closest separation, replace the duct with a serviceable part; or

(5) If more than three cracks are found, replace the duct with a serviceable part; and

(6) Mark all allowable cracks, on the duct, with suitable metal marking material; and

Note 2: Marking materials that are suitable for use on the the exhaust duct may be found in the P&WC Engine Manual.

(7) Record the length of the crack, location, number of duct hours, and time since overhaul (TSO).

Repetitive Visual Inspection of Welds That Do Not Meet SB Acceptable Criteria

(d) Repeat the inspection specified in paragraph (c) of this AD as follows:

(1) For ducts that did not exhibit any cracking at the last inspection, repeat the inspection within 150 hours TIS since the last inspection. Return the duct to service or replace with a serviceable part as specified in paragraph (c)(1) through paragraph (c)(5) of this AD.

(2) For ducts that exhibited cracking at the last inspection, repeat the inspection within 25 hours TIS since the last inspection. Return the duct to service or replace with a serviceable part as follows:

(i) Inspect for new cracks, and cracks that were recorded as specified in paragraph (c) of this AD. Return the duct to service or replace with a serviceable part as specified in paragraph (c)(1) through paragraph (c)(5) of this AD.

(ii) In addition, if the growth rate of an existing crack exceeds 0.015 inch per hour TIS since the last inspection, replace the duct with a serviceable part.

Optional Terminating Action

(e) Replacing an affected exhaust duct with a serviceable part constitutes terminating action for the repetitive inspection requirements of this AD.

Definition of a Serviceable Exhaust Duct

(f) For the purposes of this AD, a serviceable duct is defined as a duct that meets the acceptability limits of this AD.

Alternative Method of Compliance

(g) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager,Engine Certification Office (ECO). Operators must submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the ECO.

Note 3: Information concerning the existence of approved alternative methods of compliance with this airworthiness directive, if any, may be obtained from the ECO.

Special Flight Permits

(h) Special flight permits are not allowed.

Note 4: The subject of this AD is addressed in AD CF–98–41 in order to assure the airworthiness of these P&WC PT6A series turboprop engines in Canada.

Issued in Burlington, Massachusetts, on May 30, 2002.

Mark C. Fulmer,

Acting Manager, Engine and Propeller Directorate, Aircraft Certification Service.

[FR Doc. 02–14251 Filed 6–7–02; 8:45 am]

BILLING CODE 4910–13–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–46019, File No. S7–20–02]

RIN 3235–AI51

Customer Protection—Reserves and Custody of Securities

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

ACTION: Proposed rule.

SUMMARY: The Commission is publishing for comment a proposed rule amendment that would allow for the expansion of the categories of collateral broker-dealers may pledge when borrowing securities from customers. Currently, broker-dealers are required to provide cash, U.S. Treasury bills and notes, and irrevocable bank letters of credit. The amendment would allow them also to pledge such other collateral as the Commission, by order, designates.

DATES: The comment period will expire on July 25, 2002.

ADDRESSES: 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: *rulecomments@sec.gov.* Comment letters should refer to File No. S7–20–02; 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 at the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549–0102. Electronically submitted comment letters will be posted on the Commission's Internet web site (*http//www.sec.gov*). Personal identifying information, such as names or e-mail addresses, will not be edited from electronic submissions. Submit only information you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, 202/942–0131; Thomas K. McGowan, Assistant Director, 202/942–4886; or Randall W. Roy, Special Counsel, 202/942–0798, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–1001.

SUPPLEMENTARY INFORMATION: The Commission is publishing for comment a proposed amendment to Rule 15c3–3 [1] under the Securities Exchange Act of 1934 (''Exchange Act'').

I. Discussion

A. Introduction

The Commission is proposing an amendment to its customer protection rule, Rule 15c3–3, under which broker-dealers may pledge, when borrowing fully paid or excess margin securities from customers, such collateral as the Commission may designate by order. Proceeding by Commission order would allow new categories of collateral to be designated as permissible more expeditiously and, if necessary, with conditions to account for differences among collateral types. The flexibility to impose conditions on the use of certain additional collateral would permit the establishment of safeguards designed to ensure that the objective of Rule 15c3–3(b)(3) '' the full collateralization of such loans '' is not compromised. In addition, the amendment would allow for a wider range of broker-dealer assets to be deemed permissible collateral, thereby adding liquidity to the securities lending markets and lowering borrowing costs for broker-dealers. For these reasons, we expect that the amendment will promote two fundamental Commission goals: (1) The protection of broker-dealer customers, and (2) the promotion of efficient securities markets.

B. Background

The Commission adopted Rule 15c3–3 in 1972 in response to a congressional directive to create rules regarding, among other things, the acceptance, custody, and use of customer securities.[2] The rule requires broker-dealers to take steps to protect the securities that customers leave in their custody. These steps include the requirement that broker-dealers promptly obtain and thereafter maintain possession or control of all ''fully paid'' [3] and ''excess-margin'' [4] securities

[1] 17 CFR 240.15c3–3.

[2] Exchange Act Release No. 9856 (Nov. 10, 1972).

[3] Subparagraph (a)(3) of Rule 15c3–3 defines ''fully paid securities'' as securities carried in any type of account for which the customer has made a full payment.

[4] Subparagraph (a)(5) of Rule 15c3–3 defines ''excess margin securities'' as securities having a market value in excess of 140% of the amount the customer owes the broker-dealer and which the

carried for the accounts of customers [5] (''customer securities''). The possession or control requirement is designed to ensure that broker-dealers do not put customers at risk by borrowing their securities to expand or otherwise further the broker-dealer's proprietary activities.[6]

Subparagraph (b)(3) of Rule 15c3–3 sets forth conditions under which broker-dealers may borrow fully paid or excess margin securities from customers for their own use without violating the rule's possession or control requirement. These conditions include the requirement that broker-dealers and their lending customers enter into written agreements that (1) set forth the basis of compensation for the loans as well as the rights and liabilities of the parties in the borrowed securities, (2) require the broker-dealers to provide the lenders with schedules of the securities actually borrowed, (3) require the broker-dealers to provide the lenders with, at least, 100% collateral consisting exclusively of cash, United States Treasury bills and notes, or an irrevocable letter of credit issued by a bank, and (4) contain a prominent notice that the provisions of the Securities Investor Protection Act of 1970 [7] may not protect the lenders with respect to the securities loan transactions.[8] Moreover, the loaned securities and pledged collateral must be marked to market daily, and additional collateral posted if necessary to maintain the 100% collateralization requirement.[9] These requirements are designed to ensure that these borrowings remain fully collateralized for the term of the loan.

Generally, broker-dealers borrow securities in order to meet obligations to deliver securities that they do not possess. This situation frequently arises in the normal course of a broker-dealer's business, such as when it sells securities that have been purchased but not received, sells securities it does not own to open a ''short'' position, needs to deliver securities against the exercise of a derivatives contract, or needs to cover a failed transaction in a securities settlement system.[10] Broker-dealers also borrow securities as part of the services they provide their customers, and as intermediaries in securities lending transactions. On the other hand, customers generally lend securities to increase the rate of return earned on their portfolios through compensation paid by the broker-dealers for the loan of the securities. Typically, the customers that lend securities are large institutions such as pension funds.

Since the rule was adopted, the securities lending markets have grown substantially, particularly in the last ten years. These markets also have become more global in scope. In addition, market participants now use a broad array of highly complex financial products. These factors make it necessary for U.S. broker-dealers to borrow a wider range and greater volume of domestic and foreign securities in order to accommodate the trading activities of their customers. Market participants believe that increasing the categories of permissible collateral under Rule 15c3–3 would add liquidity to the securities lending markets and help to lower borrowing costs. We preliminarily agree with that assessment. Rather than expressly add new categories of collateral into the rule, we propose amending Rule 15c3–3(b)(3) to permit the use of other collateral designated as permissible through Commission order as necessary or appropriate in the public interest and consistent with the protection of investors after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness.

The relative weight given to these factors will vary on a case-by-case basis. Moreover, orders permitting a type of collateral may impose limitations and conditions on its use to account for the fact that some permitted securities may not be appropriate as collateral in all situations. Such conditions should further the rule's goal of maintaining full collateralization of the customer's loan.

The Commission's aim is to increase liquidity and decrease costs, while maintaining the customer protection objectives of Rule 15c3–3. The Commission believes our proposal should achieve this goal because it would allow the Commission to select collateral that has been shown to be sufficiently liquid, and to tailor its orders to account for liquidity and other differences among the categories of collateral selected. The proposed amendment would require the Commission to consider the quality and liquidity of a particular instrument before designating it as permissible collateral. This would include a consideration of the creditworthiness of the issuer of the instrument, the depth of the instrument's market, the locations where the instrument is traded, and the historical volatility of the instrument's price.

Moreover, adding collateral through orders would provide the Commission with the flexibility to place conditions on the use of less liquid instruments. For example, in this release the Commission is seeking comment on ten categories of collateral the Commission is considering adding by order to the permissible categories of collateral under Rule 15c3–3. Two of these categories consist of instruments that may be pledged only when borrowing instruments with similar risk characteristics. The ability to prescribe such conditions would allow for a wider range of broker-dealer assets to be designated as permissible collateral. In addition, should a designated category of collateral become insufficiently liquid or should the conditions to use the collateral need to be modified, the Commission could issue an order withdrawing its designation, limiting its use as collateral, or altering the conditions to use it as collateral.

The Commission anticipates that, if it were to issue orders designating additional categories of permissible collateral pursuant to the proposed amendment, the Commission would take into account several considerations. The Commission likely would consider whether the risks of customer losses associated with permitting a new category of collateral would be sufficiently small relative to the benefits the additional kinds of collateral are expected to provide to justify permitting the new category of collateral. Those expected benefits would include adding liquidity to the securities lending markets and lowering borrowing costs for broker-dealers. The Commission also expects it would draw on its experience in assessing the liquidity of markets in a variety of contexts including, for

broker-dealer has designated as not constituting margin securities.

[5] Subparagraph (a)(1) of Rule 15c3–3 defines the term ''customer.'' Generally, a customer is any person from whom or on whose behalf the broker-dealer has received or acquired securities for such person's securities account. The definition does not include general partners, directors, or principals of the broker-dealer, or other broker-dealers to the extent of they have proprietary accounts at the broker-dealer.

[6] The Commission proposed amendments to Rule 15c3–3 to add certain categories of collateral in 1989. *See* Exchange Act Release No. 26608 (March 8, 1989), 54 FR 10680 (March 15, 1989). The Commission did not adopt the proposed amendments.

[7] 15 U.S.C. 78aaa *et seq.*

[8] Rule 15c3–3(b)(3).

[9] Rule 15c3–3(b)(3)(iii).

[10] Regulation T promulgated by the Board of Governors of the Federal Reserve System limits the purposes for which broker-dealers can borrow customer securities to making delivery of securities in the case of short sales, failure to receive securities required to be delivered, or other similar situations. The purpose of this limitation is to prevent customers from avoiding the initial margin requirements of Regulation T by structuring securities transactions as loans rather than purchases or sales.

example, the net capital requirements for broker-dealers.

Should the Commission adopt the amendment, the Commission is considering whether to delegate its authority to the Division of Market Regulation to issue exemptive orders designating additional categories of collateral permissible under the rule. The Commission preliminarily believes this delegation would allow for flexibility in the establishment of collateral requirements that are more responsive to changes in the securities lending markets.

II. Proposed Order

If the Commission adopts the amendment, the Commission is considering issuing an order that would permit the following categories of collateral to be permissible under the rule. The Commission seeks comment on these collateral types and the conditions specified, including whether they would be appropriate to meet the rule's goal of ensuring that borrowings of customer securities remain fully collateralized. For example, the Commission seeks comment on whether the one and five percent over-collateralization requirements for cross-currency transactions are appropriate for addressing currency risk.[11]

1. ''Government securities'' as defined in Section 3(a)(42)(A) and (B) of the Exchange Act may be pledged when borrowing any securities.

2. ''Government securities'' as defined in Section 3(a)(42)(C) of the Exchange Act issued or guaranteed as to principal or interest by the following corporations may be pledged when borrowing any securities: (i) The Federal Home Loan Mortgage Corporation, (ii) the Federal National Mortgage Association, (iii) the Student Loan Marketing Association, and (iv) the Financing Corporation.

3. Securities issued by, or guaranteed as to principal and interest by, the following Multilateral Development Banks—the obligations of which are backed by the participating countries, including the U.S.—may be pledged when borrowing any securities: (i) The International Bank for Reconstruction and Development, (ii) the Inter-American Development Bank, (iii) the Asian Development Bank, (iv) the African Development Bank, (v) the European Bank for Reconstruction and Development, and (vi) the International Finance Corporation.

4. Mortgage-backed securities meeting the definition of a ''mortgage related security'' set forth in Section 3(a)(41) of the Exchange Act may be pledged when borrowing any securities.

5. Negotiable certificates of deposit and bankers acceptances issued by a ''bank'' as that term is defined in Section 3(a)(6) of the Exchange Act, and which are payable in the United States and deemed to have a ''ready market'' as that term is defined in 17 CFR 240.15c3–1 (''Rule 15c3–1''),[12] may be pledged when borrowing any securities.

6. Foreign sovereign debt securities may be pledged when borrowing any securities, *provided* that, (i) at least one nationally recognized statistical rating organization (''NRSRO'') has rated in one of its two highest rating categories [13] either the issue, the issuer or guarantor, or other outstanding unsecured long-term debt securities issued or guaranteed by the issuer or guarantor; and (ii) if the securities pledged are denominated in a different currency than those borrowed,[14] the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of Rule 15c3–3 (100%) by 1% when the collateral is denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen, or by 5% when it is denominated in another currency.[15]

7. Foreign sovereign debt securities that do not meet the NRSRO rating condition set forth in Item 6 above may be pledged only when borrowing non-equity securities issued by a person organized or incorporated in the same jurisdiction (including other debt securities issued by the foreign sovereign); *provided* that, if such foreign sovereign debt securities have been assigned a rating lower than the securities borrowed, such foreign sovereign debt securities must be rated in one of the four highest rating categories by at least one NRSRO. If the securities pledged are denominated in a different currency than those borrowed, the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of Rule 15c3–3 by 1% when the collateral is denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen, or by 5% when it is denominated in another currency.[16]

8. The Euro, British pound, Swiss franc, Canadian dollar or Japanese yen may be pledged when borrowing any securities, *provided* that, when the securities borrowed are denominated in a different currency than that pledged, the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of Rule 15c3–3 by 1%.

9. Foreign currency other than the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen may be pledged only when borrowing non-equity securities denominated in the same currency.

10. Non-governmental debt securities may be pledged when borrowing any securities, *provided* that, in the relevant cash market they are not traded flat or in default as to principal or interest, and are rated in one of the two highest rating categories by at least one NRSRO. If such securities are not denominated in U.S. dollars or in the currency of the securities being borrowed, the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of Rule 15c3–3 by 1% when the securities pledged are denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese

[11] The over-collateralization requirements are described below in items 6, 7, 8 and 10.

[12] Certificates of deposit and bankers acceptances are deemed to have a ''ready market'' under Rule 15c3–1 if, among other things, they are issued by a bank as defined in Section 3(a)(6) of the Exchange Act that is (i) subject to supervision by a federal banking authority, and (ii) rated investment grade by at least two nationally recognized statistical rating organizations or, if not so rated, has shareholders' equity of at least $400 million.

[13] The NRSROs use different symbols to designate credit ratings. For the purposes of the examples in this release, the ratings symbols used as examples are, in order of highest to lowest: AAA, AA, A, BBB, BB, B, and C.

[14] Equity securities would be deemed to be denominated in the currency of the jurisdiction in which the issuer of such securities has its principal place of business.

[15] For example, a broker-dealer that needed to borrow equity or debt securities of a U.S. company could pledge debt securities issued by a foreign sovereign, provided the country is rated ''AAA'' or ''AA.'' Moreover, because the borrowed and pledged securities would be denominated in different currencies, the broker-dealer would have to provide excess collateral. Thus, if the borrowed securities were worth $100,000, the broker-dealer would have to pledge enough collateral to equal $101,000 (1% of the value of the borrowed securities for collateral denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen) or $105,000 (5% of the value for collateral denominated in another currency).

[16] For example, if a broker-dealer needed to borrow equity securities of a U.S. company, it would not be permitted to pledge debt securities issued by a foreign sovereign rated ''A'' or lower. First, lower-rated sovereign debt can only be pledged when borrowing non-equity securities. Second, it only can be used when borrowing securities issued by a person from the same jurisdiction. However, the broker-dealer could pledge the sovereign debt of a country rated ''A'' or lower if it was borrowing debt securities of a company incorporated in that country, provided the country is rated ''A'' or ''BBB'' or the rating of the company is equal to or less than that of the country. Thus, below investment grade sovereign debt only can be pledged when borrowing securities with an equal or lower rating.

yen, or by 5% when they are denominated in any other currency.[17]

The categories of potential permissible collateral identified above do not include securities that (i) have no principal component, or (ii) accrue interest at the time of the pledge at a stated rate equal to or greater than 100% per annum (expressed as a percentage of the actual principal amount of the security).

In issuing an order, the Commission may require broker-dealers pledging new types of collateral to include in the written agreements with the customers a notice that some of the securities being provided by the borrower as collateral under the agreement may not be guaranteed by the United States, in addition to satisfying the notice requirements already contained in paragraph (b)(3) of Rule 15c3–3.

III. General Request for Comments

The Commission solicits comments on the above proposals. The Commission specifically solicits comment on the types of collateral that, if deemed permissible, would materially add liquidity to the securities lending markets, and, at the same time, meet the customer protection objectives of Rule 15c3–3. Further, the Commission solicits comment on whether the correct factors for evaluating potentially permissible collateral have been selected, or should additional factors be considered or identified factors be eliminated. The Commission also solicits comments on the appropriate methods for evaluating the potentially permissible collateral.

The Commission also seeks comment generally on whether Rule 15c3–3(b)(3)(iii) should limit the types of collateral that must be supplied by a broker-dealer in borrowing from an institutional customer or whether the collateral should be left to negotiation between a particular institutional customer and broker-dealer after adequate disclosure. If the latter, should the ability to negotiate collateral be limited to a certain category of institutional customers? How should we define this category? What disclosures would be necessary if the collateral were left to negotiation? Should there be any required minimum amount of collateral to protect the customer and the broker-dealer?

[17] For example, a broker-dealer that needed to borrow equity or debt securities of a U.S. company could pledge debt securities of another company (U.S. or foreign), provided the company issuing the securities being pledged is rated ''AAA'' or ''AA.''

IV. Paperwork Reduction Act

The proposal does not require a new collection of information. The proposed amendment does not alter the range of collateral that a broker-dealer can pledge when borrowing customer securities, but instead amends the rule to establish criteria that the Commission will consider when issuing an order. In connection with Rule 15c3–3, the Commission submitted to the Office of Management and Budget, pursuant to the Paperwork Reduction Act, a request for approval and received an OMB control number for the rule, OMB control number 3235–0078.

V. Costs and Benefits of the Proposed Rule Amendments

The Commission is considering the costs and benefits of the proposed amendment to Rule 15c3–1.

The primary benefits of the amendment should be lowered borrowing costs and increased liquidity in the securities lending markets. The current collateral requirements in Rule 15c3–3 make it more economical for broker-dealers to borrow securities from other broker-dealers (which are not customers) since customers must be provided with a limited range of collateral. In such a case, the broker-dealer would be limited to borrowing the securities from broker-dealers agreeable to accepting another type of collateral. Expanding the categories of collateral will increase the supply of eligible lenders, which should decrease costs as a consequence of greater competition.

On the other side, customers will have the opportunity to enter into more lending transactions with broker-dealers. This will allow them to earn the fees associated with such transactions and thereby realize greater returns on their securities portfolios. The increased opportunities to borrow and lend securities should add liquidity to the securities lending markets.

The Commission does not believe there are any direct costs associated with the proposal, as it is deregulatory. The amendment will have no impact on broker-dealers that do not borrow customer securities or customers that do not lend securities. For those who participate in such transactions, the amendment is not imposing any changes as to how they must be structured. As described above, it will provide greater opportunities; however, it also maintains the status quo, and therefore, broker-dealers and customers do not have to avail themselves of these new opportunities. Broker-dealers can continue to pledge the types of collateral currently allowed under the rule and, while new categories of collateral may have risk characteristics that differ from those applicable to currently permitted collateral, customers could choose not to accept new categories of collateral.

The Commission requests comment on this analysis of the costs and benefits of the proposed rule amendments and invite commenters to submit their own estimates of costs and benefits that would result from the proposal. In order to evaluate fully the costs and benefits associated with the proposed amendments, we request that commenters' estimates of the costs and benefits of the proposed amendments be accompanied by specific empirical data supporting their estimates.

VI. Effects on Competition, Efficiency, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, when engaged in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act requires the Commission to consider the impact on competition of any rule proposed under that Act. In addition, the law requires that the Commission not adopt any rule that would impose a burden on competition not necessary or appropriate in the furtherance of the purposes of the Exchange Act.

The Commission preliminarily believes the proposed amendment should improve efficiency, competition, and capital formation by adding liquidity to the securities lending markets, lowering the costs of borrowing securities, and providing investors with the opportunity to realize greater returns on their securities portfolios. In addition, the proposed amendment should have no anticompetitive effects not necessary or appropriate in furtherance of the purposes of the Act because it would apply equally to all broker-dealers.

To evaluate more fully the effects on competition of the proposed amendments, the Commission is requesting that commenters provide views and specific empirical data as to any effects their adoption would have on competition. The Commission also requests comments on what effect the proposals, if adopted, would have on efficiency and capital formation.

VII. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act[18] requires the Commission to undertake an initial regulatory flexibility analysis of the effects of proposed rules and rule amendments on small entities, unless the Chairman certifies that the rules and rule amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.[19]

The amendment is unlikely to have a significant economic impact on a substantial number of small entities because it concerns an activity that is only engaged in by entities that are not deemed ''small'' under the Regulatory Flexibility Act. Under Rule 15c3–3, a broker-dealer must pledge certain specified categories of collateral when borrowing fully paid or excess margin securities from its customers. The proposed amendment to Rule 15c3–3 would increase the range of permissible collateral by allowing broker-dealers to pledge such other collateral as the Commission designates by Order as being appropriate in the public interest and consistent with the protection of investors after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness.

According to the Commission's Office of Economic Analysis, as of December 31, 2000, there were approximately 409 broker-dealers that carried customer securities, and therefore could conceivably borrow fully paid or excess margin securities from their customers. Of these 409 broker-dealers, only sixteen firms met the definition of a ''small business'' or ''small organization'' as those terms are defined in Commission Rule 17 CFR 240.0–10. Moreover, not one of these sixteen ''small'' broker-dealers reported borrowed securities on their balance sheets in their quarterly FOCUS filings during 1998, 1999 and 2000. This would indicate that these broker-dealers do not borrow any securities, let alone customer securities, as part of their business activities. Accordingly, the proposed amendment—which relates to broker-dealer borrowings of customer securities—should have no impact on the few ''small'' entities that could conceivably engage in this activity. The primary effect of the proposal would be on broker-dealers that are not considered small entities under the Regulatory Flexibility Act.

[18] 5 U.S.C. 603(a).

[19] 5 U.S.C. 605(b).

The Chairman has certified that the proposed amendments would not have a significant economic impact on a substantial number of small entities. A copy of the certification is attached as Appendix A.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission is also requesting information regarding the potential impact of the proposed rules and rule amendments on the economy on an annual basis. Commenters should provide empirical data to support their views.

VIII. Statutory Authority

Pursuant to the Exchange Act and particularly Sections 15(c)(3), 23(a) and 36 thereof, 15 U.S.C. 78o(c)(3), 78w, and 78mm, the Commission proposes to amend § 240.15c3–3 of Title 17 of the Code of Federal Regulation in the manner set forth below.

List of Subjects

17 CFR Part 240

Broker-dealers, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rule Amendments

In accordance with the foregoing, the Commission proposes to amend Title 17, Chapter II of the *Code of Federal Regulations* as follows.

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

1. The general authority citation for Part 240 is amended by adding the following citation.

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–1, 78k, 78k–*1*, 78l, 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.

* * * * *

Section 240.15c3–3 is also issued under secs. 15 U.S.C. 78o, 78q, 78w, 78fff.

* * * * *

2. Section 240.15c3–3 is revised by removing the authority following § 240.15c3–3 and revising paragraph (b)(3)(iii) to read as follows:

§ 240.15c3–3 Customer protection—reserves and custody of securities.

* * * * *

(b) *Physical possession or control of securities.* * * *

(3) * * *

(iii) Specifies that the broker or dealer:

(A) Must provide to the lender, upon the execution of the agreement or by the close of the business day of the loan if the loan occurs subsequent to the execution of the agreement, collateral, which fully secures the loan of securities, consisting exclusively of cash or United States Treasury bills and Treasury notes or an irrevocable letter of credit issued by a bank as defined in Section 3(a)(6)(A)—(C) of the Act (15 U.S.C. 78c(a)(6)(A)—(C)) or such other collateral as the Commission designates as permissible by order as necessary or appropriate in the public interest and consistent with the protection of investors after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness; and

(B) Must mark the loan to the market not less than daily and, in the event that the market value of all the outstanding securities loaned at the close of trading at the end of the business day exceeds 100 percent of the collateral then held by the lender, the borrowing broker or dealer must provide additional collateral of the type described in paragraph (b)(3)(iii)(A) of this section to the lender by the close of the next business day as necessary to equal, together with the collateral then held by the lender, not less than 100 percent of the market value of the securities loaned; and

* * * * *

By the Commission.

Dated: June 3, 2002.

Jill M. Peterson,

Assistant Secretary.

Note: Appendix A to the preamble will not appear in the Code of Federal Regulations.

Appendix A

Securities and Exchange Commission Regulatory Flexibility Act Certification

I, Harvey L. Pitt, Chairman of the Securities and Exchange Commission (the ''Commission''), based on the representations of the Division of Market Regulation, and the analysis of the Office of Economic Analysis and the Office of the General Counsel provided to me, hereby certify, pursuant to 5 U.S.C. 605(b), that the proposed amendment to paragraph (b)(3) of Commission Rule 15c3–3 (17 CFR 240.15c3–3), would not, if adopted, have a significant economic impact on a substantial number of small entities.

Dated: May 31, 2002.

Harvey L. Pitt,
Chairman.

[FR Doc. 02–14296 Filed 6–7–02; 8:45 am]

BILLING CODE 8010–01–P