox"/> NO <input type="checkbox"/> 13
(4) in the past ten years entered an order against the applicant or a control affiliate in connection with investment-related activity?	YES <input type="checkbox"/> NO <input type="checkbox"/> 14
(5) ever denied, suspended, or revoked the applicant's or a control affiliate's registration or license, prevented it from associating with an investment-related business, or otherwise disciplined it by restricting its activities?	YES <input type="checkbox"/> NO <input type="checkbox"/> 15
(6) ever revoked or suspended the applicant's or a control affiliate's license as an attorney or accountant?	YES <input type="checkbox"/> NO <input type="checkbox"/> 16

To amend, circle question numbers amended and file with a completed Execution page (Page 1).

FORM BD Page 4	OFFICIAL USE
Applicant Name _____	
Date _____ Firm CRD No. _____	
E Has any self-regulatory organization or commodities exchange ever	
(1) found the applicant or a control affiliate to have made a false statement or omission?	YES <input type="checkbox"/> NO <input type="checkbox"/> 17
(2) found the applicant or a control affiliate to have been involved in a violation of its rules?	YES <input type="checkbox"/> NO <input type="checkbox"/> 18
(3) found the applicant or a control affiliate to have been the cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?	YES <input type="checkbox"/> NO <input type="checkbox"/> 19
(4) disciplined the applicant or a control affiliate by expelling or suspending it from membership, by barring or suspending its association with other members, or by otherwise restricting its activities?	YES <input type="checkbox"/> NO <input type="checkbox"/> 20
F Has any foreign government, court, regulatory agency, or exchange ever entered an order against the applicant or a control affiliate related to investments or fraud?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 21	
G Is the applicant or a control affiliate now the subject of any proceeding that could result in a "yes" answer to parts A-F of this item?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 22	
H Has a bonding company denied, paid out on, or revoked a bond for the applicant?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 23	
I Does the applicant have any unsatisfied judgments or liens against it?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 24	
J Has the applicant or a control affiliate of the applicant ever been a securities firm or a control affiliate of a securities firm that has been declared bankrupt, had a trustee appointed under the Securities Investor Protection Act, or had a direct payment procedure begun?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 25	
Item 7 Instructions	
If a "yes" answer on Item 7 involves:	
<ul style="list-style-type: none"> ● the applicant broker-dealer, or an individual without a Form U-4 (individual registration) in the CRD, give the details on Schedule D. ● an individual with a Form U-4 (individual registration) in the CRD, attach any necessary Form U-4 amendments to the Form BD. The CRD will update the Forms U-4 and BD. 	
For each "yes" to Item 7, give the following details of any court or regulatory action:	
<ul style="list-style-type: none"> ● the broker-dealer and individuals named, ● the title and date of the action, ● the court or body taking the action, and ● a description of the action. 	
8. Does applicant:	
A. Have any arrangement with any other person, firm or organization under which	
(1) Any of the accounts or records of applicant are kept or maintained by such person, firm, or organization?	YES <input type="checkbox"/> NO <input type="checkbox"/> 26
(2) Such other person, firm or organization (other than a bank or satisfactory control location as defined in paragraph (c) of Rule 15c3-3 under the Securities Exchange Act of 1934, 17 CFR §240.15c3-3) holds or maintains funds or securities of applicant or of any of its customers?	YES <input type="checkbox"/> NO <input type="checkbox"/> 27
B. Have any arrangements with any other broker or dealer under which applicant refers or introduces customers to such other broker or dealer?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 28	
(If the answer to any question of Item 8 is "yes," furnish as to each such arrangement the full name and principal business address of the other person, firm, or organization, and the summary of each such arrangement on Schedule D.)	
9. Does applicant control, is applicant controlled by, or is applicant under common control with, directly or indirectly, any partnership, corporation, or other organization engaged in the securities or investment advisory business?	
YES <input type="checkbox"/> NO <input type="checkbox"/> 29	
(If "yes," state full name and principal business address of such partnership, corporation, or other organization and describe the nature of control on Schedule D. See instructions for definition of control.)	

To amend, circle question numbers amended and file with a completed Execution page (Page 1).

FORM 80 Page 5 Applicant Name _____ Date _____ Firm CRD No. _____	OFFICIAL USE

10. Check types of business engaged in (or to be engaged in, if not yet active) by applicant. Do not check any category which accounts for or is expected to account for less than 10% of annual revenue from the securities or investment advisory business.
- A. Exchange member engaged in exchange commission business..... EBC
 - B. Exchange member engaged in floor activities..... EBF
 - C. Broker or dealer making inter-dealer markets in corporate securities over-the-counter..... ICM
 - D. Broker or dealer retailing corporate securities over-the-counter..... EDR
 - E. Underwriter or selling group participant (corporate securities other than mutual funds)..... UEG
 - F. Mutual fund underwriter or sponsor..... MFU
 - G. Mutual fund retailer..... MFR
 - H. 1. U.S. government securities dealer..... GSD
 - 2. U.S. government securities broker..... GSB
 - I. Municipal securities dealer..... MSD
 - J. Municipal securities broker..... MSB
 - K. Broker or dealer selling variable life insurance or annuities..... VLA
 - L. Solicitor of savings and loan accounts..... SSL
 - M. Real estate syndicator..... RES
 - N. Broker or dealer selling oil and gas interests..... OGI
 - O. Put and call broker or dealer or option writer..... PCB
 - P. Broker or dealer selling securities of only one issuer or associated issuers (other than mutual funds)..... BIA
 - Q. Broker or dealer selling securities of non-profit organizations (e.g., churches, hospitals)..... NPB
 - R. Investment advisory services..... IAD
 - S. Broker or dealer selling tax shelters or limited partnerships..... TSP
 - T. Other (give details on Schedule D)..... OTH
-
11. A. Does applicant effect transactions in commodity futures, commodities, commodity options as a broker for others or dealer for its own account?..... YES NO
- B. Does applicant engage in any other non-securities business? (If "yes," describe each other business briefly on Schedule D.)..... YES NO
-
12. Is applicant applying for registration solely as a government securities broker or dealer?... YES NO
-
13. Notice of Government Securities Activities
- A. Is applicant acting or intending to act as a government securities broker or dealer? (Do not answer "Yes" if applicant answered "yes" to Question 12.)..... YES NO
- B. Is applicant ceasing its activities as a government securities broker or dealer? (Do not answer "Yes" unless previously answered "yes" to Question 13A.)..... YES NO

FEDERAL RESERVE SYSTEM**[Docket No. R-0596]****Financial Institutions Acting as Government Securities Brokers or Government Securities Dealers****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Notice.

SUMMARY: Under section 15C(a)(1)(B) of the Securities Exchange Act of 1934, 15 U.S.C. 78o-5(a)(1)(B), as amended by the Government Securities Act of 1986 (Pub. L. 99-571), all financial institutions that act as government securities brokers or government securities dealers must notify their designated federal supervisory agencies of their broker/dealer activities, unless exempted from the notice requirement by Treasury Department regulation. The Board of Governors has the responsibility for establishing the form for this notice, as well as the form of the notice to be filed by financial institutions that are no longer acting as government securities brokers or government securities dealers. In discharging these responsibilities, the Board is proposing to adopt Form G-FIN (notification by financial institution of status as government securities broker or dealer) and Form G-FINW (notification by financial institution of termination of status as government securities broker or dealer).

These forms are also being submitted for review and approval under the Paperwork Reduction Act (chapter 35 of 44 U.S.C.) and OMB regulations on Controlling Paperwork Burdens on the Public (5 CFR Part 1320). Copies of the proposed forms and supporting documents are available from the Board clearance officer listed below.

DATES: Comments must be received by March 27, 1987.

ADDRESSES: Comments, which should refer to Docket No. R-0596, should be sent to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, DC 20551. Comments may also be sent to Mr. Robert Neal, Desk Officer, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director (202-452-2782), or Susan S. Meyers, Senior Securities Regulation Analyst (202-452-2781), Division of Banking Supervision and Regulation; or, for the hearing impaired *only*: Telecommunications Device for the Deaf (202-452-3544), Earnestine Hill or Dorothea Thompson, Board of Governors of the Federal Reserve System. Federal Reserve Paperwork Clearance Officer: Nancy Steele, Division of Research and Statistics (202-452-3822). Interested parties may also contact the OMB Desk Officer, Robert Neal (202-395-6880).

SUPPLEMENTARY INFORMATION: The Board is proposing to prescribe forms G-FIN and G-FINW as the vehicles for financial institutions to submit the notices of status as government securities brokers and government securities dealers required by the Government Securities Act of 1986, 15 U.S.C. 78o-5(a)(1)(B). All financial institutions (generally federal and state chartered commercial banks, foreign banks, savings banks, and savings and loan associations, but not credit unions) that act or cease to act as government securities brokers or government securities dealers are required by section 78o-5(a)(1)(B) to file these notices with their appropriate regulatory agencies unless exempted from the notice requirement by Treasury

Department rule. Financial institutions that are currently acting as government securities brokers or government securities dealers and not otherwise exempt must file a notice on Form G-FIN by July 25, 1987. Financial institutions that intend to engage in these activities after that date must file a notice prior to commencement of these operations.

In general, the appropriate regulatory agency for national banks is the Comptroller of the Currency; for state member banks, the Board of Governors of the Federal Reserve System; for insured non-member state banks, the Federal Deposit Insurance Corporation; for savings and loan associations, the Federal Home Loan Bank Board; and for non-federally insured financial institutions, the Securities and Exchange Commission. A foreign bank should refer to section 3(a)(34) of the Securities Exchange Act (15 U.S.C. 78c(a)(34)) as amended by section 102 of the Government Securities Act to determine its appropriate regulatory agency.

In a related action the Treasury Department is proposing rules under the Government Securities Act that, among other things, establishes exemptions from the notice requirement for certain classes of financial institutions. (See proposed 17 CFR Part 401.) In addition, the Treasury Department is proposing to require the filing of an amendment to the notice if any information contained therein becomes inaccurate. (See proposed 17 CFR 400.5(b).)

Reference to the Forms G-FIN and G-FINW will be at 17 CFR 449.1 and 449.2.

Board of Governor of the Federal Reserve System February 23, 1987.

William W. Wiles,

Secretary of the Board.

[FR Doc. 87-4043 Filed 2-24-87; 8:45 am]

BILLING CODE 6210-01-M