

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

(3) Subordinated liabilities of a consolidated subsidiary or affiliate which are consolidated in accordance with paragraph (c)(2) of this section may not be prepaid, repaid or accelerated if any of the entities included in such consolidation would otherwise be unable to comply with the provisions of Appendix (D), 17 CFR 240.15c3-1d.

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

(d) *Certain Precluded Acts.* No broker or dealer shall guarantee, endorse or assume directly or indirectly any obligation or liability of a subsidiary or affiliate unless the obligation or liability is reflected in the computation of net capital and/or aggregate indebtedness pursuant to 17 CFR 240.15c3-1 or this Appendix (C), except as provided in paragraph (b)(1) of this section.

[40 FR 29808, July 16, 1975, as amended at 57 FR 56988, Dec. 2, 1992]

§ 240.15c3-1d Satisfactory Subordination Agreements (Appendix D to 17 CFR 240.15c3-1).

(a) *Introduction.* (1) This Appendix sets forth minimum and non-exclusive requirements for satisfactory subordination agreements (hereinafter “subordination agreement”). The Examining Authority may require or the broker or dealer may include such other provisions as deemed necessary or appropriate to the extent such provisions do not cause the subordination agreement to fail to meet the minimum requirements of this Appendix (D).

(2) *Certain Definitions.* For purposes of 17 CFR 240.15c3-1 and this Appendix (D):

(i) A subordination agreement may be either a subordinated loan agree-

ment or a secured demand note agreement.

(ii) The term *subordinated loan agreement* shall mean the agreement or agreements evidencing or governing a subordinated borrowing of cash.

(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 percentage deductions set forth in paragraph (c)(2)(vi) of § 240.15c3-1 except for paragraph (c)(2)(vi)(J). In lieu of the deduction under (c)(2)(vi)(J), the broker or dealer shall reduce the market value of the securities pledged to secure the secured demand note by 30 percent.

(iv) The term *Payment Obligation* shall mean the obligation of a broker or dealer in respect to any subordination agreement (A) to repay cash loaned to the broker or dealer pursuant to a subordinated loan agreement or (B) to return a secured demand note contributed to the broker or dealer or reduce the unpaid principal amount thereof and to return cash or securities pledged as collateral to secure the secured demand note and (C) “Payment” shall mean the performance by a broker or dealer of a Payment Obligation.

(v)(A) The term *secured demand note agreement* shall mean an agreement (including the related secured demand note) evidencing or governing the contribution of a secured demand note to a broker or dealer and the pledge of securities and/or cash with the broker or dealer as collateral to secure payment of such secured demand note. The secured demand note agreement may provide that neither the lender, his heirs, executors, administrators or assigns shall be personally liable on such note and that in the event of default the broker or dealer shall look for payment of such note solely to the collateral then pledged to secure the same.

(B) The secured demand note shall be a promissory note executed by the lender and shall be payable on the demand of the broker or dealer to which it is contributed; provided, however, that the making of such demand may be conditioned upon the occurrence of

any of certain events which are acceptable to the Commission and to the Examining Authority for such broker or dealer.

(C) If such note is not paid upon presentment and demand as provided for therein, the broker or dealer shall have the right to liquidate all or any part of the securities then pledged as collateral to secure payment of the same and to apply the net proceeds of such liquidation, together with any cash then included in the collateral, in payment of such note. Subject to the prior rights of the broker or dealer as pledgee, the lender, as defined herein, may retain ownership of the collateral and have the benefit of any increases and bear the risks of any decreases in the value of the collateral and may retain the right to vote securities contained within the collateral and any right to income therefrom or distributions thereon, except the broker or dealer shall have the right to receive and hold as pledgee all dividends payable in securities and all partial and complete liquidating dividends.

(D) Subject to the prior rights of the broker or dealer as pledgee, the lender may have the right to direct the sale of any securities included in the collateral, to direct the purchases of securities with any cash included therein, to withdraw excess collateral or to substitute cash or other securities as collateral, provided that the net proceeds of any such sale and the cash so substituted and the securities so purchased or substituted are held by the broker or dealer, as pledgee, and are included within the collateral to secure payment of the secured demand note, and provided further that no such transaction shall be permitted if, after giving effect thereto, the sum of the amount of any cash, plus the Collateral Value of the securities, then pledged as collateral to secure the secured demand note would be less than the unpaid principal amount of the secured demand note.

(E) Upon payment by the lender, as distinguished from a reduction by the lender which is provided for in (b)(6)(iii) or reduction by the broker or dealer as provided for in subparagraph (b)(7) of this Appendix (D), of all or any part of the unpaid principal amount of

the secured demand note, a broker or dealer shall issue to the lender a subordinated loan agreement in the amount of such payment (or in the case of a broker or dealer that is a partnership credit a capital account of the lender) or issue preferred or common stock of the broker or dealer in the amount of such payment, or any combination of the foregoing, as provided for in the secured demand note agreement.

(F) The term *lender* shall mean the person who lends cash to a broker or dealer pursuant to a subordinated loan agreement and the person who contributes a secured demand note to a broker or dealer pursuant to a secured demand note agreement.

(b) *Minimum Requirements for Subordination Agreements.* (1) Subject to paragraph (a) of this section, a subordination agreement shall mean a written agreement between the broker or dealer and the lender, which (i) has a minimum term of one year, except for temporary subordination agreements provided for in paragraph (c)(5) of this Appendix (D), and (ii) is a valid and binding obligation enforceable in accordance with its terms (subject as to enforcement to applicable bankruptcy, insolvency, reorganization, moratorium and other similar laws) against the broker or dealer and the lender and their respective heirs, executors, administrators, successors and assigns.

(2) *Specific Amount.* All subordination agreements shall be for a specific dollar amount which shall not be reduced for the duration of the agreement except by installments as specifically provided for therein and except as otherwise provided in this Appendix (D).

(3) *Effective Subordination.* The subordination agreement shall effectively subordinate any right of the lender to receive any Payment with respect thereto, together with accrued interest or compensation, to the prior payment or provision for payment in full of all claims of all present and future creditors of the broker or dealer arising out of any matter occurring prior to the date on which the related Payment Obligation matures consistent with the provisions of 17 CFR 240.15c3-1 and 240.15c3-1d, except for claims which are the subject of subordination agreements which rank on the same priority

as or junior to the claim of the lender under such subordination agreements.

(4) *Proceeds of Subordinated Loan Agreements.* The subordinated loan agreement shall provide that the cash proceeds thereof shall be used and dealt with by the broker or dealer as part of its capital and shall be subject to the risks of the business.

(5) *Certain Rights of the Broker or Dealer.* The subordination agreement shall provide that the broker or dealer shall have the right to:

(i) Deposit any cash proceeds of a subordinated loan agreement and any cash pledged as collateral to secure a secured demand note in an account or accounts in its own name in any bank or trust company;

(ii) Pledge, repledge, hypothecate and rehypothecate, any or all of the securities pledged as collateral to secure a secured demand note, without notice, separately or in common with other securities or property for the purpose of securing any indebtedness of the broker or dealer; and

(iii) Lend to itself or others any or all of the securities and cash pledged as collateral to secure a secured demand note.

(6) *Collateral for Secured Demand Notes.* Only cash and securities which are fully paid for and which may be publicly offered or sold without registration under the Securities Act of 1933, and the offer, sale and transfer of which are not otherwise restricted, may be pledged as collateral to secure a secured demand note. The secured demand note agreement shall provide that if at any time the sum of the amount of any cash, plus the Collateral Value of any securities, then pledged as collateral to secure the secured demand note is less than the unpaid principal amount of the secured demand note, the broker or dealer must immediately transmit written notice to that effect to the lender and the Examining Authority for such broker or dealer. The secured demand note agreement shall also require that following such transmittal:

(i) The lender, prior to noon of the business day next succeeding the transmittal of such notice, may pledge as collateral additional cash or securities sufficient, after giving effect to such

pledge, to bring the sum of the amount of any cash plus the Collateral Value of any securities, then pledged as collateral to secure the secured demand note, up to an amount not less than the unpaid principal amount of the secured demand note; and

(ii) Unless additional cash or securities are pledged by the lender as provided in paragraph (b)(6)(i) of this section, the broker or dealer at noon on the business day next succeeding the transmittal of notice to the lender must commence sale, for the account of the lender, of such of the securities then pledged as collateral to secure the secured demand note and apply so much of the net proceeds thereof, together with such of the cash then pledged as collateral to secure the secured demand note as may be necessary to eliminate the unpaid principal amount of the secured demand note; *Provided, however,* That the unpaid principal amount of the secured demand note need not be reduced below the sum of the amount of any remaining cash, plus the Collateral Value of the remaining securities, then pledged as collateral to secure the secured demand note. The broker or dealer may not purchase for its own account any securities subject to such a sale.

(iii) The secured demand note agreement also may provide that, in lieu of the procedures specified in the provisions required by paragraph (b)(6)(ii) of this section, the lender with the prior written consent of the broker or dealer and the Examining Authority for the broker or dealer may reduce the unpaid principal amount of the secured demand note. After giving effect to such reduction, the aggregate indebtedness of the broker or dealer may not exceed 1000 percent of its net capital or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, net capital may not be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3-3a, or, if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers

Securities and Exchange Commission

§ 240.15c3-1d

subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater. No single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No Examining Authority shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1.

Permissive Prepayments

(7) A 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 that 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 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 broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 1000 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, its net capital would be less than 5 percent of its aggregate debit items computed in ac-

cordance with § 240.15c3-3a, or if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of § 240.15c3-1. Notwithstanding the above, no Prepayment shall occur without the prior written approval of the Examining Authority for such broker or dealer.

Suspended Repayment

(8)(i) The Payment Obligation of the 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 that are scheduled to mature on or before such Payment Obligation) either (A) the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital, or in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3-3a or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or (B) its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1 including paragraph (a)(1)(ii), if applicable. The subordination agreement may provide that if the Payment Obligation of the 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 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 § 240.15c3-1 and § 240.15c3-1d.

(9) *Accelerated Maturity-Obligation to Repay to Remain Subordinate.* (i) Subject to the provisions of paragraph (b)(8) of this appendix, a subordination agreement may provide that the lender may, upon prior written notice to the broker or dealer and the Examining Authority given not earlier than six months after the effective date of such subordination agreement, accelerate the date on which the Payment Obligation of the broker or dealer, together with accrued interest or compensation, is scheduled to mature to a date not earlier than six months after the giving of such notice, 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.

(ii) Notwithstanding the provisions of paragraph (b)(8) of this appendix, the Payment Obligation of the broker or dealer with respect to a subordination agreement, together with accrued interest and compensation, shall mature in the event of any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to the bankruptcy laws, or any other marshalling of the assets and liabilities of the broker or dealer 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.

(10)(i) *Accelerated Maturity of Subordination Agreements on Event of Default and Event of Acceleration—Obligation to Repay to Remain Subordinate.* A subordination agreement may provide that the lender may, upon prior written notice to the broker or dealer and the Examining Authority of the broker or dealer

of the occurrence of any Event of Acceleration (as hereinafter defined) given no sooner than six months after the effective date of such subordination agreement, accelerate the date on which the Payment Obligation of the broker or dealer, together with accrued interest or compensation, is scheduled to mature, to the last business day of a calendar month which is not less than six months after notice of acceleration is received by the broker or dealer and the Examining Authority for the broker or dealer. Any subordination agreement containing such Events of Acceleration may also provide, that if upon such accelerated maturity date the Payment Obligation of the broker or dealer is suspended as required by paragraph (b)(8) of this Appendix (D) and liquidation of the broker or dealer has not commenced on or prior to such accelerated maturity date, then notwithstanding paragraph (b)(8) of this appendix the Payment Obligation of the broker or dealer with respect to such subordination agreement shall mature on the day immediately following such accelerated maturity date and in any such event the Payment Obligations of the broker or dealer with respect to all other subordination agreements then outstanding shall also mature at the same time but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this Appendix (D). Events of Acceleration which may be included in a subordination agreement complying with this paragraph (b)(10) shall be limited to:

(A) Failure to pay interest or any installment of principal on a subordination agreement as scheduled;

(B) Failure to pay when due other money obligations of a specified material amount;

(C) Discovery that any material, specified representation or warranty of the broker or dealer which is included in the subordination agreement and on which the subordination agreement was based or continued was inaccurate in a material respect at the time made;

(D) Any specified and clearly measurable event which is included in the subordination agreement and which the

Securities and Exchange Commission

§ 240.15c3-1d

lender and the broker or dealer agree (1) is a significant indication that the financial position of the broker or dealer has changed materially and adversely from agreed upon specified norms or (2) could materially and adversely affect the ability of the broker or dealer to conduct its business as conducted on the date the subordination agreement was made; or (3) is a significant change in the senior management of the broker or dealer or in the general business conducted by the broker or dealer from that which obtained on the date the subordination agreement became effective;

(E) Any continued failure to perform agreed covenants included in the subordination agreement relating to the conduct of the business of the broker or dealer or relating to the maintenance and reporting of its financial position; and

(ii) Notwithstanding the provisions of paragraph (b)(8) of this appendix, a subordination agreement may provide that, if liquidation of the business of the broker or dealer has not already commenced, the Payment Obligation of the broker or dealer shall mature, together with accrued interest or compensation, upon the occurrence of an Event of Default (as hereinafter defined). Such agreement may also provide that, if liquidation of the business of the broker or dealer has not already commenced, the rapid and orderly liquidation of the business of the broker or dealer shall then commence upon the happening of an Event of Default. Any subordination agreement which so provides for maturity of the Payment Obligation upon the occurrence of an Event of Default shall also provide that the date on which such Event of Default occurs shall, if liquidation of the broker or dealer has not already commenced, be the date on which the Payment Obligations of the broker or dealer with respect to all other subordination agreements then outstanding shall mature but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this Appendix (D). Events of Default which may be included in a subordination agreement shall be limited to:

(A) The making of an application by the Securities Investor Protection Corporation for a decree adjudicating that customers of the broker or dealer are in need of protection under the Securities Investor Protection Act of 1970 and the failure of the broker or dealer to obtain the dismissal of such application within 30 days;

(B) The aggregate indebtedness of the broker or dealer exceeding 1500 percent of its net capital or, in the case of a broker or dealer that has elected to operate under paragraph (a)(1)(ii) of § 240.15c3-1, its net capital computed in accordance therewith is less than 2 percent of its aggregate debit items computed in accordance with § 240.15c3-3a or, if registered as a futures commission merchant, 4 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, 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 broker or dealer, or the Examining Authority or the Commission first determines and notifies the broker or dealer of such fact;

(C) The Commission shall revoke the registration of the broker or dealer;

(D) The Examining Authority shall suspend (and not reinstate within 10 days) or revoke the broker's or dealer's status as a member thereof;

(E) Any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to bankruptcy laws, or any other marshalling of the assets and liabilities of the broker or dealer.

A subordination agreement which contains any of the provisions permitted by this paragraph (b)(10) shall not contain the provision otherwise permitted by clause (i) of paragraph (b)(9).

BROKERS AND DEALERS CARRYING THE ACCOUNTS OF SPECIALISTS AND MARKET MAKERS IN LISTED OPTIONS

(1) A subordination agreement which becomes effective on or after August 1, 1977 in favor of a broker or dealer who guarantees, endorses, carries or clears specialist or market maker transactions in options listed on a national securities exchange or facility of a national securities association shall provide that reduction, prepayment or repayment of the unpaid principal amount thereof, pursuant to those terms of the agreement required or permitted by paragraphs (b)(6)(iii), (b)(7), or (b)(8)(i) of this section, shall not occur in contravention of paragraphs (a)(6)(v), (a)(7)(iv), or (c)(2)(x)(B)(1) of § 240.15c3-1 insofar as they apply to such broker or dealer.

(c) *Miscellaneous Provisions*—(1) *Prohibited Cancellation*. The subordination agreement shall not be subject to cancellation by either party; no Payment shall be made with respect thereto and the agreement shall not be terminated, rescinded or modified by mutual consent or otherwise if the effect thereof would be inconsistent with the requirements of 17 CFR 240.15c3-1 and 240.15c3-1d.

(2) Every 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 that are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer either the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3-1, or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3-3a, or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers

on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of § 240.15c3-1.

(3) *Certain Legends*. If all the provisions of a satisfactory subordination agreement do not appear in a single instrument, then the debenture or other evidence of indebtedness shall bear on its face an appropriate legend stating that it is issued subject to the provisions of a satisfactory subordination agreement which shall be adequately referred to and incorporated by reference.

(4) *Legal Title to Securities*. All securities pledged as collateral to secure a secured demand note must be in bearer form, or registered in the name of the broker or dealer or the name of its nominee or custodian.

Temporary and Revolving Subordination Agreements

(5)(i) For the purpose of enabling a broker or dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the net capital requirements of § 240.15c3-1, a 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 that 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 broker or dealer if, within the preceding thirty calendar days, it has given notice pursuant to § 240.17a-11, or if immediately prior to entering into such subordination agreement, either:

(A) The aggregate indebtedness of the broker or dealer exceeds 1000 percent of its net capital or its net capital is less than 120 percent of the minimum dollar amount required by § 240.15c3-1, or

(B) In the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3-1, its net capital is less than 5 percent of aggregate debits computed in accordance with § 240.15c3-1, or, if registered as a futures commission merchant, less than 7 percent of the funds required to be segregated

Securities and Exchange Commission

§ 240.15c3-1d

pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section, or

(C) The amount of its then outstanding subordination agreements exceeds the limits specified in paragraph (d) of §240.15c3-1. Such temporary subordination agreement shall be subject to all other provisions of this Appendix D.

(ii) A broker or dealer shall be permitted to enter into a revolving subordinated loan agreement which provides for prepayment within less than one year of all or any portion of the Payment Obligation thereunder at the option of the broker or dealer upon the prior written approval of the Examining Authority for the broker or dealer. The Examining Authority, however, shall not approve any prepayment if:

(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 broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 900 percent of its net capital or its net capital would be less than 200 percent of the minimum dollar amount required by §240.15c3-1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of §240.15c3-1, its net capital would be less than 6 percent of aggregate debit items computed in accordance with §240.15c3-3a, or, if registered as a futures commission merchant, 10 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less

the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 200 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section or

(B) Pre-tax losses during the latest three-month period equalled more than 15% of current excess net capital.

Any subordination agreement entered into pursuant to this paragraph (c)(5)(ii) shall be subject to all the other provisions of this Appendix D. Any such subordination agreement shall not be considered equity for purposes of subsection (d) of section 15c3-1, despite the length of the initial term of the loan.

(6)(i) *Filing.* Two copies of any proposed subordination agreement (including nonconforming subordination agreements) shall be filed at least 10 days prior to the proposed execution date of the agreement with the Commission's Regional Office for the region in which the broker or dealer maintains its principal place of business or at such other time as the Regional Office for good cause shall accept such filing. Copies of the proposed agreement shall also be filed with the Examining Authority in such quantities and at such time as the Examining Authority may require. The broker or dealer shall also file with said parties a statement setting forth the name and address of the lender, the business relationship of the lender to the broker or dealer, and whether the broker or dealer carried funds or securities for the lender at or about the time the proposed agreement was so filed. All agreements shall be examined by the Commission's Regional Office or the Examining Authority with whom such agreement is required to be filed prior to their becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the Examining Authority has found the agreement acceptable and such agreement has become effective in the form found acceptable.

§ 240.15c3-1e

17 CFR Ch. II (4-1-10 Edition)

(ii) The broker or dealer need not file with the Regional Office for the region in which the broker or dealer maintains its principal place of business (if a Regional Office is not its Examining Authority) copies of any proposed subordination agreement or the statement described above if the Examining Authority for that broker or dealer has consented to file with the Commission periodic reports (not less than monthly) summarizing for the period, on a firm-by-firm basis, the subordination agreements it has approved for that period. Such reports should include at the minimum, the amount of the loan and its duration, the name of the lender and the business relationship of the lender to the broker or dealer.

(7) *Subordination Agreements in Effect Prior to Adoption.* Any subordination agreement which has been entered into prior to December 20, 1978 and which has been deemed to be satisfactorily subordinated pursuant to 17 CFR 240.15c3-1 as in effect prior to December 20, 1978, shall continue to be deemed a satisfactory subordination agreement until the maturity of such agreement. *Provided,* That no renewal of an agreement which provides for automatic or optional renewal by the broker or dealer or lender shall be deemed to be a satisfactory subordination agreement unless such renewed agreement meets the requirements of this Appendix within 6 months from December 20, 1978. *Provided, further,* That all subordination agreements must meet the requirements of this Appendix within 5 years of December 20, 1978.

[40 FR 29808, July 16, 1975, as amended at 42 FR 31778, June 23, 1977; 44 FR 34887, June 15, 1979; 46 FR 35635, July 10, 1981; 47 FR 21775, May 20, 1982; 49 FR 31848, Aug. 9, 1984; 57 FR 56988, Dec. 2, 1992; 58 FR 37657, July 13, 1993; 59 FR 5945, Feb. 9, 1994; 73 FR 32228, June 5, 2008]

§ 240.15c3-1e Deductions for market and credit risk for certain brokers or dealers (Appendix E to 17 CFR 240.15c3-1).

PRELIMINARY NOTE: Appendices E and G to the net capital rule set forth a program that allows a broker or dealer to use an alternative approach to computing net capital deductions, subject to the conditions described in the Appendices, including supervision of the broker's or dealer's ultimate holding

company under the program. The program is designed to reduce the likelihood that financial and operational weakness in the holding company will destabilize the broker or dealer, or the broader financial system. The focus of this supervision of the ultimate holding company is its financial and operational condition and its risk management controls and methodologies.

Application

(a) A broker or dealer may apply to the Commission for authorization to compute deductions for market risk pursuant to this Appendix E in lieu of computing deductions pursuant to §§ 240.15c3-1(c)(2)(vi) and (c)(2)(vii) and to compute deductions for credit risk pursuant to this Appendix E on credit exposures arising from transactions in derivatives instruments (if this Appendix E is used to calculate deductions for market risk on these instruments) in lieu of computing deductions pursuant to § 240.15c3-1(c)(2)(iv):

(1) A broker-dealer shall submit the following information to the Commission with its application:

(i) An executive summary of the information provided to the Commission with its application and an identification of the ultimate holding company of the broker or dealer;

(ii) A comprehensive description of the internal risk management control system of the broker or dealer and how that system satisfies the requirements set forth in § 240.15c3-4;

(iii) A list of the categories of positions that the broker or dealer holds in its proprietary accounts and a brief description of the methods that the broker or dealer will use to calculate deductions for market and credit risk on those categories of positions;

(iv) A description of the mathematical models to be used to price positions and to compute deductions for market risk, including those portions of the deductions attributable to specific risk, if applicable, and deductions for credit risk; a description of the creation, use, and maintenance of the mathematical models; a description of the broker's or dealer's internal risk management controls over those models, including a description of each category of persons who may input data into the models; if a mathematical