SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–46492; File No. S7–34–02]

RIN 3235–AI61

Rule 15c3–3 Reserve Requirements for Margin Related to Security Futures Products

AGENCY: Securities and Exchange Commission (the ''Commission'').

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for comment amendments to the formula for determination of customer reserve requirements of broker-dealers under the Securities Exchange Act of 1934 in response to the anticipated trading of security futures products. The proposed amendments would permit a broker-dealer to include margin related to security futures products written, purchased or sold in customer securities accounts required and on deposit with a registered clearing agency or a derivatives clearing organization as a debit item in calculating its customer reserve requirement.

DATES: Comments must be received on or before October 23, 2002.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by one method only.

Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comments should refer to File No. S7–34–02; this file number should be included on the subject line if e-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549 and on the SEC's Internet web site (*http://www.sec.gov*). The SEC does not edit personal identifying information, such as names or e-mail addresses, from electronic submissions. Submit only the information you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 942–0132; Thomas K. McGowan, Assistant Director, at (202) 942–4886; Bonnie L. Gauch, Attorney, at (202) 942–0765; or Matthew B. Comstock, Attorney, at (202) 942–0156, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–1001.

I. Introduction

The Commission is proposing amendments to Rule 15c3–3a.[1] The amendments delineate how a broker-dealer would calculate its customer reserve requirement in light of enactment of the Commodity Futures Modernization Act of 2000 (''CFMA'')[2] and the expected trading of security futures products.

A. Background

The CFMA, which became law on December 21, 2000, amended the Commodity Exchange Act (''CEA'') and the Securities Exchange Act of 1934 (''Exchange Act'') to permit the trading of single stock and narrow-based index futures (''securities futures'') and established a framework for the regulation of security futures products (''SFPs'').[3] SFPs are both a security and a future.[4] Thus, a customer who wishes to buy or sell an SFP must conduct the SFP transaction through a person registered both with the Commodity Futures Trading Commission (''CFTC'') as a futures commission merchant (''FCM'') or as an introducing broker (''IB'') and with the Commission as a broker-dealer. The CFTC and the Commission issued joint final rules under which either the firm or the customer, if the firm so permits, may choose whether customer funds would be protected under the CFTC's segregation rules or the Commission's Rule 15c3–3[5] and the Securities Investor Protection Act of 1970 (''SIPA'').[6]

B. Protection of Customer Funds Related to SFP Transactions in Customer Securities Accounts

A person who holds an SFP in a securities account would be a customer under Exchange Act Rule 15c3–3.[7] As SIPA required,[8] the Commission adopted Rule 15c3–3 in 1972, in part, to ensure that a broker-dealer in possession of customers' funds either deployed those funds ''in safe areas of the broker-dealer's business related to servicing its customers'' or, if not deployed in such areas, deposited the funds in a reserve bank account to prevent commingling of customer and firm funds.[9] Under Rule 15c3–3, a broker-dealer must calculate what amount, if any, it must deposit on behalf of customers in the reserve bank account, entitled ''Special Reserve Bank Account for the Exclusive Benefit of Customers'' (''Reserve Bank Account''), according to the formula set forth in Rule 15c3–3a (''Reserve Formula'').[10] Generally, under the Reserve Formula, a broker-dealer must calculate any amounts it owes to its customers and the amount of funds generated through the use of customer securities, called credits, and compare this amount to any amounts its customers owe it, called debits.[11] If credits exceed customer debits, the broker-dealer must deposit that net amount in the Reserve Bank Account.[12] Therefore, the Reserve Formula requires broker-dealers to maintain a reserve against customer funds and funds generated through the use of customer securities.

Rule 15c3–3 seeks to inhibit a broker-dealer's use of customer assets in its business by prohibiting the use of those assets except for designated purposes.[13] The rule also aims to protect customers involved in a broker-dealer liquidation. If a broker-dealer holding customer property fails, Rule 15c3–3 seeks to ensure that the firm has sufficient reserves and possesses sufficient securities so that customers promptly receive their property and there is no need to use the Securities Investor Protection Corporation (''SIPC'') fund.[14]

C. Clearance and Settlement of SFPs

A clearing and carrying broker-dealer[15] may clear and settle an SFP transaction through a clearing agency registered with the Commission (''Clearing Agency'') or through a derivatives clearing organization

[1] 17 CFR 240.15c3–3a.

[2] Pub. L. No. 106–554, 114 Stat. 2763 (2000).

[3] The term ''security futures product'' includes both a security future and any option or privilege on a security future. CEA section 1a(32) (7 U.S.C. 1a(32)) and Exchange Act section 3(a)(56) (15 U.S.C. 78c(a)(56)).

[4] Exchange Act sections 3(a)(10) and (11) (15 U.S.C. 78c(a)(10) and (11)).

[5] Exchange Act Release No. 46473 (Sept. 9, 2002).

[6] 15 U.S.C. 78aaa *et seq*.

[7] *See* 17 CFR 240.15c3–3(a)(1) (definition of ''customer'').

[8] Exchange Act section 15(c)(3) (15 U.S.C. 78o(c)(3)).

[9] Exchange Act Release No. 9856 (Nov. 10, 1972), 37 FR 25224; 17 CFR 240.15c3–3(e).

[10] 17 CFR 240.15c3–3(e)(1) and (2).

[11] 17 CFR 240.15c3–3(e)(2).

[12] *Id.*

[13] Exchange Act Release No. 9856 (Nov. 10, 1972), 37 FR 25224.

[14] *Id.* SIPC may advance money from the SIPC fund to satisfy claims of customers of a failed broker-dealer, subject to certain limitations, under the Securities Investor Protection Act of 1970. 15 U.S.C. 78fff–3.

[15] A clearing and carrying broker-dealer is an entity that may hold customer funds or securities under Exchange Act Rule 15c3–1(a)(2)(i) (17 CFR 240.15c3–1(a)(2)(i)).

(''DCO'') [16] registered with the CFTC. [17] A DCO is not required to register as a Clearing Agency with the Commission under section 17A solely because it clears SFPs.[18] Similarly, a Clearing Agency is not required to register as a DCO with the CFTC solely because it clears SFPs.[19]

As part of the clearance and settlement process for customer SFP transactions, a Clearing Agency or DCO, pursuant to its rules, will require the broker-dealer carrying customer SFP accounts to post margin at the Clearing Agency or DCO. The Clearing Agency or DCO collects this margin to protect itself if a broker-dealer defaults on its obligations related to SFPs. The broker-dealer, in turn, must collect margin from the customer engaging in the SFP transaction.[20] Customer margin protects the broker-dealer if the customer defaults on its obligations under an SFP transaction.

II. Proposed Amendments

The Commission proposes to amend Rule 15c3–3a to delineate the treatment of customer margin deposited with a Clearing Agency or DCO related to SFPs for Reserve Formula purposes. Specifically, the Commission proposes to redesignate Item 14 as Item 15, add a new Item 14 and new Note G, amend Item B and amend newly redesignated Item 15, as described below. Generally, these proposed changes would permit a broker-dealer to include the amount of customer SFP margin required and on deposit at a Clearing Agency or DCO as a debit in the Reserve Formula.[21] The Reserve Formula would require a broker-dealer that clears and carries SFPs in securities accounts on behalf of customers to include SFP margin that it receives from the customer as a credit item in calculating the customer reserve requirement.[22] The Reserve Formula, however, currently does not permit a broker-dealer that clears and carries SFPs in securities accounts on behalf of customers to record an offsetting debit for customer SFP margin that it posts with a Registered Clearing Agency or DCO. Without the proposed changes to Rule15c3–3a, the broker-dealer would be required to fund its customer reserve requirement at least in part with proprietary assets, which would require the broker-dealer to maintain two reserves to cover the same customer property, one reserve in the Reserve Bank Account and the second with the Clearing Agency or DCO.

Proposed new Item 14 would permit the broker-dealer to include a debit in its Reserve Formula computation to the extent of customer SFP margin required and on deposit with a Clearing Agency or a DCO, subject to the conditions in proposed Note G. Recordation of the debit reflects the broker-dealer's use of firm assets for customer purposes.

Subparagraph (b) of proposed Note G would permit a broker-dealer to include a debit for customer SFP margin required and on deposit at a Clearing Agency or DCO under Item 14 only if it uses a Clearing Agency or DCO that meets specified criteria. Under subparagraph (b)(1) of proposed Note G, a broker-dealer could include customer SFP margin as a debit item only if the Clearing Agency or DCO has sufficient financial resources, as set forth in the proposed rule. In particular, a broker-dealer could include this debit only if the registered Clearing Agency or DCO either: (1) Maintains the highest investment-grade rating from a nationally recognized statistical rating organization (''NRSRO''), or (2) maintains security deposits from clearing members in connection with regulated options or futures transactions of least $500 million and retains additional assessment power over member firms of at least $1.5 billion.

These standards for financial resources are consistent with the customer protection function of Rule 15c3–3 and are necessary because of the unsecured nature of the debits. Requiring the highest investment-grade rating from an NRSRO provides the strongest protection against losses to margin deposited at a Clearing Agency or DCO, regardless of changing market conditions. With a lower credit rating, a Clearing Agency or DCO may not have the financial ability to meet its obligations to broker-dealers during times of market stress, which may compromise investor protection. Similarly, setting the security deposit level at $500 million and the assessment power at $1.5 billion should help to ensure that a Clearing Agency or DCO maintains liquidity and financial resources sufficient to protect customer margin on deposit. The Commission set the rating requirement, the amount of the security deposit and the assessment power at these levels based upon the Commission staff's experience and their discussions with the industry.

The term ''security deposits'' in subparagraph (b)(1) of Note G refers to a general fund consisting of cash or securities held by a Clearing Agency or DCO. The Clearing Agency or DCO may use this fund to secure its general obligations to creditors. The security deposit is in addition to, and separate from, performance bonds and margin deposited with the Clearing Agency or DCO. The term ''assessment power'' included in the proposed rule relates to a Clearing Agency or DCO's ability, under its rules, to assess its members in excess of amounts required for a security deposit to meet emergency funding needs.

Under subparagraph (b)(2) of proposed Note G, a broker-dealer could include customer SFP margin as a debit in the Reserve Formula only if the Clearing Agency or DCO at which the margin is deposited in turn deposits the margin in a bank, as that term is defined under section 3(a)(6) of the Exchange Act. Furthermore, a broker-dealer could include the debit only if the Clearing Agency or DCO with which the customer SFP margin is deposited obtains certification from the bank, in writing, that the bank, or any person claiming through the bank, cannot place a lien against, or otherwise attach, the customer margin. The purpose of these conditions is to prevent the commingling of customer property with non-customer property and, thus, help to ensure that customer property is readily available to each customer if a Clearing Agency or DCO fails.

Furthermore, a broker-dealer could include a debit item in the Reserve Formula for customer SFP margin required and on deposit with a Clearing Agency or DCO only if that clearing house, in compliance with Rule 15c3–

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[16] CEA section 1a(9) (7 U.S.C. 1a(9)). The term ''derivatives clearing organization'' means a clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction—

(i) enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties;

(ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the derivatives clearing organization; or

(iii) otherwise provides clearing services or arrangements that mutualize or transfer among participants in the derivatives clearing organization the credit risk arising from such agreements, contracts, or transactions executed by the participants.

[17] CEA section 7a-1(a), (b) and (c) (7 U.S.C. 7a-1(a), (b) and (c)).

[18] Exchange Act section 17A(b)(7)(A) (15 U.S.C 78q-1(b)(7)(A)).

[19] CEA section 7a-1(a)(2) (7 U.S.C. 7a-1(a)(2)).

[20] Exchange Act Release No. 46292 (Aug. 1, 2002), 67 FR 53145.

[21] The proposed changes would provide customer SFP margin required and on deposit at a Clearing Agency or DCO with similar debit treatment under the Reserve Formula as customer options margin required and on deposit with The Options Clearing Corporation (''OCC''). To receive debit treatment under the Reserve Formula, the collateral posted at a Clearing Agency or DCO as customer SFP margin must be the same type of collateral posted at OCC as customer options margin.

[22] 17 CFR 240.15c3–3, Item 1.

3, establishes, documents and maintains: (1) A system to safeguard the handling, transfer and delivery of cash and securities; (2) provisions for fidelity bond coverage of its employees and agents; and (3) provisions for periodic examination by independent public accountants. This proposed requirement is designed to protect customers' cash and securities by limiting the debit treatment under the Reserve Formula to customer SFP margin deposited at a Clearing Agency or DCO that addresses internal risk. Implementation of the proposed rule's requirements would assist these entities in monitoring whether customer margin is protected from both default and use in other areas of the entities' business.

Under subparagraph (b)(4) of proposed Note G, a broker-dealer could include a debit in the Reserve Formula for customer SFP margin deposited at a DCO not otherwise registered with the Commission only if the DCO has provided an undertaking to the Commission. In the undertaking, the DCO would agree to examination by the Commission for compliance with proposed subparagraphs (b)(1) through (b)(3) of proposed Note G. With the undertaking, the Commission is assured of having the ability to examine a DCO to determine if customer property is protected in the manner that Rule 15c3–3 requires.

The Commission also proposes other, related amendments to Rule 15c3–3a. First, based upon existing criteria in Note F, proposed subparagraph (a) of Note G would harmonize the type of collateral acceptable for deposit as customer SFP margin for purposes of proposed Item 14 with the type of collateral acceptable for deposit as customer options margin under Note F for purposes of Item 13. Note F currently permits inclusion of a debit in the Reserve Formula under Item 13 only if a broker-dealer deposits cash, proprietary qualified securities or letters of credit with OCC as customer options margin.[23] Subparagraph (a) of proposed Note G would permit inclusion of a debit in the Reserve Formula under proposed Item 14 only if a broker-dealer deposits the same type of collateral set forth in Note F with a Clearing Agency or a DCO as customer SFP margin.

Second, the Commission proposes to amend Note B to extend to SFPs the same Reserve Formula treatment currently afforded a letter of credit collateralized by customer securities deposited with OCC for options margin purposes. Under current Note B to the Reserve Formula, a broker-dealer that posts a letter of credit collateralized by customer securities at OCC as customer options margin must include the amount of that letter of credit as a credit item in its Reserve Formula computation, to the extent of the margin requirement. Recordation of the credit reflects the broker-dealer's use of customer assets to secure the letter of credit. A firm must include both the credit under Note B and the debit under Item 13 to set the customer reserve requirement at the appropriate level.

Similarly, the proposed amendment to Note B would require a broker-dealer to include a letter of credit collateralized by customer securities deposited with a Clearing Agency or DCO as customer SFP margin as a credit item in its Reserve Formula calculation. As with options margin, inclusion of the credit reflects use of customer assets to secure the letter of credit.[24]

Third, the Commission proposes to amend Rule 15c3–3a to redesignate current Item 14 as proposed Item 15. Proposed Item 15 would be amended to include proposed Item 14 relating to customer SFP margin in the computation of debits under the Reserve Formula.

III. Request for Comments

We invite interested persons to submit written comments on all aspects of the proposed amendments, in addition to the specific requests for comments included in the release. Further, we invite comment on other matters that might have an effect on the proposals contained in the release, including any competitive impact.

We invite comments on proposed Note G to the Reserve Formula. A broker-dealer may include customer SFP margin required and on deposit at a Clearing Agency or DCO as a debit in the Reserve Formula only if the clearing house: (1) Either maintains the highest investment-grade rating from an NRSRO, or (2) maintains security deposits from clearing members of at least $500 million and assessment power over member firms of $1.5 billion. Are these conditions necessary to help ensure the creditworthiness of those entities? Should we consider different or additional criteria to determine creditworthiness?

We also invite comment on subparagraph (b)(2) of proposed Note G. Specifically, is the requirement that customer margin be deposited in a bank as defined in section 3(a)(6) of the Act a sufficient means to segregate customer margin from non-customer property? Should we permit a broker-dealer to include customer SFP margin as a debit in the Reserve Formula if a Clearing Agency or DCO holds that margin in places other than in a bank as defined under section 3(a)(6) of the Act? Should customer SFP margin represented by securities be held in a location different from customer SFP margin represented by cash?

Furthermore, we invite comment on subparagraph (b)(3) of proposed Note G. To include a debit in the Reserve Formula for customer SFP margin, a broker-dealer must use a Clearing Agency or DCO that establishes, documents and maintains: (1) A system to safeguard the handling, transfer and delivery of cash and securities; (2) provisions for fidelity bond coverage of its employees and agents; and (3) provisions for periodic examination by independent public accountants. Would these conditions protect customer assets that a broker-dealer deposits at a Clearing Agency or DCO by aiding the clearing house in addressing internal risk? Should we consider other or additional tools to measure this risk? Are any of these criteria unnecessary?

We also invite comment on the requirement in proposed subparagraph (b)(4) that a broker-dealer obtain an undertaking from a DCO not otherwise registered with the Commission. The undertaking will clarify that representatives of, or designees to, the Commission may examine the DCO for compliance with the requirements of Rule 15c3–3a. Is the undertaking an appropriate means to help protect customers under Rule 15c3–3?

IV. Paperwork Reduction Act

Certain provisions of the proposed amendments to Rule 15c3–3a contain ''collection of information requirements'' within the meaning of the Paperwork Reduction Act of 1995.[25] The Commission has submitted the proposed amendment to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The Commission is revising the collection of information entitled ''Customer Protection—Reserves and Custody of Securities (17 CFR 240.15c3–3)'', OMB Control Number 3235–0078. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

[23] 17 CFR 240.15c3–3a, Item 13, Note F.

[24] 17 CFR 240.15c3–3a, Item 2, Note B.

[25] 44 U.S.C. 3501.

A. Collection of Information Under These Amendments

As discussed, the proposed amendments to Rule 15c3–3a would permit a broker-dealer that clears and carries customer SFPs in securities accounts on behalf of customers to include certain credits and debits in its Reserve Formula calculation relating to SFP margin required and on deposit with a Clearing Agency or a DCO. The amendments would permit a broker-dealer to include as a debit the amount of customer SFP margin required and on deposit with a Clearing Agency or DCO only if that entity: maintains sufficient liquid capital; deposits customer SFP margin in a Reserve Bank Account to ensure the ready availability of those funds; and maintains a system for safeguarding the handling, transfer and delivery of SFPs. In addition, the amendments require a broker-dealer to obtain from a DCO not otherwise registered with the Commission an executed undertaking in which the DCO agrees to examination by the Commission to monitor the DCO's compliance with the applicable conditions set forth in the amendments to Rule 15c3–3a.

B. Proposed Use of Information

The Commission, self-regulatory organizations (''SROs'') and other securities regulatory authorities would use the information collected under the proposed amendments to Rule 15c3–3a to determine whether a broker-dealer is in compliance with Rule 15c3–3 and with other, related customer protection requirements. The Commission, SROs and other securities regulatory authorities also would use this information to monitor whether a Clearing Agency or DCO properly has safeguarded customer funds.

C. Respondents

The proposed amendments to Rule 15c3–3a would apply only to those broker-dealers that clear and carry SFPs in securities accounts for the benefit of customers. Moreover, these provisions would apply only to broker-dealers that carry customer funds, securities or property and do not claim an exemption from Rule 15c3–3a. As of October 31, 2001, there were 412 clearing firms. As of March 31, 2001, 90 broker-dealers were registered with the CFTC as FCMs, 63 of which are clearing and carrying firms. Based upon conversations between the Commission and industry representatives about the number of firms that may conduct SFP business, the staff estimates that the number of firms likely to engage in this business, in addition to the broker-dealers already registered with the CFTC as FCMs, is 10% of the clearing and carry firms not presently registered with the CFTC.[26] Thus, the staff estimates that approximately 98 firms ($63 + ((412 - 63) \times 10\%)$) will be required to comply with these proposed amendments to obtain the debit treatment.

D. Total Annual Reporting and Recordkeeping Burden

Under the proposed amendments to add new Item 14, amend and redesignate Item 15, amend Note B and add new Note G to Rule 15c3–3a, a broker-dealer that clears and carries SFPs in securities accounts for the benefit of customers may include customer SFP margin required and on deposit at a Clearing Agency or DCO as a debit item in the Reserve Formula. The Commission staff estimates that broker-dealers that engage in an SFP business will spend approximately 490 hours (or 5 hours each x 98 clearing broker-dealers) to modify software to accommodate changes in the calculation of the Reserve Formula pursuant to the proposed amendment to Note B and proposed new Item 14, and amended and redesignated Item 15. This will be a one-time burden. The Commission staff also estimates that broker-dealers will spend approximately 24.5 hours per week (or 0.25 hours $\times$ 98 clearing broker-dealers), for a yearly total of 1,274 hours (24.5 hours $\times$ 52 weeks), to verify and input the information required under the proposed amendment to Note B and proposed new Item 14.

Furthermore, broker-dealers that clear and settle SFP transactions through DCOs not otherwise registered with the Commission would spend time verify that the DCO has made the undertaking to the Commission under subparagraph (b) to Note G. The Commission staff estimates these broker-dealers will spend 24.5 hours (or 0.25 hours x 98 clearing broker-dealers) to obtain the undertakings. This will be a one-time burden unless a broker-dealer changes clearing DCOs.

E. Collection of Information Is Mandatory

The collection of information is mandatory if a broker-dealer clears and carries SFPs in securities accounts on behalf of customers and wants to record customer margin required and on deposit with a Clearing Agency or DCO as a debit item in its Reserve Formula calculation.

[26] These estimates are identical to those set forth in Exchange Act Release No. 46473 (Sept. 9, 2002).

F. Confidentiality

The collection of information under the proposed amendments to Rule 15c3–3a would be provided to the Commission and SROs, but not subject to public availability.

G. Record Retention Period

Rule 17a-4(b)(8)(xiii) requires broker-dealers to preserve information related to possession and control requirements under Rule 15c3–3 for three years, the first two years in an accessible place.

H. Request for Comment

Under 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) Evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;

(iii) Enhance the quality, utility, and clarity of the information to be collected; and

(iv) Minimize the burden of the collection of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons who desire to submit comments on the collection of information requirements should direct them to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609, and refer to File No. S7–34–02. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the **Federal Register**; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–34–02, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW, Washington, DC 20549.

V. Costs and Benefits of the Proposed Amendments

A. Introduction

Passage of the CFMA in December of 2000 permitted the trading of SFPs and established a framework for the Commission and CFTC to regulate SFPs jointly. This framework was necessary because the CFMA defined an SFP to be both a security and a future [27] and, therefore, subject both to the CEA and the Exchange Act. Accordingly, both Clearing Agencies, which are regulated by the Commission, and DCOs, which are regulated by the CFTC, may clear SFPs. Consistent with these provisions, the Commission is proposing to amend Exchange Act Rule 15c3–3a by redesignating Item 14 as Item 15, adding new Item 14 and new Note G, amending Item B and amending newly redesignated Item 15.

B. Benefits

The proposed amendments to Rule 15c3–3a would enhance the customer protection function of Rule 15c3–3. In particular, proposed Note G would help to protect customer property by requiring that a broker-dealer, if it wishes to include customer SFP margin as a debit item in the Reserve Formula, use only a Clearing Agency or DCO that has significant financial resources to clear and settle its customer SFP transactions. Proposed Note G would further protect customer property by conditioning the debit treatment on requirement that a broker-dealer use only a Clearing Agency or DCO that deposits customer SFP margin in a Reserve Bank Account that is for the exclusive benefit of SFP customers. The Reserve Bank Account would protect customer property from being commingled with non-customer property. The internal risk management system contemplated under proposed Note G would protect a broker-dealer and its customers by helping its Clearing Agency or DCO to monitor whether customer margin is protected from both default and use in other areas of the entities' business. These proposed enhanced customer protections would make it less likely that there would be a need to use the SIPC fund.

Proposed amended Note B, new Item 14 and new Note G are designed to help a broker-dealer that clears and carries SFPs in securities accounts on behalf of customers to calculate the appropriate customer reserve requirement under the Reserve Formula. Without amended Note B, a broker-dealer's Reserve Formula computation would not include a credit to reflect the firm's use of customer assets to secure a letter of credit, which is then used as customer SFP margin deposit with a Clearing Agency or DCO. Similarly, without proposed Item 14 and Note G, a broker-dealer's Reserve Formula computation would not include a debit to reflect the firm's use of assets for customer purposes to meet its customer SFP margin deposit requirements. In that case, a broker-dealer's regulatory costs would be higher.

Proposed amended Note B, new Item 14 and new Note G would permit a broker-dealer to include the amount of customer SFP margin required and on deposit at a Clearing Agency or DCO as a debit in the Reserve Formula. Without the proposed changes to Rule15c3–3a, the broker-dealer would be required to fund its customer reserve requirement at least in part with proprietary assets, which would require the broker-dealer to maintain two reserves to cover the same customer property, one reserve in the Reserve Bank Account and the second with the Clearing Agency or DCO. As a result, the costs of engaging in a customer SFP business would increase. Thus, proposed amended Note B, new Item 14 and new Note G lower the costs of clearing and carrying SFPs in customer securities accounts and potentially spur the growth of the SFP markets.

C. Costs

The amendments were drafted to reduce the burden of the Reserve Formula on broker-dealers by allowing a broker-dealer to include the amount of customer SFP margin required and on deposit at a Clearing Agency or DCO as a debit in the Reserve Formula. This treatment would permit a broker-dealer that clears and carries SFPs in securities accounts on behalf of customers to calculate the appropriate customer reserve requirement.

Proposed amended Note B would require broker-dealers to include certain customer SFP margin required and on deposit with a Clearing Agency or DCO as a credit item in the Reserve Formula. Proposed new Item 14 would permit broker-dealers to include customer SFP margin required and on deposit with a Registered Clearing Agency or DCO as a debit item. A broker-dealer would incur a one-time cost to re-program software that performs Reserve Formula calculations to include proposed Note B and Item 14 in those calculations. Based on the paperwork costs described above, the Commission staff preliminarily estimates total reprogramming costs would be $25,320.[28]

Under proposed Note B and proposed Item 14, the broker-dealer also would incur minimal, annual costs to verify and input debit item amounts into its customer reserve requirement calculation. We estimate the yearly paperwork burden to be 1,274 hours to complete these tasks. Therefore, the Commission staff preliminarily estimates the annual paperwork cost to broker-dealers would be $53,508 (1274 hours × $42.00 per hour for an operations specialist).[29]

Moreover, a broker-dealer that clears SFP transactions through a DCO would incur costs to obtain an undertaking from the DCO as proposed Note G requires. The Commission staff estimates the paperwork cost to the broker-dealer of obtaining the undertaking required under Note G would be $3,822.[30] The costs would be recurring only if the broker-dealer decided to clear its transactions through a different DCO. Note that only clearing and carrying broker-dealers that engage in customer SFP transactions would incur any of the costs described above.

VI. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act [31] requires the Commission, whenever it engages in rulemaking and must consider or determine if an action is necessary or appropriate in the public interest, to consider if the action will promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act [32] requires the

[27] Exchange Act sections 3(a)(10) and (11) (15 U.S.C. 78c(a)(10) and (11).

[28] Security Industry Association's (''SIA'') *Report on Management and Professional Earnings in the Securities Industry 2001,* Tables 157 and 158. According to Table 157, the hourly cost of a programmer is approximately $46.78 and the hourly cost of a senior programmer is approximately $71.25. These hourly wage costs, and all other hourly wage costs in this document, include a 35% increase above the SIA wage figures to account for overhead costs. The staff estimates that a programmer would spend approximately 4 hours to modify software to meet the requirements of proposed Note B and Items 14 and 15. Further, the Staff estimates that a senior programmer would spend approximately 1 hour on the project. Total cost: (4 hours × $46.78 per hour × 98 broker-dealers) + (1 hour × $71.25 per hour × 98 broker-dealers)) = $25,320.36.

[29] SIA's *Report on Management and Professional Earnings in the Securities Industry 2001,* Table 119.

[30] SIA's *Report on Management and Professional Earnings in the Securities Industry 2001,* Tables 107 and 110. According to Table 107, the hourly cost of an attorney is approximately $156. The Staff estimates that an attorney would spend approximately 15 minutes obtaining the undertaking. Total cost: (24.5 hours x $156 per hour) = $3,822.

[31] 15 U.S.C. 78c(f).

[32] 15 U.S.C. 78w(a)(2).

Commission, in making rules under the Exchange Act, to consider the impact that any such rule would have on competition. Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The proposed amendments to Rule 15c3–3a are intended to clarify the treatment of customer SFP margin required and on deposit with a Clearing Agency or DCO for purposes of calculating a broker-dealer's customer reserve requirement under the Reserve Formula. We preliminarily believe that clarification of the debit treatment of customer SFP margin for Reserve Formula purposes serves as an efficient and cost-effective means for broker-dealers to determine how they will calculate their customer reserve requirements if they clear and carry SFPs in securities accounts for the benefit of customers. The proposed amendments to Rule 15c3–3a should promote efficiency because firms still may use their present systems for computation of customer reserve requirements under the Reserve Formula, after they make the required adjustments, rather than build new Reserve Formula systems.

Furthermore, the proposed amendments to Rule 15c3–3a are designed to help a broker-dealer avoid depositing proprietary assets unnecessarily in the Reserve Bank Account to meet its obligations under the Reserve Formula. We preliminarily believe that the proposals would permit broker-dealers to direct a greater portion of their assets to their businesses and, therefore, promote capital formation.

As discussed, the proposed amendments to Rule 15c3–3a would permit a broker-dealer that clears and carries SFPs in securities accounts on behalf of customers to include customer SFP margin required and on deposit with a Clearing Agency or DCO as a debit item for purposes of calculating its customer reserve requirement under the Reserve Formula. Furthermore, we note that the proposed amendments would permit this treatment regardless of whether the broker-dealer clears customer SFP transactions through a Clearing Agency or DCO, provided the Clearing Agency or DCO meets certain minimum financial standards and segregates customer SFP margin funds. Thus, we preliminarily believe that the proposed amendments to Rule 15c3–3a do not impose any competitive burden that is not necessary and appropriate in furtherance of the purposes of the Exchange Act.

The Commission requests comment on whether the proposed amendments are expected to promote efficiency, competition, and capital formation.

VII. Regulatory Flexibility Act Certification

The Commission hereby certifies, pursuant to 5 U.S.C. § 605(b), that the proposed amendments to Rule 15c3–3a, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed amendments to Rule 15c3–3a would apply only to broker-dealers that clear and carry SFPs in securities accounts for the benefit of customers. The Commission's Office of Economic Analysis has determined that as of March 31, 2001, 90 broker-dealers were also registered with the CFTC as FCMs. None of those broker-dealers is a small entity.[33] The Commission estimates that an additional eight clearing and carrying broker-dealers may clear and carry customer SFPs. None of those broker-dealers is likely to be a small entity.

The proposed amendments to Rule 15c3–3a would affect only those broker-dealers that clear and carry customer SFP transactions in securities accounts for the benefit of customers. The proposed amendment to Note B, proposed new Item 14 and proposed new Note G would permit a broker-dealer that clears and carries SFPs in customer securities accounts to include customer SFP margin required and on deposit with a Clearing Agency or DCO as a debit item for Reserve Formula purposes. As noted, these proposed amendments would allow a broker-dealer to calculate the appropriate level of the customer reserve requirement under the Reserve Formula. Thus, the proposed amendments to Rule 15c3–3, if adopted, actually would reduce the burden these entities face in meeting the customer protection requirements of the Exchange Act. Accordingly, we do not believe that the proposed amendments to Exhibit A to Exchange Act Rule 15c3–3 would have a significant economic impact on a substantial number of small entities.

We encourage written comments regarding this certification. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or ''SBREFA,''[34] we must advise the Office of Management and Budget as to whether the proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

- An annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

If a rule is ''major,'' its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed regulation on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Statutory Authority

The Commission is proposing amendments to Rule 15c3–3a under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 15 and 17.[35]

Text of Proposed Rule Amendments

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission hereby proposes that Title 17, Chapter II of the Code of Federal Regulation be amended as follows.

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

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

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–l, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.15c3–3a is amended by:

a. In the chart, redesignating Item No. 14 as Item No. 15;

b. Adding new Item No. 14;

c. Revising newly redesignated Item No. 15;

d. Revising Note B; and

e. Adding Note G

The revisions and additions read as follows:

[33] *See* 17 CFR 240.0–10.

[34] Pub. L. No. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. 15 U.S.C. and as a note to 5 U.S.C. 601).

[35] 15 U.S.C. 78o and 78q.

§ 240.15c3–3a Exhibit A—formula for determination reserve requirement of brokers and dealers under § 240.15c3–3.

* * * * *

	Credits	Debits
14. Margin related to security futures products written, purchased or sold in customer accounts required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 17A) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 5b). (See Note G).	.....	XXX
Total Credits	.....	
Total Debits	.....	
15. Excess of total credits (sum of items 1–9) over total debits (sum of items 10–14) required to be on deposit in the ''Reserve Bank Account'' (§ 240.15c3–3(e)). If the computation is made monthly as permitted by this section, the deposit shall be not less than 105 percent of the excess of total credits over total debits.	.....	XXX

* * * * *

Note B. Item 2 shall include the amount of options-related or security futures product-related Letters of Credit obtained by a member of a registered clearing agency or a derivatives clearing organization which are collateralized by customers' securities, to the extent of the member's margin requirement at the registered clearing agency or derivatives clearing organization.

* * * * *

Note G. (a) Item 14 shall include the amount of margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 17q–1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 5b) for customer accounts to the extent that the margin is represented by cash, proprietary qualified securities, and letters of credit collateralized by customers' securities.

(b) Item 14 shall apply only if:

(1) The registered clearing agency or derivatives clearing organization maintains:

(i) The highest investment-grade rating from a nationally recognized statistical rating organization; or

(ii) Security deposits from clearing members in connection with regulated options or futures transactions of at least $500 million and retains assessment power over member firms of at least $1.5 billion; and

(2) The registered clearing agency or derivatives clearing organization deposits customer margin in a bank as defined in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)) in an account designated as a ''Special Account for the Exclusive Benefit of Securities Customers.'' The bank must acknowledge in writing that the customer margin on deposit is not subject to any right, charge, security interest, lien or claim of any kind in favor of the bank or any person claiming through the bank; and

(3) The registered clearing agency or derivatives clearing organization establishes, documents, and maintains:

(i) Safeguards in the handling, transfer and delivery of cash and securities;

(ii) Provisions for fidelity bond coverage of the employees and agents of the registered clearing organization or derivatives clearing organization or other subsidiary organization; and

(iii) Provisions for periodic examination by independent public accountants; and

(iv) The derivatives clearing organization, if it is not otherwise registered with the Commission, has provided the following undertaking to the Commission:

With respect to the clearance and settlement of the customer security futures products of [BD], the undersigned hereby undertakes to permit representatives or designees of the Securities and Exchange Commission to examine it for compliance with the requirements set forth in Rule 15c3–3a, Note G. (b)(1) through (3) at any time or from time to time during business hours, and promptly to furnish to the Commission or its designees all information that the Commission reasonably deems necessary to determine that compliance.

Dated: September 12, 2002.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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