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WHEN: Tuesday, December 11, 2012
9 a.m.–12:30 p.m.

WHERE: Office of the Federal Register
Conference Room, Suite 700
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Washington, DC 20002

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This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

The Code of Federal Regulations is sold by the Superintendent of Documents. Prices of new books are listed in the first FEDERAL REGISTER issue of each week.

DEPARTMENT OF ENERGY

10 CFR Parts 429 and 430

[Docket No. EERE–2010–BT–TP–0039]

RIN 1904–AC01

Energy Conservation Program: Test Procedures for Residential Dishwashers, Dehumidifiers, and Conventional Cooking Products; Correction.

AGENCY: Office of Energy Efficiency and Renewable Energy, Department of Energy.

ACTION: Final rule; correction.

SUMMARY: The Department of Energy is correcting a final rule that appeared in the **Federal Register** of October 31, 2012. The rule established new test procedures for residential dishwashers and dehumidifiers, and amended the currently applicable test procedure for conventional cooking products under the Energy Policy and Conservation Act.

DATES: The effective date of this rule is December 17, 2012.

FOR FURTHER INFORMATION CONTACT:

Ms. Ashley Armstrong, U.S. Department of Energy, Office of Energy Efficiency and Renewable Energy, Building Technologies Program, EE–2J, 1000 Independence Avenue SW., Washington, DC 20585–0121. Telephone: (202) 586–6590. Email: *Ashley.Armstrong@ee.doe.gov.*

Ms. Elizabeth Kohl, U.S. Department of Energy, Office of the General Counsel, GC–71, 1000 Independence Avenue SW., Washington, DC 20585–0121. Telephone: (202) 586–7796. Email: *Elizabeth.Kohl@hq.doe.gov.*

SUPPLEMENTARY INFORMATION:

Procedural Issues and Regulatory Review

The regulatory reviews conducted for this rulemaking are those set forth in the October 31, 2012 final rule. (77 FR 65941)

Pursuant to the Administrative Procedure Act, 5 U.S.C. 553(b), DOE has determined that notice and prior opportunity for comment on this rule are unnecessary and contrary to the public interest. The instruction is being revised to delete reference to adding section 3.1.3.3 because there is no accompanying text for such a section; the insertion was made in error. DOE has determined that there is good cause to waive the 30-day delay in effective date for these same reasons.

Correction

■ In FR Doc. 2012–25645, appearing on page 65941 in the **Federal Register** of Wednesday, October 31, 2012, the following correction is made:

Appendix I to Subpart B of Part 430 [Corrected]

■ On page 65987, in the second column, the language of amendatory instruction 11.d.4, ''Adding sections 3.1.3, 3.1.3.1, 3.1.3.2, and 3.1.3.3;'' is corrected to read as follows: ''Adding sections 3.1.3, 3.1.3.1, and 3.1.3.2;''

Issued in Washington, DC, on November 16, 2012.

Kathleen B. Hogan,

Deputy Assistant Secretary for Energy Efficiency, Energy Efficiency and Renewable Energy.

[FR Doc. 2012–28451 Filed 11–21–12; 8:45 am]

BILLING CODE 6450–01–P

BUREAU OF CONSUMER FINANCIAL PROTECTION

12 CFR Part 1026

[Docket No. CFPB–2012–0045]

RIN 3170–AA32

Delayed Implementation of Certain New Mortgage Disclosures

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Final rule; official interpretation.

SUMMARY: The Bureau of Consumer Financial Protection (Bureau) is amending Regulation Z (Truth in Lending) to, in effect, delay implementation of certain new mortgage disclosure requirements in title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act that would otherwise take effect on January 21, 2013. Instead, to avoid potential consumer confusion and reduce compliance burden for industry, the Bureau plans to implement these disclosures as part of the integrated mortgage disclosure forms proposed earlier this year, which combine certain disclosures that consumers receive in connection with applying for and closing on a mortgage loan under the Truth in Lending Act and the Real Estate Settlement Procedures Act. Accordingly, this rulemaking exempts persons from complying with these mortgage disclosure requirements and provides that such exemptions are intended to last only until the integrated mortgage disclosure forms take effect.

DATES: The rule is effective on November 23, 2012.

FOR FURTHER INFORMATION CONTACT: Michael G. Silver, Counsel; and Richard B. Horn, Senior Counsel, Office of Regulations, Consumer Financial Protection Bureau, 1700 G Street NW., Washington, DC 20552 at (202) 435–7700.

SUPPLEMENTARY INFORMATION:

I. Overview

A. Dodd-Frank Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Public Law 111–203, amended the Real Estate Settlement Procedures Act of 1974 (RESPA) and the Truth in Lending Act (TILA) to mandate that the Bureau of Consumer Financial Protection (Bureau) establish a single disclosure scheme for use by lenders or creditors in complying with certain mortgage disclosure requirements under both statutes.[1] Sections 1098 and 1100A of the Dodd-Frank Act amended RESPA section 4(a) and TILA section 105(b), respectively, to require that the Bureau publish a single, integrated disclosure for mortgage loan transactions (including real estate settlement cost statements) which includes the disclosure requirements of TILA and sections 4 and 5 of RESPA that, taken

[1] RESPA and TILA historically have been implemented by regulations of the Department of Housing and Urban Development (HUD) under Regulation X and the Board of Governors of the Federal Reserve System (the Board) under Regulation Z, respectively. The Dodd-Frank Act generally consolidated and transferred these rulemaking authorities to the Bureau.

together, may apply to a transaction that is subject to both or either provisions of law. 12 U.S.C. 2603(a); 15 U.S.C. 1604(b). Section 1032(f) of the Dodd-Frank Act mandated that the Bureau propose for public comment rules and model disclosures that integrate the TILA and RESPA disclosures by July 21, 2012. 12 U.S.C. 5532(f). As noted below, the Bureau satisfied this statutory mandate and issued proposed rules and forms on July 9, 2012.[2]

In addition to the integrated disclosure requirements in title X of the Dodd-Frank Act, various provisions of title XIV of the Dodd-Frank Act amend TILA, RESPA, and other consumer financial laws to impose new disclosure requirements for mortgage transactions (the Title XIV Disclosures). These provisions generally require disclosure of certain information when a consumer applies for a mortgage loan or shortly before consummation of the loan, around the same time that consumers will receive the TILA–RESPA integrated disclosures required by sections 1032(f), 1098, and 1100A of the Dodd-Frank Act (the TILA–RESPA integrated disclosures), and after consummation of the loan if certain events occur. Dodd-Frank Act title XIV provisions generally take effect within 18 months after the designated transfer date (*i.e.,* by January 21, 2013) unless final rules implementing those requirements are issued on or before that date and provide for a different effective date pursuant to Dodd-Frank Act section 1400(c)(3).[3]

The Title XIV Disclosures generally include the following:

- Warning regarding negative amortization features. Dodd-Frank Act section 1414(a); TILA section 129C(f)(1).[4]
- Disclosure of State law anti-deficiency protections. Dodd-Frank Act section 1414(c); TILA section 129C(g)(2) and (3).
- Disclosure regarding creditor's partial payment policy prior to consummation and, for new creditors, after consummation. Dodd-Frank Act section 1414(d); TILA section 129C(h).
- Disclosure regarding mandatory escrow or impound accounts. Dodd-Frank Act section 1461(a); TILA section 129D(h).
- Disclosure prior to consummation regarding waiver of escrow in connection with the transaction. Dodd-Frank Act section 1462; TILA section 129D(j)(1)(A).
- Disclosure regarding cancellation of escrow after consummation. Dodd-Frank Act section 1462; TILA section 129D(j)(1)(B).
- Disclosure of monthly payment, including escrow, at initial and fully-indexed rate for variable-rate residential mortgage loan transactions. Dodd-Frank Act section 1419; TILA section 128(a)(16).
- Repayment analysis disclosure to include amount of escrow payments for taxes and insurance. Dodd-Frank Act section 1465; TILA 128(b)(4).
- Disclosure of aggregate amount of settlement charges, amount of charges included in the loan and the amount of such charges the borrower must pay at closing, the approximate amount of the wholesale rate of funds, and the aggregate amount of other fees or required payments in connection with a residential mortgage loan. Dodd-Frank Act section 1419; TILA section 128(a)(17).
- Disclosure of aggregate amount of mortgage originator fees and the amount of fees paid by the consumer and the creditor. Dodd-Frank Act section 1419; TILA section 128(a)(18).
- Disclosure of total interest as a percentage of principal. Dodd-Frank Act section 1419; TILA section 128(a)(19).
- Optional disclosure of appraisal management company fees. Dodd-Frank Act section 1475; RESPA section 4(c).
- Disclosure regarding notice of reset of hybrid adjustable rate mortgage. Dodd-Frank Act section 1418(a); TILA section 128A(b).
- Loan originator identifier requirement. Dodd-Frank section 1402(a)(2); TILA section 129B(b)(1)(B).
- Consumer notification regarding appraisals for higher-risk mortgages. Dodd-Frank Act section 1471; TILA section 129H(d).
- Consumer notification regarding the right to receive an appraisal copy. Dodd-Frank Act section 1474; Equal Credit Opportunity Act (ECOA) section 701(e)(5).

As noted in the list above, the Title XIV Disclosures include certain disclosures that may need to be given both before and after consummation. For example, the Title XIV Disclosures include disclosures regarding a creditor's policy for acceptance of partial loan payments both before consummation and, for persons who subsequently become creditors for the transaction, after consummation as required by new TILA section 129C(h), added by Dodd-Frank Act section 1414(d).[5] In addition, the Title XIV Disclosures include disclosures for consumers who waive or cancel escrow services both before and after consummation, added by Dodd-Frank Act section 1462. Specifically, new TILA section 129D(j)(1)(A) requires a creditor or servicer to provide a disclosure with the information set forth under TILA section 129D(j)(2) when an impound, trust, or other type of account for the payment of property taxes, insurance premiums, or other purposes relating to real property securing a consumer credit transaction is not established in connection with the transaction (the Pre-Consummation Escrow Waiver Disclosure). New TILA section 129D(j)(1)(B) requires a creditor or servicer to provide disclosures post-consummation with the information set forth under TILA section 129D(j)(2) when a consumer chooses, and provides written notice of the choice, to close his or her escrow account established in connection with a consumer credit transaction secured by real property in accordance with any statute, regulation, or contractual agreement (the Post-Consummation Escrow Cancellation Disclosure). 15 U.S.C. 1639d(j)(1)(A),

[2] *See* the Bureau's press release *Consumer Financial Protection Bureau proposes ''Know Before You Owe'' mortgage forms* (July 9, 2012), available at *http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-proposes-know-before-you-owe-mortgage-forms/;* the Bureau's blog post *Know Before You Owe: Introducing our proposed mortgage disclosure forms* (July 9, 2012), available at *http://www.consumerfinance.gov/blog/know-before-you-owe-introducing-our-proposed-mortgage-disclosure-forms/.*

[3] Dodd-Frank Act section 1400(c)(3) is codified at 15 U.S.C. 1601 note.

[4] Dodd-Frank Act section 1414(a) also added to TILA new section 129C(f)(2), which requires first-time borrowers for certain residential mortgage loans that could result in negative amortization to provide the creditor with documentation to demonstrate that the consumer received homeownership counseling from organizations or counselors certified as competent to provide such counseling by HUD. That provision is implemented in the Bureau's proposal to implement Dodd-Frank Act requirements expanding protections for ''high-cost'' mortgage loans under the Home Ownership and Equity Protection Act of 1994 (HOEPA), pursuant to TILA sections 103(bb) and 129, as amended by Dodd-Frank Act sections 1431 through 1433 (the 2012 HOEPA Proposal). 77 FR 49090 (Aug. 15, 2012). The 2012 HOEPA Proposal also implements the requirement of RESPA section 5(c), added by section 1450 of the Dodd-Frank Act, that lenders provide borrowers with a list of certified homeownership counselors. The Bureau expects to issue a final rule related to the 2012 HOEPA Proposal on or before January 21, 2013.

[5] As it stated in the TILA–RESPA Integration Proposal, the Bureau believes that to give effect to the legislative purpose of section 1414(d) of the Dodd-Frank Act, the disclosure requirements of TILA section 129C(h) should apply without regard to whether the person would be a ''creditor'' under TILA and Regulation Z. *See* 77 FR 51116, 51265. For these reasons, in the TILA–RESPA Integration Proposal, the Bureau proposed to retain the term ''covered person'' under § 1026.39(a)(1) and its definition, which would subject such covered persons to the proposed disclosure requirements. *Id.* As in the TILA–RESPA Integration Proposal, in this final rule the Bureau is temporarily exempting ''persons'' (as defined in Regulation Z) rather than ''creditors'' from compliance with the provisions of TILA section 129C(h), which includes covered persons.

1639d(j)(1)(B). The statute sets forth an identical set of information for both of these disclosures.[6]

B. TILA–RESPA Integration Proposal

On July 9, 2012, the Bureau issued a proposal requesting comment on proposed rules and forms to integrate certain disclosure requirements of TILA and RESPA for most closed-end consumer credit transactions secured by real property (the TILA–RESPA Integration Proposal), as required by sections 1032(f), 1098, and 1100A of the Dodd-Frank Act.[7] The proposed rule would amend the Bureau's Regulation X, 12 CFR part 1024, and Regulation Z, 12 CFR part 1026. The proposal was published in the **Federal Register** on August 23, 2012. 77 FR 51116 (Aug. 23, 2012).

Among other things, the TILA–RESPA Integration Proposal requested comment on an amendment to § 1026.1(c) of Regulation Z that would temporarily exempt persons from compliance with the following Title XIV Disclosures (collectively, the Affected Title XIV Disclosures) so that the disclosures could instead be incorporated into the TILA–RESPA integrated disclosures that would be finalized in the future:

- Warning regarding negative amortization features. Dodd-Frank Act section 1414(a); TILA section 129C(f)(1).
- Disclosure of State law anti-deficiency protections. Dodd-Frank Act section 1414(c); TILA section 129C(g)(2) and (3).
- Disclosure regarding creditor's partial payment policy prior to consummation and, for new creditors, after consummation. Dodd-Frank Act section 1414(d); TILA section 129C(h).
- Disclosure regarding mandatory escrow or impound accounts. Dodd-Frank Act section 1461(a); TILA section 129D(h).
- Disclosure prior to consummation regarding waiver of escrow in connection with the transaction. Dodd-Frank Act section 1462; TILA section 129D(j)(1)(A).
- Disclosure of monthly payment, including escrow, at initial and fully-indexed rate for variable-rate residential mortgage loan transactions. Dodd-Frank Act section 1419; TILA section 128(a)(16).
- Repayment analysis disclosure to include amount of escrow payments for taxes and insurance. Dodd-Frank Act section 1465; TILA 128(b)(4).
- Disclosure of aggregate amount of settlement charges, amount of charges included in the loan and the amount of such charges the borrower must pay at closing, the approximate amount of the wholesale rate of funds, and the aggregate amount of other fees or required payments in connection with a residential mortgage loan. Dodd-Frank Act section 1419; TILA section 128(a)(17).
- Disclosure of aggregate amount of mortgage originator fees and the amount of fees paid by the consumer and the creditor. Dodd-Frank Act section 1419; TILA section 128(a)(18).
- Disclosure of total interest as a percentage of principal. Dodd-Frank Act section 1419; TILA section 128(a)(19).
- Optional disclosure of appraisal management company fees. Dodd-Frank Act section 1475; RESPA section 4(c).

The TILA–RESPA Integration Proposal provided for a bifurcated comment process. Comments regarding the proposed amendments to § 1026.1(c) were required to have been received on or before September 7, 2012. For all other proposed amendments and comments pursuant to the Paperwork Reduction Act, comments were required to have been received on or before November 6, 2012.[8]

C. 2011 Escrows Proposal

Sections 1461 and 1462 of the Dodd-Frank Act create new TILA section 129D, which substantially codifies requirements that the Board had previously adopted in Regulation Z regarding escrow requirements for higher-priced mortgage loans, but also adds disclosure requirements and lengthens the period for which escrow accounts are required. 15 U.S.C. 1639d. On March 2, 2011, the Board proposed amendments to Regulation Z implementing certain requirements of sections 1461 and 1462 of the Dodd-Frank Act. 76 FR 11598 (Mar. 2, 2011) (2011 Escrows Proposal). The Board proposed, among other things, to implement the disclosure requirements under TILA section 129D(j)(1) in Regulation Z under a new § 226.19(f)(2)(ii) and § 226.20(d) of the Board's Regulation Z, including both the Pre-Consummation Escrow Waiver Disclosure and the Post-Consummation Escrow Cancellation Disclosure.

The comment period for the 2011 Escrows Proposal closed on May 2, 2011. The Board did not finalize the 2011 Escrows Proposal. Subsequent to the issuance of the 2011 Escrows Proposal, the authority for finalizing the proposal was transferred to the Bureau pursuant to the Dodd-Frank Act.[9]

II. Summary of Proposed Rule and Comments

A. Affected Title XIV Disclosures

As described above, the Affected Title XIV Disclosures impose certain new disclosure requirements for mortgage transactions. Section 1400(c)(3) of the Dodd-Frank Act[10] provides that, if regulations implementing the Affected Title XIV Disclosures are not issued on the date that is 18 months after the designated transfer date (*i.e.,* by January 21, 2013), the statutory requirements will take effect on that date.

The Bureau provided in the TILA–RESPA Integration Proposal that it believed that implementing integrated disclosures that satisfy the applicable sections of TILA and RESPA and the Affected Title XIV Disclosures would benefit consumers and facilitate compliance for industry with TILA and RESPA. The Bureau provided further that consumers would benefit from a consolidated disclosure that conveys loan terms and costs to consumers in a

[6] The information set forth under TILA section 129D(j)(2) includes information concerning any applicable fees or costs associated with either the non-establishment of the escrow account at the time of the transaction, or any subsequent closure of the account; a clear and prominent statement that the consumer is responsible for personally and directly paying the non-escrowed items, in addition to paying the mortgage loan payment, in the absence of any such account, and the fact that the costs for taxes, insurance, and related fees can be substantial; a clear explanation of the consequences of any failure to pay non-escrowed items, including the possible requirement for the forced placement of insurance by the creditor or servicers and the potentially higher cost (including any potential commission payments to the servicer) or reduced coverage for the consumer in the event of any such creditor-placed insurance; and other information the Bureau determines is necessary for consumer protection. 15 U.S.C. 1639d(j)(2).

[7] *See* the Bureau's press release *Consumer Financial Protection Bureau proposes ''Know Before You Owe'' mortgage forms* (July 9, 2012), available at *http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-proposes-know-before-you-owe-mortgage-forms/;* the Bureau's blog post *Know Before You Owe: Introducing our proposed mortgage disclosure forms* (July 9, 2012), available at *http://www.consumerfinance.gov/blog/know-before-you-owe-introducing-our-proposed-mortgage-disclosure-forms/.*

[8] In its initial **Federal Register** notice, the Bureau also applied the September 7, 2012 deadline to comments on the proposed amendments to the definition of finance charge in § 1026.4. On August 31, 2012, however, the Bureau issued a notice extending the deadline for such comments to November 6, 2012. *See* the Bureau's blog post, *More time for comments on proposed changes to the definition of the finance charge* (August 31, 2012), available at *http://www.consumerfinance.gov/blog/more-time-for-comments-on-proposed-changes-to-the-definition-of-the-finance-charge/.* The extension was published in the **Federal Register** on September 6, 2012. *See* 77 FR 54843 (Sept. 6, 2012). It did not change the comment period for any other aspects of the TILA–RESPA Integration Proposal, which, as noted above, ended November 6, 2012.

[9] Effective July 21, 2011, the Dodd-Frank Act generally transferred rulemaking authority for TILA to the Bureau (except for certain rulemaking authority over motor vehicle dealers that remains with the Board). *See* sections 1061 and 1100A of the Dodd-Frank Act.

[10] Codified at 15 U.S.C. 1601 note.

coordinated way, and industry would benefit by integrating two sets of overlapping disclosures into a single form and by avoiding regulatory burden associated with revising systems and practices multiple times. 77 FR 51116, 51133.

However, given the broad scope and complexity of TILA–RESPA Integration Proposal and the 120-day comment period provided, the Bureau stated that it believed a final rule would not be issued by January 21, 2013. The Bureau was concerned that absent a final rule implementing the Affected Title XIV Disclosures, institutions would have to comply with those disclosures beginning January 21, 2013 due to the statutory requirement that any section of Dodd-Frank Act title XIV for which regulations have not been issued by January 21, 2013 are self-effectuating as of that date. The Bureau stated that this likely would result in widely varying approaches to compliance in the absence of regulatory guidance, creating confusion for consumers, and would impose a significant burden on industry. For example, this could result in a consumer who shops for a mortgage loan receiving different disclosures from different creditors. The Bureau noted that it believed such disclosures would not only be unhelpful to consumers, but likely would be confusing since the same disclosures would be provided in widely different ways, and, moreover, implementing the Affected Title XIV Disclosures separately from the TILA–RESPA integrated disclosures would increase compliance costs and burdens on industry. The Bureau also noted in the TILA–RESPA Integration Proposal that nothing in the Dodd-Frank Act itself or its legislative history suggests that Congress contemplated how the separate requirements in titles X and XIV would work together.[11]

Accordingly, in the TILA–RESPA Integration Proposal, the Bureau proposed to implement the Affected Title XIV Disclosures for purposes of Dodd-Frank Act section 1400(c) by providing a temporary exemption from the requirement to comply with such requirements such that they would not become self-effective on January 21, 2013, and instead would be required at the time the TILA–RESPA integrated disclosure requirements become effective.[12] The Bureau proposed such temporary exemption pursuant to its authority under TILA sections 105(a) and 105(f), RESPA section 19(a), Dodd-Frank Act section 1032(a) and, for residential mortgage loans, Dodd-Frank Act section 1405(b). The Bureau explained that fully implementing the Affected Title XIV Disclosures as part of the broader integrated TILA–RESPA rulemaking, rather than issuing rules implementing each requirement individually or allowing those statutory provisions to take effect by operation of law, will improve the overall effectiveness of the integrated disclosures for consumers and reduce burden on industry.

Specifically, as set forth in the section-by-section analysis to proposed § 1026.1(c) in the TILA–RESPA Integration Proposal, the Bureau proposed to delay those requirements by temporarily exempting persons from the requirement to comply on January 21, 2013.[13] The Bureau stated in the TILA–RESPA Integration Proposal that it would remove this regulatory exemption in the final rule implementing the TILA–RESPA integrated disclosures. The proposed exemption would be, in effect, a delay of the effective date of the Affected Title XIV Disclosures.

B. Other Title XIV Disclosures

The Bureau proposed to exclude the following Title XIV Disclosures from the list of Affected Title XIV Disclosures in the TILA–RESPA Integration Proposal, stating they would be implemented in separate rulemakings:

- Disclosure regarding notice of reset of hybrid adjustable rate mortgage. Dodd-Frank Act section 1418(a); TILA section 128A(b).
- Loan originator identifier requirement. Dodd-Frank section 1402(a)(2); TILA section 129B(b)(1)(B).
- Consumer notification regarding appraisals for higher-risk mortgages. Dodd-Frank Act section 1471; TILA section 129H(d).
- Consumer notification regarding the right to receive an appraisal copy. Dodd-Frank Act section 1474; ECOA section 701(e)(5).
- Post-Consummation Escrow Cancellation Disclosure. Dodd-Frank Act section 1462; TILA section 129D(j)(1)(B).

The Bureau stated generally that these disclosures were expected to be proposed separately in summer 2012 and finalized by January 21, 2013. However, the Post-Consummation Escrow Cancellation Disclosure was excluded from the list of Affected Title XIV Disclosures, in part, because the Bureau stated it ''will be implemented by final rule pursuant to an outstanding proposal published by the Board,'' referring to the Board's 2011 Escrows Proposal.[14]

The Bureau proposed to delay the Affected Title XIV Disclosures to the fullest extent those requirements could apply under the statutory provisions, including to transactions not covered by the proposed integrated disclosure provisions, including open-end credit plans, transactions secured by dwellings that are not real property, and reverse mortgages. The Bureau specifically solicited comment on this scope of the exemption of the Affected Title XIV Disclosures. The Bureau also solicited comment on whether the regulatory exemption should sunset on a specific date, rather than provide an exemption until a final rule for the integrated disclosures becomes effective.

C. Comments on the Proposed Amendments to Section 1026.1(c)

As of September 7, 2012, the Bureau had received nearly 500 comments on the TILA–RESPA Integration Proposal from depository institutions, credit unions, settlement agents, mortgage brokers, mortgage brokerage companies, industry trade groups, consumers, consumer advocacy organizations, a State attorney general, Government-Sponsored Enterprises (GSEs), and other sources. More than 20 of these comments specifically addressed the Bureau's proposed delay of the Affected Title XIV Disclosures, and those commenters were unanimously supportive of a temporary exemption from the Affected Title XIV Disclosures until the TILA–RESPA integrated disclosure rulemaking is finalized. Several industry commenters and their trade groups stated that this approach would result in disclosures that are more useful for consumers and would facilitate compliance for financial institutions by delaying compliance until a comprehensive implementation of all such rules could be accomplished. A State attorney general commented in support of this delayed implementation

[11] As the Bureau stated in the TILA–RESPA Integration Proposal, certain of the Affected Title XIV Disclosures indicate that Congress did not intend for those disclosure requirements and the TILA–RESPA integrated disclosures to operate independently. For example, Dodd-Frank Act section 1419 amended paragraphs (a)(16) through (19) of TILA section 128 to require additional content on the disclosure provided to consumers within three days of application and in final form at or before consummation. 15 U.S.C. 1638(a)(16) through (19). Pursuant to TILA section 128(b)(1), for residential mortgage transactions, all disclosures required by TILA section 128(a) must be ''conspicuously segregated'' from all other information provided in connection with the transaction. 15 U.S.C. 1638(b)(1). Therefore, the Bureau stated that these sections are directly implicated by the integrated TILA–RESPA requirement. 77 FR 51116, 51133.

[12] *Id.*

[13] 77 FR 51116, 51134.

[14] 77 FR 51116, 51134.

of the Affected Title XIV Disclosures, stating that it would allow business entities the time to make extensive changes to their software and retrain staff in order to comply with the new integrated disclosure requirements.

A number of commenters urged the Bureau to delay implementation of other Title XIV Disclosures or otherwise addressed the Title XIV Disclosures more generally. One mortgage company expressly urged the Bureau to delay implementation of the other Title XIV Disclosures (which include the Post-Consummation Escrow Cancellation Disclosure) in addition to the Affected Title XIV Disclosures. A national trade association for credit unions encouraged the Bureau to use its exemption authority under the Dodd-Frank Act, TILA, and RESPA to the fullest extent permissible to relieve regulatory burdens for credit unions. Several state-level trade associations for credit unions urged the Bureau to finalize all Regulation Z rulemakings at the same time. A GSE noted the benefits of implementing rules in a manner that would necessitate only a one-time change for software and other systems. One trade association supported the proposal to delay implementation of the Affected Title XIV Disclosures and urged the Bureau to clarify in the final rule its reasoning for exercising its exemption authority under section 1032(a) of the Dodd-Frank Act to specifically incorporate the considerations in section 1032(c) of the Dodd-Frank Act. Two trade associations commented that the Bureau should make clear that proposed § 1026.1(c) is a rule in ''final form'' pursuant to section 1400(c)(1) of the Dodd-Frank Act and that such a rule prevents the triggering of section 1400(c)(3) of the Dodd-Frank Act.

Several industry trade associations were opposed to a sunset of the regulatory exemption on a specific date and instead, were in favor of the exemption existing until the TILA–RESPA integrated disclosures final rule becomes effective. These industry trade group commenters were concerned that a specific sunset date may precede the effective date for the TILA–RESPA integration final rule. Removing the exemption at the same time as implementing the TILA–RESPA integrated disclosures would, in their view, reduce unnecessary disruption and provide regulatory certainty.

In addition, the Bureau did not receive any comments in favor of limiting the scope of the temporary exemptions, such that the disclosure requirements would become self-effective for the types of loans that are not subject to the TILA–RESPA integrated disclosure requirements in the TILA–RESPA Integration Proposal. One national trade association representing the reverse mortgage industry commented in support of exemptions from the Affected Title XIV Disclosures for reverse mortgage loans. A national trade association representing banks and bank holding companies that provide retail financial services commented that the exemption should also apply to the fullest extent under the statute, and not be limited to the loans subject the TILA–RESPA integrated disclosure requirements as proposed. The trade association specifically stated that many banks use similar systems for home equity lines of credit, reverse mortgages, and loans secured by dwellings that are not real property and noted that including them in the exemption would allow banks to implement the disclosure requirements in a coordinated manner. A trade association representing financial institutions in a particular State also commented in favor of the full scope of the temporary exemption.

D. Board's 2011 Escrows Proposal for the Post-Consummation Escrow Cancellation Disclosure

The 2011 Escrows Proposal proposed to implement the Pre-Consummation Escrow Waiver Disclosure required under TILA section 129D(j)(1)(A) and the Post-Consummation Escrow Cancellation Disclosure required under TILA section 129D(j)(1)(B).[15] The content requirements set forth in TILA section 129D(j)(2) are the same for the Pre-Consummation Escrow Waiver Disclosure and the Post-Consummation Escrow Cancellation Disclosure. The 2011 Escrows Proposal proposed model forms for both disclosures. Under the 2011 Escrows Proposal, the disclosures would be required to be delivered at least three business days before consummation or cancellation of the existing escrow account after consummation, as applicable. The proposed disclosures would explain what an escrow account is; how it works; and the risk of not having an escrow account. It also would state the potential consequences of failing to pay home-related costs such as taxes and insurance in the absence of an escrow account. In addition, it would state why there will be no escrow account or why it is being cancelled, as applicable; the amount of any fee imposed for not having an escrow account; and how the consumer can request that an escrow account be established or left in place, along with any deadline for such requests.[16]

The Board received approximately 70 comments to the 2011 Escrows Proposal, of which roughly a dozen addressed the timing of the implementation of the Post-Consummation Escrow Cancellation Disclosure. Specifically, national industry trade associations, State industry trade associations, large depository institutions, and community banks urged the Board to delay implementation of the Dodd-Frank Act escrow disclosure requirements until the Bureau had authority over the disclosures or until the Bureau could finalize the escrow disclosure requirements along with the TILA–RESPA integrated disclosures. These commenters stated that harmonizing the rulemakings would allow for a comprehensive approach and avoid duplicative forms and repetitive rulemakings. One industry trade association commented that it would be ''premature'' and ''potentially counterproductive'' to issue new escrow rules prior to the completion of the TILA–RESPA integrated disclosures, and therefore recommended that the Board delay finalizing the escrow rules to allow the Bureau to incorporate the Dodd-Frank Act's escrow amendments into the TILA–RESPA integrated disclosures.

As noted above, the Bureau proposed, as part of the TILA–RESPA Integration Proposal, to provide a temporary exemption from compliance with the TILA section 129D(j)(1)(A), which requires the Pre-Consummation Escrow Waiver Disclosure. The Bureau did not propose to effectively delay the Post-Consummation Escrow Cancellation Disclosure in the TILA–RESPA Integration Proposal, and instead stated it would implement the statute, TILA section 129D(j)(1)(B), by final rule pursuant to the Board's 2011 Escrows Proposal. Absent the Bureau's issuance of a final rule implementing TILA section 129D(j)(1)(B) by January 21, 2013, the provision would go into effect as of such date by operation of law under the Dodd-Frank Act section 1400(c)(3).[17]

[15] 76 FR 11598.

[16] 76 FR 11598, 11599.

[17] As described under part IV below, the Bureau considers an exemption from the disclosure requirement under TILA section 129D(j)(1)(B), such as that proposed in the TILA–RESPA Integration Proposal for the Affected Title XIV Disclosures, to be the issuance of a regulation implementing that provision for purposes of Dodd-Frank Act section 1400(c)(3).

III. Summary of the Final Rule

The final rule implements the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure in § 1026.1(c) of Regulation Z and provides for a temporary exemption for persons from these statutory disclosure requirements. The Bureau is issuing this final rule implementing the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure prior to the statutory provisions becoming self-effectuating on January 21, 2013. Accordingly, persons will not be required to comply with these statutory disclosure requirements until such time as the Bureau removes the exemption, which it plans to do in the final rule for the TILA–RESPA integrated disclosures, and such removal takes effect.

IV. Legal Authority

The Bureau is exercising its authority under and consistent with TILA section 105(a) and (f), RESPA section 19(a), Dodd-Frank section 1032(a), and, for residential mortgage loans, Dodd-Frank Act section 1405(b) to, in effect, delay the effective date of the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure by exempting regulated persons from these provisions until a final rule for the TILA–RESPA integrated disclosures mandated by Dodd-Frank Act sections 1032(f), 1098 and 1100A takes effect. 15 U.S.C. 1604(a), 1604(f); 12 U.S.C. 2617(a); 12 U.S.C. 5532(a); 15 U.S.C. 1601 note. TILA section 105(a) gives the Bureau authority to adjust or except from the disclosure requirements of TILA all or any class of transactions to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or facilitate compliance therewith. As set forth above and below, delaying the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure until such time as a final rule implementing the TILA–RESPA integrated disclosures takes effect achieves the purpose of TILA to promote the informed use of credit through a more effective, consolidated disclosure, and facilitates compliance by reducing regulatory burden associated with revising systems and practices multiple times and providing multiple disclosures to consumers.

The Bureau is also exercising exemption authority pursuant to TILA section 105(f). The Bureau has considered the factors in TILA section 105(f) and believes that an exemption is appropriate under that provision. Specifically, the Bureau believes that the exemption is appropriate for all affected borrowers, regardless of their other financial arrangements and financial sophistication and the importance of the loan to them. Similarly, the Bureau believes that the exemption is appropriate for all affected loans, regardless of the amount of the loan and whether the loan is secured by the principal residence of the consumer. Furthermore, the Bureau believes that, on balance, the exemption will simplify the credit process without undermining the goal of consumer protection or denying important benefits to consumers.

As discussed above, the Bureau believes that the exemption overall provides a benefit to consumers by facilitating a more effective, consolidated disclosure scheme. Absent an exemption, the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure would complicate and hinder the mortgage lending process because consumers would receive inconsistent disclosures and, likely, numerous additional pages of Federal disclosures that do not work together in a meaningful, synchronized way. The Bureau also believes that the credit process could be more expensive and complicated if the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure take effect independent of the larger TILA–RESPA integration rulemaking because industry would be required to revise systems and practices multiple times. The Bureau has also considered the status of mortgage borrowers in issuing the exemptions, and believes the exemption is appropriate to improve the informed use of credit. The Bureau does not believe that the goal of consumer protection would be undermined by the exemption, because of the risk that layering the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure on top of existing mandated disclosures would lead to consumer confusion. The exemption allows the Bureau to coordinate the changes in a way that improves overall consumer understanding of the disclosures.

RESPA section 19(a) provides the Bureau with authority to grant reasonable exemptions for classes of transactions from the requirements of RESPA as necessary to achieve the purposes of RESPA. 12 U.S.C. 2617(a). As discussed above, one purpose of RESPA is to achieve more effective advance disclosure to home buyers and sellers of settlement costs. RESPA section 2(b)(1); 12 U.S.C. 2601(b). Delaying the optional disclosure of the appraisal management company fee and the fee paid to the appraiser provided for by Dodd-Frank Act section 1475 (amending RESPA section 4(c)) until such time as a final rule implementing the TILA–RESPA integrated disclosures takes effect will result in a more effective disclosure and improve consumer understanding, as discussed above.

Section 1405(b) of the Dodd-Frank Act additionally gives the Bureau authority to exempt from or modify disclosure requirements, in whole or in part, for any class of residential mortgage loans if the Bureau determines that the exemption or modification is in the interest of consumers and the public. 15 U.S.C. 1601 note. As discussed above, implementing the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure with the TILA–RESPA integrated disclosures is in the interest of consumers because it allows the Bureau to coordinate the changes mandated by the Dodd-Frank Act in a way that synchronizes and harmonizes the disclosures, which in turn will improve overall consumer understanding of the disclosures. Further, implementing the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure as part of the integrated disclosure rulemaking is in the public interest because it produces a more efficient regulatory scheme by incorporating multiple, potentially confusing disclosures into clear and understandable forms through consumer testing.

Consistent with section 1032(a) of the Dodd-Frank Act,[18] implementing the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure together with

[18] As the Bureau stated in the TILA–RESPA Integration Proposal, Dodd-Frank Act section 1032(c) provides that, in prescribing rules pursuant to section 1032, the Bureau ''shall consider available evidence about consumer awareness, understanding of, and responses to disclosures or communications about the risks, costs, and benefits of consumer financial products or services.'' 12 U.S.C. 5532(c). Consistent with Dodd-Frank Act section 1032(a), in developing this final rule to delay implementation of the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure, the Bureau considered available studies, reports, and other evidence about consumer awareness, understanding of, and responses to disclosures or communications about the risks, costs, and benefits of consumer financial products or services, including the evidence developed through its consumer testing of the TILA–RESPA integrated disclosures as well as prior testing done by the Board and HUD regarding TILA and RESPA disclosures. *See* parts II and III of the TILA–RESPA Integration Proposal. For the reasons discussed in this final rule, the Bureau has considered available evidence pursuant to Dodd-Frank Act section 1032(c).

the TILA–RESPA integrated disclosures would ensure that the features of consumer credit transactions secured by real property are fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks associated with the product or service, in light of the facts and circumstances. 12 U.S.C. 5532(a). The Bureau believes that implementing a single, consolidated disclosure will benefit consumers and facilitate compliance with TILA and RESPA.

For these reasons, the Bureau is issuing this final rule to delay the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure until the Bureau issues a final rule implementing the TILA–RESPA integrated disclosures required by sections 1032(f), 1098, and 1100A of the Dodd-Frank Act and such rule takes effect. The Bureau considers the adoption of these amendments to § 1026.1(c) as prescribing the rules in final form for the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure pursuant to Dodd-Frank Act section 1400(c)(1)(A), to the extent regulations are required to be prescribed, and the effective date of the final rule as satisfying Dodd-Frank Act section 1400(c)(1)(B). The Bureau views this final rule as issuing regulations for purposes of Dodd-Frank Act section 1400(c)(3); therefore, the Affected Title XIV Disclosures and Post-Consummation Escrow Cancellation Disclosure do not take effect by operation of law with respect to any transaction covered by TILA or RESPA on January 21, 2013.

This final rule will be effective on the date of publication in the **Federal Register**. Under section 553(d) of the Administrative Procedure Act (APA), the required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except for (1) a substantive rule which grants or recognizes an exemption or relieves a restriction; (2) interpretative rules and statements of policy; or (3) as otherwise provided by the agency for good cause found and published with the rule. 5 U.S.C. 553(d). As discussed in part III above and part V below, this final rule provides for a temporary exemption from the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure such that they would not become self-effective on January 21, 2013, and instead would be required at the time the TILA–RESPA integrated disclosures become effective. Therefore, under section 553(d)(1) of the APA, the Bureau is publishing this final rule less than 30 days before its effective date because it is a substantive rule which grants or recognizes an exemption or relieves a restriction. 5 U.S.C. 553(d)(1).

V. Section-by-Section Analysis of Final Rule

In the TILA–RESPA Integration Proposal, the Bureau proposed to exempt persons temporarily from the disclosure requirements of the Affected Title XIV Disclosures (*i.e.,* sections 128(a)(16) through (19), 128(b)(4), 129C(f)(1), 129C(g)(2) and (3), 129C(h), 129D(h), and 129D(j)(1)(A) of TILA and section 4(c) of RESPA), until regulations implementing the integrated disclosures required by sections 1032(f), 1098, and 1100A of the Dodd-Frank Act take effect. 15 U.S.C. 1638(a)(16)–(19), 1638(b)(4), 1639c(f)(1), 1639c(g), 1639c(h), 1639d(h), and 1639d(j)(1)(A); 12 U.S.C. 2604(c); 12 U.S.C. 5532(f); 12 U.S.C. 2603; 15 U.S.C. 1604. The TILA–RESPA Integration Proposal provided for implementation of the exemption in proposed § 1026.1(c)(5) by stating that no person is required to provide the disclosures required by the statutory provisions listed above. Proposed comment 1(c)(5)–1 explained that § 1026.1(c)(5) implements the above-listed provisions of TILA and RESPA added by the Dodd-Frank Act by exempting persons from the disclosure requirements of those sections. The comment proposed to clarify that the exemptions provided in proposed § 1026.1(c)(5) are intended to be temporary and will apply only until compliance with the regulations implementing the integrated disclosures required by section 1032(f) of the Dodd-Frank Act become mandatory. Proposed comment 1(c)(5)–1 also clarified that the exemption in proposed § 1026.1(c)(5) does not exempt any person from any other requirement of Regulation Z, Regulation X, or of TILA or RESPA.

The Bureau has considered the comments addressing the proposed amendments to § 1026.1(c), which are summarized in part II.C, above. Based on those comments and its own analysis, the Bureau has determined that it will adopt the proposed amendments to § 1026.1(c), with only one substantive change and the technical changes described below.

1. Post-Consummation Escrow Cancellation Disclosure

Although the Post-Consummation Escrow Cancellation Disclosure was not included in the Affected Title XIV Disclosures in the TILA–RESPA Integration Proposal, the Bureau nevertheless received comment requesting that it delay implementation of this disclosure, as described above. Furthermore, as discussed above, the Board received similar requests from commenters on its 2011 Escrows Proposal, which is now the Bureau's responsibility.

The Bureau has considered the comments received by the Board and the Bureau and believes that, for the reasons given by the commenters and the reasons described in part II above, delaying implementation of the Post-Consummation Escrow Cancellation Disclosure and coordinating such implementation with that of the TILA–RESPA integrated disclosures is in the interest of industry and consumers alike. As discussed in part II above, the Dodd-Frank Act statutory requirements for the content of the Pre-Consummation Escrow Waiver Disclosure and the Post-Consummation Escrow Cancellation Disclosure are the same, and the model forms proposed in the Board's 2011 Escrows Proposal contained similar language for both disclosures. The Bureau tested language for the Pre-Consummation Escrow Waiver Disclosure at its consumer testing conducted in connection with the TILA–RESPA Integration Proposal and proposed to integrate this disclosure into the Closing Disclosure (which integrates the final TILA disclosure and the RESPA settlement statement).[19] Implementing the Post-Consummation Escrow Cancellation Disclosure along with the TILA–RESPA integrated disclosures will allow the Bureau to use feedback it has received from consumer testing conducted prior to the TILA–RESPA Integration Proposal, the comments on that proposal, and any consumer testing conducted subsequent to the proposal to harmonize the content and format of the Post-Consummation Escrow Cancellation Disclosure, the Pre-Consummation Escrow Waiver Disclosure, and the TILA–RESPA integrated disclosures. Consumers, therefore, would benefit from a more fully integrated and synchronized overall mortgage disclosure scheme, and industry would benefit from a more coordinated implementation of the overall mortgage disclosure scheme mandated by the Dodd-Frank Act and implemented by the Bureau. The Bureau also notes that no commenters supported the finalization of the Post-Consummation Escrow Cancellation

[19] For a report on the Bureau's consumer testing, see Kleimann Communication Group, Inc., *Know Before You Owe: Evolution of the Integrated TILA–RESPA Disclosures* (July 2012), available at *http://files.consumerfinance.gov/f/201207_cfpb_report_tila-respa-testing.pdf.*

Disclosure with the planned finalization of the Board's 2011 Escrows Proposal on or before January 21, 2013, and no commenters supported allowing the Post-Consummation Escrow Cancellation Disclosure to take effect by operation of law on that date.

In light of the considerations discussed above, including the comments submitted to the Board and the Bureau in support of a temporary exemption from compliance, the Bureau is modifying the proposed amendments to § 1026.1(c) to exempt persons from compliance with the Post-Consummation Escrow Cancellation Disclosure in addition to the Affected Title XIV Disclosures. Accordingly, the Bureau is adding a reference in § 1026.1(c)(5) and associated commentary to TILA section 129D(j)(1)(B).

2. Technical Changes

In addition, in the final rule the Bureau is making three technical changes to § 1026.1 and its commentary. First, in § 1026.1(a), reference has been added to reflect the implementation of certain provisions of RESPA. This technical change relates to the fact that the optional disclosure of appraisal management company fees and fees paid to appraisers under RESPA section 4(c) (as added by Dodd-Frank Act section 1475) is being implemented in Regulation Z, rather than Regulation X, by exempting persons from the disclosure requirements of that section.

Second, in comment 1(c)(5)–1, references have been added to Dodd-Frank Act sections 1098 and 1100A, which amend RESPA section 4(a) and TILA section 105(b), respectively, in addition to the proposed comment's reference to Dodd-Frank Act section 1032(f). This technical change reflects the fact that sections 1098 and 1100A of the Dodd-Frank Act also mandate the TILA–RESPA integrated disclosures. Third, the Bureau has amended § 1026.1(a) to make clear that the Office of Management and Budget control number listed applies only to Bureau respondents.

VI. Section 1022(b)(2) Analysis

Section VII of the TILA–RESPA Integration Proposal contained the Bureau's preliminary analysis under section 1022(b)(2)(A) of the Dodd-Frank Act of the potential benefits and costs of the proposed rule to consumers and covered persons (as defined in Dodd-Frank Act section 1002(6), 12 U.S.C. 5481(6)), including the potential reduction of access by consumers to consumer financial products or services; the impact on depository institutions and credit unions with $10 billion or less in total assets as described in section 1026 of the Dodd-Frank Act; and the impact on consumers in rural areas (the Preliminary Section 1022(b)(2) Analysis).[20] In the Preliminary Section 1022(b)(2) Analysis, the Bureau addressed the impact of the proposed delay of the Affected Title XIV Disclosures on covered persons and consumers. *See* section VII.D.8 of the TILA–RESPA Integration Proposal. There, the Bureau noted that the proposed rule would exempt creditors temporarily from compliance with certain new disclosure requirements added to TILA and RESPA by the Dodd-Frank Act until such final rule takes effect. Although the Dodd-Frank Act does not specifically require inclusion of the Affected Title XIV Disclosures in the TILA–RESPA integrated disclosures, the Bureau stated in the TILA–RESPA Integration Proposal that it believes these disclosures should be included in the integrated disclosures because doing so would improve the overall effectiveness of the integrated disclosures, which may benefit consumers and covered persons, and also reduce burden on covered persons. *See* 77 FR 51116, 51279. The Bureau further stated that making the requirements to provide the Affected Title XIV Disclosures become effective simultaneously with the TILA–RESPA integrated disclosures would avoid unnecessary regulatory burden by preventing creditors from having to implement multiple iterations of disclosure rules. Lastly, the Bureau stated that it did not anticipate additional costs to covered persons as a result of delayed implementation of the Affected Title XIV Disclosures, although covered persons may incur additional recurring costs associated with calculating and disclosing this additional information to consumers once the implementing rules take effect. *See* 77 FR 51116, 51279–80. As discussed above, this final rule effectively delays implementation of certain disclosure requirements and thus, consumers will not receive the information provided in such disclosures as early as they would have if the statutory requirements had become self-effective pursuant to Dodd-Frank Act section 1400(c). However, the Bureau believes that these disclosures are of lesser value to consumers without the comprehensive reform of the integrated TILA–RESPA disclosures. In addition, any benefits that consumers would derive from allowing the statutory requirements to take effect prior to the TILA–RESPA integrated disclosures would only accrue during the time between when the requirements would take effect and when the TILA–RESPA integrated disclosure requirements would be finalized.

The baseline for analysis in this final Dodd-Frank Act section 1022(b)(2) analysis is a post-statutory baseline analysis. The Preliminary Section 1022(b)(2) Analysis used a pre-statutory baseline, *i.e.,* it analyzed the benefits, costs, and impacts of the proposed temporary exemption against a pre-statutory baseline. The Bureau believes a post-statutory baseline more fully informs the rulemaking and is more appropriate for the distinct nature of this final rule—to prevent effectively certain statutory disclosure requirements from becoming self-effective. The Bureau has discretion in future rulemakings to choose the most appropriate baseline for each particular rulemaking.

The Bureau did not receive any comments on the Bureau's Preliminary Section 1022(b)(2) Analysis regarding the effect of the proposed delay of implementing the Affected Title XIV Disclosures on covered persons and consumers. The Bureau also believes that delaying implementation of the Post-Consummation Escrow Cancellation Disclosure and, instead, implementing the disclosure along with the TILA–RESPA integrated disclosures would avoid unnecessary regulatory burden by preventing covered persons from having to implement multiple iterations of disclosure rules. The Bureau does not anticipate additional costs to covered persons as a result of such delayed implementation of the Post-Consummation Escrow Cancellation Disclosure, although covered persons may incur additional recurring costs associated with calculating and disclosing this additional information to consumers once the implementing rules take effect.

In light of this, the Bureau concludes, using a post-statutory baseline, that the

[20] See 77 FR 51116, 51267. The Bureau stated that in developing the proposed rule, the Bureau had considered potential benefits, costs, and impacts, and had consulted or offered to consult with the prudential regulators, the Department of Housing and Urban Development, and the Federal Trade Commission, including regarding consistency with any prudential, market, or systemic objectives administered by such agencies. The Bureau also held discussions with or solicited feedback from the United States Department of Agriculture Rural Housing Service, the Farm Credit Administration, the Federal Housing Administration, the Federal Housing Finance Agency, and the Department of Veterans Affairs regarding the potential impacts of the proposed rule on those entities' loan programs. *Id.* In addition, prior to finalizing the rule, the Bureau consulted or offered to consult with the appropriate prudential regulators and Federal agencies regarding this final rule.

final rule will have the benefits, costs, and impacts on covered persons and consumers that were discussed in the Preliminary Section 1022(b)(2) Analysis. This final rule does not have the potential to reduce access by consumers to consumer financial products or services, as it will not increase costs on covered persons. In addition, as noted above, because this rule effectively delays the implementation of disclosure requirements, it will cause no additional costs on depository institutions and credit unions with $10 billion or less in total assets, as described in section 1026 of the Dodd-Frank Act. Further, it will have no significant or adverse impact on consumers in rural areas, as it does not increase costs for covered persons or consumers. The Bureau believes that delaying the implementation of the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure will eliminate the costs that covered persons would have incurred if they had to implement the disclosure provisions multiple times, *i.e.,* if these statutory provisions had taken effect by operation of law pursuant to Dodd-Frank Act section 1400(c)(3) and were also later implemented through the TILA–RESPA integration final rule (including potential increased compliance costs due to uncertainty of complying with statutory provisions without implementing regulations).

VII. Regulatory Flexibility Act

The Bureau's TILA–RESPA Integration Proposal included an initial regulatory flexibility analysis (IRFA) discussing the potential impact of the Bureau's regulations on small entities, including small businesses, under the Regulatory Flexibility Act (RFA). *See* 77 FR 51116, 51282. Among other issues, the IRFA discussed how the proposed rule would exempt creditors temporarily from compliance with certain new disclosure requirements added to TILA and RESPA by the Dodd-Frank Act until the integrated TILA–RESPA rule takes effect. *See* 77 FR 51116, 51293. The Bureau stated in the IRFA that, although the Dodd-Frank Act does not specifically require inclusion of all of these new disclosures in the integrated disclosures, the Bureau believes these disclosures should be included in the integrated disclosures because doing so would improve the overall effectiveness of the integrated disclosures, which may benefit consumers and covered persons that are small entities, and also reduce burden on covered persons that are small entities. The Bureau provided in the IRFA that finalizing the rules implementing these title XIV disclosures simultaneously with the final TILA–RESPA rule would avoid unnecessary regulatory burden by preventing creditors that are small entities from having to implement multiple iterations of disclosure rules. The Bureau stated in the IRFA that it does not anticipate additional costs to covered persons as a result of delayed implementation of the new disclosure requirements, although small entities may incur additional recurring costs associated with calculating and disclosing this additional information to consumers once the implementing rules take effect. *Id.* The Bureau also noted in the IRFA that incorporating the Affected Title XIV Disclosures into the TILA–RESPA integrated disclosures was being proposed to avoid duplication, overlaps, and conflicts. *See* 77 FR 51116, 51294.

The Bureau did not receive any comments on the conclusions that the Bureau made in the IRFA regarding the effect on small entities of the proposed delay of implementing the Affected Title XIV Disclosures. The Bureau also believes that delaying implementation of the Post-Consummation Escrow Cancellation Disclosure to implement it simultaneously with the TILA–RESPA integration final rulemaking will avoid unnecessary regulatory burden by preventing covered persons that are small entities from having to implement multiple iterations of disclosure rules. The Bureau does not anticipate additional costs as a result of delayed implementation of the Post-Consummation Escrow Cancellation Disclosure, although small entities may incur additional recurring costs associated with calculating and disclosing this additional information to consumers once the implementing rules take effect. *Id.* The Bureau also believes that synchronizing the format and content of the Post-Consummation Escrow Cancellation Disclosure with the Pre-Consummation Escrow Waiver Disclosure and the integrated TILA–RESPA disclosures avoids duplication, overlaps, and conflicts with other Federal rules. *See* 77 FR 51116, 51294.

Accordingly, because this final rule, which the Bureau is issuing separately from the other parts of the TILA–RESPA Integration Proposal, will not create additional costs for covered persons that are small entities, the undersigned certifies that it will not have a significant economic impact on a substantial number of small entities. Therefore, an analysis under the RFA is not required for this final rule. However, the factors required in such an analysis are addressed below for informational purposes.

The Bureau has concluded that the final rule will impose, subject to a post-statutory baseline, the impacts on small entities that were discussed in the IRFA. The delay of the implementation of the Affected Title XIV Disclosures and the Post-Consummation Escrow Cancellation Disclosure, so that they may be implemented with the integrated TILA–RESPA disclosures, will improve the integrated disclosures, which may benefit consumers and small entities, and avoid unnecessary regulatory burden by preventing covered persons that are small entities from having to implement multiple iterations of disclosure rules.

As described in the TILA–RESPA Integration Proposal, the Bureau estimates the final rule to affect small entities that are engaged in closed-end mortgage transactions that are commercial banks and savings associations, credit unions, non-bank mortgage lenders, mortgage brokers, and settlement agents, totaling about 26,000 small entities.[21] This rule provides an exemption and, therefore, does not contain any reporting, recordkeeping, or other requirements. The Bureau has reviewed possible steps to minimize the impact on small entities in connection with the TILA–RESPA Integration Proposal. As the nature of this final rule is an exemption, it is itself a step taken to minimize impact on small entities (as opposed to the alternative of letting the statutory disclosure provisions become self-effective). The final rule covers all small entities subject to the statutory provisions, because the final rule applies to persons generally.

In sum, this final rule will eliminate the costs that covered small entities would have incurred if they had to implement the disclosure provisions multiple times, *i.e.,* if these statutory provisions had taken effect by operation of law pursuant to Dodd-Frank Act section 1400(c)(3) and were also later implemented through the TILA–RESPA integration final rule (including potential increased compliance costs due to uncertainty of complying with statutory provisions without implementing regulations).

VIII. Paperwork Reduction Act

The Bureau has determined that this final rule does not impose any new recordkeeping, reporting, or disclosure requirements on covered persons or members of the public that would be collections of information requiring OMB approval under the Paperwork Reduction Act (PRA), 44 U.S.C. 3501, *et seq.* Rather, the final rule defers certain

[21] *See* 77 FR 51116, 51285–6.

information collection requirements subject to the PRA until such time as the TILA–RESPA integrated disclosure final rule, and the corresponding information collection requirements, becomes effective. The Bureau did not receive any comments related to this exemption under the PRA.

List of Subjects in 12 CFR Part 1026

Advertising, Consumer protection, Credit, Credit unions, Mortgages, National banks, Recordkeeping requirements, Reporting, Savings associations, Truth in lending.

Authority and Issuance

For the reasons stated in the preamble, the Bureau amends Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING (REGULATION Z)

■ 1. The authority citation for part 1026 is revised to read as follows:

Authority: 12 U.S.C. 2601; 2603–2605, 2607, 2609, 2617, 5511, 5512, 5532, 5581; 15 U.S.C. 1601 *et seq.*

■ 2. Section 1026.1 is amended by revising paragraph (a) and adding paragraph (c)(5) to read as follows:

§ 1026.1 Authority, purpose, coverage, organization, enforcement, and liability.

(a) *Authority.* This part, known as Regulation Z, is issued by the Bureau of Consumer Financial Protection to implement the Federal Truth in Lending Act, which is contained in title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 *et seq.*). This part also implements title XII, section 1204 of the Competitive Equality Banking Act of 1987 (Pub. L. 100–86, 101 Stat. 552). Furthermore, this part implements certain provisions of the Real Estate Settlement Procedures Act of 1974, as amended (12 U.S.C. 2601 *et seq.*). The Bureau's information-collection requirements contained in this part have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 *et seq.* and have been assigned OMB No. 3170–0015 (Truth in Lending).

* * * * *

(c) * * *

(5) No person is required to provide the disclosures required by sections 128(a)(16) through (19), 128(b)(4), 129C(f)(1), 129C(g)(2) and (3), 129C(h), 129D(h), 129D(j)(1)(A), or 129D(j)(1)(B) of the Truth in Lending Act or section 4(c) of the Real Estate Settlement Procedures Act.

* * * * *

■ 3. In Supplement I to Part 1026:

A. Under *Section 1026.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability,* under subheading *1(c) Coverage,* add in alphanumerical order the subheading *Paragraph 1(c)(5)* and paragraph 1. under that subheading.

The additions read as follows:

Supplement I to Part 1026—Official Interpretations

* * * * *

Subpart A—General

Section 1026.1—Authority, Purpose, Coverage, Organization, Enforcement and Liability 1(c) Coverage

* * * * *

Paragraph 1(c)(5).

1. *Temporary exemption.* Section 1026.1(c)(5) implements sections 128(a)(16) through (19), 128(b)(4), 129C(f)(1), 129C(g)(2) and (3), 129C(h), 129D(h), 129D(j)(1)(A), and 129D(j)(1)(B) of the Truth in Lending Act and section 4(c) of the Real Estate Settlement Procedures Act, by exempting persons from the disclosure requirements of those sections. These exemptions are intended to be temporary, lasting only until regulations implementing the integrated disclosures required by sections 1032(f), 1098, and 1100A of the Dodd-Frank Act (12 U.S.C. 5532(f), 12 U.S.C. 2603(a), 15 U.S.C. 1604(b)) become mandatory. Section 1026.1(c)(5) does not exempt any person from any other requirement of this part, Regulation X (12 CFR part 1024), the Truth in Lending Act, or the Real Estate Settlement Procedures Act.

* * * * *

Dated: November 13, 2012.

Richard Cordray,

Director, Bureau of Consumer Financial Protection.

[FR Doc. 2012–28341 Filed 11–21–12; 8:45 am]

BILLING CODE 4810–AM–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2012–0846; Directorate Identifier 2012–CE–021–AD; Amendment 39–17237; AD 2012–22–01]

RIN 2120–AA64

Airworthiness Directives; Cessna Aircraft Company Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: We are adopting a new airworthiness directive (AD) for certain Cessna Aircraft Company Models 172R and 172S airplanes. This AD was prompted by reports of chafed fuel return line assemblies, which were caused by the fuel return line assembly rubbing against the right steering tube assembly during full rudder pedal actuation. This AD requires you to inspect the fuel return line assembly for chafing; replace the fuel return line assembly if chafing is found; inspect the clearance between the fuel return line assembly and both the right steering tube assembly and the airplane structure; and adjust as necessary. We are issuing this AD to correct the unsafe condition on these products.

DATES: This AD is effective December 28, 2012.

Director of the Federal Register approved the incorporation by reference of a certain other publication listed in this AD as of March 13, 2012 (77 FR 6003, February 7, 2012).

ADDRESSES: For service information identified in this AD, contact Cessna Aircraft Company, Customer service, P.O. Box 7706, Wichita, KS 67277; telephone: (316) 517–5800; fax: (316) 517–7271; Internet: *http://www.cessnasupport.com.* You may review copies of the referenced service information at the FAA, Small Airplane Directorate, 901 Locust, Kansas City, MO 64106. For information on the availability of this material at the FAA, call (816) 329–4148.

Examining the AD Docket

You may examine the AD docket on the Internet at *http://www.regulations.gov;* or in person at the Docket Management Facility between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this AD, the regulatory evaluation, any comments received, and other information. The address for the Docket Office (phone: 800–647–5527) is Document Management Facility, U.S. Department of Transportation, Docket Operations, M–30, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590.

FOR FURTHER INFORMATION CONTACT: Jeff Janusz, Aerospace Engineer, Wichita Aircraft Certification Office, FAA, 1801 S. Airport Road, Room 100, Wichita, Kansas 67209; phone: (316) 946–4148; fax: (316) 946–4107; email: *jeff.janusz@faa.gov.*

SUPPLEMENTARY INFORMATION:

Discussion

We issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 to include an AD that would apply to the specified products. That NPRM published in the **Federal Register** on August 20, 2012 (77 FR 50054). That NPRM proposed to require you to inspect the fuel return line assembly for chafing; replace the fuel return line assembly if chafing is found; inspect the clearance between the fuel return line assembly and both the right steering tube assembly and the airplane structure; and adjust as necessary.

Comments

We gave the public the opportunity to participate in developing this AD. We received no comments on the NPRM (77 FR 50054, August 20, 2012) or on the determination of the cost to the public.

Conclusion

We reviewed the relevant data and determined that air safety and the public interest require adopting the AD as proposed except for minor editorial changes. We have determined that these minor changes:

- Are consistent with the intent that was proposed in the NPRM (77 FR 50054, August 20, 2012) for correcting the unsafe condition; and
- Do not add any additional burden upon the public than was already proposed in the NPRM (77 FR 50054, August 20, 2012).

Costs of Compliance

We estimate that this AD affects 55 airplanes of U.S. registry.

We estimate the following costs to comply with this AD:

ESTIMATED COSTS

Action	Labor cost	Parts cost	Cost per product	Cost on U.S. operators
Inspection of the fuel return line assembly for chafing and clearance.	1 work-hour × $85 per hour = $85	Not applicable	$85	$4,675

We estimate the following costs to do any necessary replacements and adjustments that would be required based on the results of the inspection. We have no way of determining the number of aircraft that might need these replacements:

ON-CONDITION COSTS

Action	Labor cost	Parts cost	Cost per product
Replacement of the fuel return line assembly and adjustment of the clearance between the fuel return line assembly and both the steering tube assembly and the airplane structure.	1 work-hour × $85 per hour = $85	$123	$208

Authority for This Rulemaking

Title 49 of the United States Code specifies the FAA's authority to issue rules on aviation safety. Subtitle I, section 106, describes the authority of the FAA Administrator. Subtitle VII: Aviation Programs, describes in more detail the scope of the Agency's authority.

We are issuing this rulemaking under the authority described in Subtitle VII, Part A, Subpart III, Section 44701: ''General requirements.'' Under that section, Congress charges the FAA with promoting safe flight of civil aircraft in air commerce by prescribing regulations for practices, methods, and procedures the Administrator finds necessary for safety in air commerce. This regulation is within the scope of that authority because it addresses an unsafe condition that is likely to exist or develop on products identified in this rulemaking action.

Regulatory Findings

This AD will not have federalism implications under Executive Order 13132. This AD will not have a substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

For the reasons discussed above, I certify that this AD:

(1) Is not a ''significant regulatory action'' under Executive Order 12866,

(2) Is not a ''significant rule'' under DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979),

(3) Will not affect intrastate aviation in Alaska, and

(4) Will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, under the authority delegated to me by the Administrator, the FAA amends 14 CFR part 39 as follows:

PART 39—AIRWORTHINESS DIRECTIVES

■ 1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40113, 44701.

§ 39.13 [Amended]

■ 2. The FAA amends § 39.13 by adding the following new airworthiness directive (AD):

2012–22–01 Cessna Aircraft Company: Amendment 39–17237; Docket No. FAA–2012–0846; Directorate Identifier 2012–CE–021–AD.

(a) Effective Date

This AD is effective December 28, 2012.

(b) Affected ADs

None.

(c) Applicability

This AD applies to the following Cessna Aircraft Company (Cessna) airplanes, certificated in any category:

(1) Model 172R, serial numbers (S/N) 17280001 through 17281187, that have

incorporated Cessna Aircraft Company Service Bulletin SB04–28–03, dated August 30, 2004, and Engine Fuel Return System, Modification Kit MK172–28–01, dated August 30, 2004; and

(2) Model 172S, S/N l72S8001 through 172S9490, that have incorporated Cessna Aircraft Company Service Bulletin SB04–28–03, dated August 30, 2004, and Engine Fuel Return System, Modification Kit MK172–28–01; dated August 30, 2004.

(d) Subject

Joint Aircraft System Component (JASC)/Air Transport Association (ATA) of America Code 2820, Aircraft Fuel Distribution System.

(e) Unsafe Condition

This AD was prompted by reports of chafed fuel return line assemblies caused by the fuel return line assembly rubbing against the right steering tube assembly during full rudder pedal actuation. We are issuing this AD to correct the unsafe condition on these products.

(f) Compliance

Comply with this AD within the compliance times specified, unless already done.

(g) Inspect the Fuel Return Line Assembly

At whichever of the following that occurs later, inspect the fuel return line assembly (Cessna part number (P/N) 0500118–49) for chafing following Cessna Service Bulletin SB07–28–01, Revision 1, dated September 22, 2011.

(1) At the next annual inspection after December 28, 2012 (the effective date of this AD); or

(2) Within the next 100 hours time-in-service (TIS) after December 28, 2012 (the effective date of this AD); or

(3) Within the next 12 calendar months after December 28, 2012 (the effective date of this AD).

(h) Replace the Fuel Line Assembly

If you find evidence of chafing of the fuel return line assembly (Cessna P/N 0500118–49) as a result of the inspection required by paragraph (g) of this AD, then before further flight, replace the fuel return line assembly (Cessna P/N 0500118–49) following Cessna Service Bulletin SB07–28–01, Revision 1, dated September 22, 2011.

(i) Inspect for a Minimum Clearance Between Certain Parts

After any inspection required by paragraph (g) of this AD and no chafing of the fuel return line assembly (Cessna P/N 0500118–49) is found or after replacement of the fuel return line assembly (Cessna P/N 0500118–49) required by paragraph (h) of this AD, before further flight, inspect for a minimum clearance between the following parts throughout the range of copilot pedal travel:

(1) A minimum clearance of 0.5 inch between the fuel return line assembly (Cessna P/N 0500118–49) and the right steering tube assembly (Cessna P/N MC0543022–2C); and

(2) Visible positive clearance between the fuel return line assembly (Cessna P/N 0500118–49) and the airplane structure.

(j) Adjust Clearance for Fuel Return Line Assembly

If the clearance between the fuel return line assembly and the right steering tube assembly and the clearance between the fuel return line assembly and the aircraft structure do not meet the minimums as specified in paragraphs (i)(l) and (i)(2) of this AD, before further flight, adjust the clearances to meet the required minimums following the Instructions paragraph of Cessna Service Bulletin SB07–28–01, Revision 1, dated September 22, 2011.

(k) Engine Fuel Return System Modification

Do not incorporate Cessna Aircraft Company Engine Fuel Return System Modification Kit MK 172–28–01 as referenced in Service Bulletin SB 04–28–03, both dated August 30, 2004, without performing the actions in this AD before further flight after installation.

(l) Alternative Methods of Compliance (AMOCs)

(1) The Manager, Wichita Aircraft Certification Office (ACO), FAA, has the authority to approve AMOCs for this AD, if requested using the procedures found in 14 CFR 39.19. In accordance with 14 CFR 39.19, send your request to your principal inspector or local Flight Standards District Office, as appropriate. If sending information directly to the manager of the ACO, send it to the attention of the person identified in the Related Information section of this AD.

(2) Before using any approved AMOC, notify your appropriate principal inspector, or lacking a principal inspector, the manager of the local flight standards district office/certificate holding district office.

(m) Related Information

For more information about this AD, contact Jeff Janusz, Aerospace Engineer, Wichita ACO, FAA, 1801 S. Airport Road, Room 100, Wichita, Kansas 67209; phone: (316) 946–4148; fax: (316) 946–4107; email: *jeff.janusz@faa.gov.*

(n) Material Incorporated by Reference

(1) The Director of the Federal Register approved the incorporation by reference (IBR) of the service information listed in this paragraph under 5 U.S.C. 552(a) and 1 CFR part 51.

(2) You must use this service information as applicable to do the actions required by this AD, unless the AD specifies otherwise.

(3) The following service information was approved for IBR on March 13, 2012 (77 FR 6003, February 7, 2012).

(i) Cessna Aircraft Company Cessna Service Bulletin SB07–28–01, Revision 1, dated September 22, 2011.

(ii) Reserved.

(4) For Cessna Aircraft Company service information identified in this AD, contact Cessna Aircraft Company, Customer service, P.O. Box 7706, Wichita, KS 67277; telephone: (316) 517–5800; fax: (316) 517–7271; Internet: *http://www.cessnasupport.com.*

(5) You may view this service information at FAA, Small Airplane Directorate, 901 Locust, Kansas City, MO 64106. For information on the availability of this material at the FAA, call (816) 329–4148.

(6) You may view this service information that is incorporated by reference at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to: *http://www.archives.gov/federal-register/cfr/ibr-locations.html.*

Issued in Kansas City, Missouri, on October 22, 2012.

James E. Jackson,

Acting Manager, Small Airplane Directorate, Aircraft Certification Service.

[FR Doc. 2012–26500 Filed 11–21–12; 8:45 am]

BILLING CODE 4910–13–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34–67717A; File No. S7–42–10]

RIN 3235–AK85

Disclosure of Payments by Resource Extraction Issuers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; correction.

SUMMARY: This release makes a technical correction to Release No. 34–67717 (August 22, 2012), which adopted disclosure rules for resource extraction issuers and was published in the **Federal Register** on September 12, 2012 (77 FR 56365). We are correcting the release to include the text of a footnote that was omitted when published.

DATES: *Effective Date:* November 23, 2012.

FOR FURTHER INFORMATION CONTACT: Tamara Brightwell, Senior Special Counsel, or Eduardo Aleman, Special Counsel, Division of Corporation Finance, at 202–551–3290, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are making the following correction to Release No. 34–67717 (August 22, 2012), which was published in FR Doc. 2012–21155 and appeared on page 56365 of the **Federal Register** on September 12, 2012:

On page 56395, above the last line of the second column, the following footnote text is inserted: ''471 *See* letters from Bon Secours, Calvert, CRS, Earthworks, EIWG, ERI, ERI 2, Global Financial 2, Global Witness 1, Greenpeace, HII, HURFOM 1, HURFOM 2, Newground, ONE, Oxfam 1, PGGM, PWYP 1, RWI 1, Sanborn, Sen. Cardin *et al.* 1, Sen. Cardin *et al.* 2, Sen. Levin 1, Soros 1, TIAA, USAID, USW, and WRI.''

Dated: November 19, 2012.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2012–28455 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 270

[Release No. IC–30268; File No. S7–07–11]

RIN 3235–AL02

Purchase of Certain Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is adopting a new rule under the Investment Company Act of 1940 (''Investment Company Act'') to establish a standard of credit-worthiness in place of a statutory reference to credit ratings that the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'') removes. The rule will establish the standard of credit quality that must be met by certain debt securities purchased by entities relying on the Investment Company Act exemption for business and industrial development companies.

DATES: *Effective date:* December 24, 2012.

FOR FURTHER INFORMATION CONTACT: Anu Dubey, Senior Counsel, or Penelope Saltzman, Assistant Director (202) 551–6792, Office of Regulatory Policy, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–8549.

SUPPLEMENTARY INFORMATION: The Commission is adopting new rule 6a–5 [17 CFR 270.6a–5] under the Investment Company Act.[1]

Table of Contents

I. Background
II. Discussion
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Statutory Authority
Text of Rule

[1] 15 U.S.C. 80a–1. Unless otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act are to Title 17, Part 270 of the Code of Federal Regulations [17 CFR part 270].

I. Background

The Dodd-Frank Act was enacted on July 21, 2010.[2] Section 939(c) of the Dodd-Frank Act removes a reference to credit ratings from section 6(a)(5) of the Investment Company Act and replaces it with a reference to ''such standards of credit-worthiness as the Commission shall adopt.'' [3] To implement this mandate, last year the Commission proposed new rule 6a–5 under the Investment Company Act that would establish a credit-worthiness standard to replace the credit rating reference in section 6(a)(5) of that Act that the Dodd-Frank Act eliminates.[4] We received one comment letter regarding proposed rule 6a–5, which we discuss below.[5] Today, we are adopting new rule 6a–5, which implements section 939(c) of the Dodd-Frank Act.

II. Discussion

Business and industrial development companies (''BIDCOs'') are companies that operate under state statutes that provide direct investment and loan financing, as well as managerial assistance, to state and local enterprises.[6] Because they invest in securities, BIDCOs frequently meet the definition of ''investment company'' under the Investment Company Act.[7] In 1996, the Investment Company Act was amended to add section 6(a)(5) to exempt these companies from most provisions of the Act subject to certain conditions.[8] The statutory exemption was premised on states having a strong interest in overseeing the structure and operations of these companies, thus rendering regulation under the Investment Company Act largely duplicative and unnecessary.[9]

BIDCOs that seek to rely on the exemption in section 6(a)(5) are limited with respect to the types of securities issued by investment companies and companies exempt from the definition of investment company under section 3(c)(1) or 3(c)(7) of the Investment Company Act (''private funds'') that they may purchase. Specifically, section 6(a)(5)(A)(iv) prohibits these BIDCOs from purchasing securities issued by investment companies and private funds other than debt securities that are rated investment grade by at least one NRSRO and securities issued by registered open-end investment companies that invest at least 65 percent of their assets in investment grade

[2] Public Law 111–203, 124 Stat. 1376 (2010).

[3] Section 939(c) of the Dodd-Frank Act (amending section 6(a)(5)(A)(iv)(I) of the Investment Company Act). This amendment to the Investment Company Act becomes effective on July 21, 2012. *See* section 939(g) of the Dodd-Frank Act.

[4] *See* References to Credit Ratings in Certain Investment Company Act Rules and Forms, Investment Company Act Release No. 29592 (Mar. 3, 2011) [76 FR 12896 (Mar. 9, 2011)] (''2011 Proposing Release''). In that release, we also proposed amendments to replace references to credit ratings in rules 2a–7 and 5b–3 under the Investment Company Act and Forms N–1A, N–2, N–3 and N–MFP under the Investment Company Act and the Securities Act of 1933 (15 U.S.C. 77a). Those proposed amendments would implement section 939A of the Dodd-Frank Act, which requires the Commission to review its regulations for any references to or requirements regarding credit ratings that require the use of an assessment of the credit-worthiness of a security or money market instrument, remove these references or requirements, and substitute in those regulations other standards of credit-worthiness that we determine to be appropriate. We intend to address the proposed amendments to rule 2a–7, rule 5b–3 and Forms N–1A, N–2, N–3 and N–MFP separately. Rule 3a–7 under the Investment Company Act also contains a reference to ratings. In August 2011, in a concept release soliciting comment on the treatment of asset-backed issuers under the Investment Company Act, we sought comment on the role, if any, that credit ratings should continue to play in the context of rule 3a–7. *See* Treatment of Asset-Backed Issuers under the Investment Company Act, Investment Company Act Release No. 29779 (Aug. 31, 2011) [76 FR 55308 (Sept. 7, 2011)] at Section III.A.1.

[5] The comment letters on the 2011 Proposing Release (File No. S7–07–11) are available at *http://www.sec.gov/comments/s7-07-11/s70711.shtml*. In addition, to facilitate public input on the Dodd-Frank Act, we provided a series of email links, organized by topic on our Web site at *http://www.sec.gov/spotlight/regreformcomments.shtml*. The public comments we received in response to our solicitation for comment on Title IX of the Dodd-Frank Act (which includes sections 939 and 939A) are available on our Web site at *http://www.sec.gov/comments/df-title-ix/credit-rating-agencies/credit-rating-agencies.shtml*.

[6] *See* Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 479, S. Rep. No. 103–166, at 11 (1993) (''1993 Senate Report'').

[7] For purposes of the Investment Company Act, an ''investment company'' means any issuer that: (A) Is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; (B) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or (C) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of government securities and cash items) on an unconsolidated basis. 15 U.S.C. 80a–3(a)(1).

[8] 15 U.S.C. 80a–6(a)(5); Public Law 104–290 § 501, 110 Stat. 3416, 3444 (1996). Section 6(a)(5)(B) provides that section 9 and, to the extent necessary to enforce section 9, sections 38 through 51, apply to a BIDCO as though the company were a registered investment company. Among other conditions to reliance on the exemption in section 6(a)(5), a BIDCO may not issue redeemable securities.

[9] *See* 1993 Senate Report, *supra* note 6, at 19 (further stating that states are well positioned to monitor these companies and address the needs of resident investors). Prior to the addition of section 6(a)(5), the Commission had granted orders to exempt BIDCOs from regulation under the Act. *See, e.g.,* The Idaho Company, Investment Company Release Nos. 18926 (Sept. 3, 1992) (notice) and 18985 (Sept. 30, 1992) (order).

securities or securities that the fund determines are comparable in quality.[10] This provision was intended to provide limited flexibility to invest capital not immediately needed for the company's long-term commitments.[11] Although the legislative history of the provision does not specifically explain why Congress restricted BIDCOs to acquiring ''investment grade'' debt of investment companies and private funds, as we noted in the 2011 Proposing Release, it may have been designed to limit BIDCOs to investing in debt securities of sufficiently high credit quality that they are likely to maintain a fairly stable market value and that could be liquidated easily, as appropriate, for the BIDCO to support its investment and financing activities.[12]

As described above, section 939(c) of the Dodd-Frank Act eliminates the credit rating reference in section 6(a)(5)(A)(iv) of the Investment Company Act. Instead of limiting BIDCOs to purchasing debt securities issued by investment companies and private funds that are rated ''investment grade,'' the amendment requires such debt securities to meet ''such standards of credit-worthiness as the Commission shall adopt.''

We do not understand that the statutory amendment was intended to change the standard of credit quality represented by an investment grade rating. Accordingly, we are adopting rule 6a–5, as proposed, to establish a standard of credit-worthiness designed to achieve the same degree of risk limitation as the credit rating it replaces. Rule 6a–5 deems a BIDCO to have met the requirements for credit-worthiness of certain debt securities under section 6(a)(5)(A)(iv)(I) if the board of directors or members of the company (or its or their delegate) determines, at the time of purchase, that the debt security is (i) subject to no greater than moderate credit risk and (ii) sufficiently liquid that the security can be sold at or near its carrying value within a reasonably short period of time.[13] The board of directors or members of a BIDCO (or its or their delegate) would have to make this determination at the time of acquisition of the securities.[14] As a result of rule 6a–5, section 6(a)(5) of the Investment Company Act will also limit a BIDCO's investments in registered open-end funds to those funds that invest at least 65 percent of their assets in debt securities that meet our standard.[15]

The final rule does not, as one commenter suggested, include specific factors or tests that the board must apply in performing its credit analysis.[16] We believe that the new credit quality standards (that the debt security be subject to no greater than moderate credit risk and be sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time) are clear enough for a BIDCO's board or members (or its or their delegate) to understand the risks acceptable under the rule. We note that the number and scope of factors that may be appropriate to making a credit quality determination with respect to a security may vary significantly depending on the particular security. We are concerned that prescribing a list of specific factors in a rule today might function as a limit to the credit quality analysis that boards or members would undertake and may not address information that would be relevant to credit quality determinations regarding new types of debt securities that investment companies or private funds may issue and in which BIDCOs may invest in the future.[17]

The standard we are adopting is designed to limit BIDCOs to purchasing debt securities issued by investment companies or private funds of sufficiently high credit quality that they are likely to maintain a fairly stable market value and may be liquidated easily, as appropriate, for the BIDCO to support its investment and financing activities.[18] Debt securities (or their issuers) subject to a moderate level of credit risk would demonstrate at least average credit-worthiness relative to other similar debt issues (or issuers of similar debt).[19] Moderate credit risk would denote current low expectations of default risk associated with the security, with an adequate capacity for payment by the issuer of principal and interest.[20] In making their credit quality determinations, a BIDCO's board of directors or members (or its or their delegate) can also consider credit quality reports prepared by outside sources, including NRSRO ratings, that the BIDCO board or members conclude are credible and reliable for this purpose.

III. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'') imposes certain requirements on federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. Rule 6a–5 does not create any new collections of information.

IV. Economic Analysis

As discussed above, we are adopting a new rule to implement section 939(c) of the Dodd-Frank Act to replace a statutory reference to a credit rating with an alternative credit-worthiness standard. We considered the economic effects, including costs and benefits, of our proposed new rule in the 2011 Proposing Release and we discuss below the comment received related to our analysis.

The Commission has discretion in adopting the alternative standard of credit-worthiness, and we undertake

[10] 15 U.S.C. 80a–6(a)(5)(A), as in effect prior to July 21, 2012 (exempting any company that is not engaged in the business of issuing redeemable securities, the operations of which are subject to regulation by the State in which the company is organized under a statute governing entities that provide financial or managerial assistance to enterprises doing business, or proposing to do business in that state if, among other things, the company does not purchase any security issued by an investment company or by any company that would be an investment company except for the exclusions from the definition of the term ''investment company'' under sections 3(c)(1) or 3(c)(7), other than (I) any debt security that is rated investment grade by not less than 1 nationally recognized statistical rating organization; or (II) any security issued by a registered open-end fund that is required by its investment policies to invest not less than 65% of its total assets in securities described in subclause (I) or securities that are determined by such registered open-end fund to be comparable in quality to securities described in subclause (I)).

[11] *See* 1993 Senate Report, *supra* note 6, at 20.

[12] *See* 2011 Proposing Release, *supra* note 4, at Section II.D.

[13] Rule 6a–5. The standard for credit-worthiness that we are adopting in rule 6a–5 is similar to the standard that we adopted in rule 10f–3 under the Investment Company Act. Rule 10f–3 defines eligible municipal securities as securities that are sufficiently liquid that they can be sold at or near their carrying value within a reasonably short period of time and either are subject to no greater than moderate credit risk or, if the issuer has been in operation for less than three years, the securities are subject to a minimal or low amount of credit risk. *See* rule 10f–3(a)(3).

[14] Rule 6a–5.

[15] Section 6(a)(5)(A)(iv)(II) (permitting a BIDCO to purchase any security issued by a registered open-end fund that is required by its investment policies to invest not less than 65% of its total assets in securities described in subclause (I) (*i.e.,* securities that meet the standards of credit-worthiness that the Commission adopts) or securities that are determined by such registered open-end fund to be comparable in quality to securities described in subclause (I)).

[16] *See* Better Markets Comment Letter (Apr. 25, 2011) (''Better Markets Comment Letter'') (asserting that the proposed standard is vague and would undermine the reliability of a board's credit risk determinations and the board's accountability for such determinations).

[17] We also agree with this commenter, who acknowledged that a reliable and objective shorthand measure of credit risk that could be incorporated into Commission regulations is currently unavailable. *See* Better Markets Comment Letter.

[18] *See supra* note 12 and accompanying text.

[19] *See* References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28939 (Oct. 5, 2009) [74 FR 52358 (Oct. 9, 2009)] at n.86 (release adopting amendments to rule 10f–3).

[20] *Id.*

below to discuss the economic effects of the new rule that are within our discretion under the Dodd-Frank Act, in addition to the economic effects of removing rating references from statutory provisions, as mandated by the Dodd-Frank Act itself. The two types of costs and benefits may not be entirely separable to the extent that our discretion is exercised to realize the benefits intended by the Dodd-Frank Act. In evaluating the economic effects of new rule 6a–5, we compare section 6(a)(5) of the Investment Company Act, as currently in effect (which includes a reference to a rating), with the new rule we are adopting.

Rule 6a–5 establishes a credit-worthiness standard under section 6(a)(5)(A)(iv)(I) of the Investment Company Act. BIDCOs that seek to rely on the exemption in section 6(a)(5) of the Act are limited to investing in debt securities issued by investment companies and private funds if, at the time of purchase, the board of directors or members of the BIDCO (or its or their delegate) determines that the debt security is (i) subject to no greater than moderate credit risk and (ii) sufficiently liquid that the security can be sold at or near its carrying value within a reasonably short period of time.

We anticipate that the adoption of rule 6a–5 may result in certain benefits. First, we do not understand that by amending section 6(a)(5), Congress intended to change the credit quality of the debt securities that BIDCOs may purchase and our rule is designed to establish a similar credit quality standard in order to achieve the same limitation on risk as the credit rating it replaces. In particular, the amended standard is designed to limit BIDCOs to purchasing debt securities issued by investment companies or private funds of sufficiently high credit quality that they are likely to maintain a fairly stable market value and may be liquidated easily, as appropriate, for the BIDCO to support its investment and financing activities. Second, the subjective credit quality standard in amended rule 6a–5 may provide BIDCOs greater flexibility in determining the pool of eligible debt securities in which they may invest. Finally, the credit quality standard in new rule 6a–5 may further Congress' stated purpose of reducing reliance on ratings in the context of a BIDCO's purchase of certain debt securities.[21]

We also recognize that BIDCOs may incur some costs as a result of the adoption of new rule 6a–5. These may be internal costs or costs to consult outside legal counsel to evaluate whether changes to any policies and procedures the BIDCOs may have currently for acquiring debt securities issued by investment companies or private funds may be appropriate in light of the new rule. We expect that, although not required by the Investment Company Act, as a matter of good business practice, directors or members of most BIDCOs that do not currently have them may prepare policies and procedures to make the credit quality and liquidity determinations required by the new rule. Staff estimates that BIDCOs will incur the costs of preparing the procedures for making determinations of credit quality and liquidity under the rule once, and directors and members of BIDCOs (or their delegates) will be able to follow these procedures for purposes of making future determinations under the rule. Commission staff estimated in the 2011 Proposing Release that each BIDCO would incur, on average, an initial one-time cost of $1000 to prepare policies and procedures and an average of $1000 in annual costs for making credit determinations with respect to the acquisition of debt securities.[22] We received no comments on those estimates. We note however, that under rule 6a–5, in evaluating whether debt securities issued by investment companies and private funds present moderate credit risk, boards of directors and members of BIDCOs (or its or their delegates) can consider credit quality determinations prepared by outside sources, including NRSRO ratings, that they conclude are credible and reliable for purposes of making these determinations, and we anticipate that many BIDCOs that invest cash in these types of debt securities will continue to do so. We expect that the ability to consider outside assessments will help minimize the burden on BIDCOs and contribute to a BIDCO's ability to make consistent and reliable credit quality determinations. Nevertheless, we recognize that some BIDCO boards or members may choose to hire consultants to assist in developing procedures and to make or oversee the determinations. Staff estimated in the 2011 Proposing Release that the cost to hire such consultants would be, on average, $8000 for each BIDCO.[23] We received no comments on this estimate.

Adopting a new credit quality standard in place of the ratings requirement in section 6(a)(5)(A)(iv) of the Investment Company Act may result in other costs for BIDCOs and their investors. The minimum rating requirement in section 6(a)(5)(A)(iv) of the Act, before it was amended by the Dodd-Frank Act, established an objective standard that is easy to apply and may have limited BIDCOs from investing in securities that posed greater credit risks. The new rule instead requires BIDCO boards or members to assess credit quality by applying a subjective standard. We acknowledge that a BIDCO could invest in lower quality debt securities that it determines meets the standard in new rule 6a–5, and that it may be difficult for the Commission to challenge the determination of a BIDCO's directors or members (or their delegates). In addition, because credit quality assessments could differ across BIDCOs, the range of risk of investments may be broader than it is currently. We do not,

[21] *See* Report of the House of Representatives Financial Services Committee to Accompany H.R. 4173, H. Rep. No. 111–517, at 871 (2010).

[22] *See* 2011 Proposing Release, supra note 4, at n.112. Staff does not have reliable data and is not aware of any databases that compile information regarding the number of existing BIDCOs. Moreover, we received no data from commenters. We note that some state regulators disclose the number of BIDCOs registered in the state on the regulators' Web sites. Of those that do, the number of registered BIDCOs ranges from one to 10. *See, e.g.,* Louisiana Office of Financial Institutions at *http://www.ofi.state.la.us/* (listing 10 BIDCOs in a directory of active BIDCOs); California Department of Financial Institutions at *http://www.dfi.ca.gov/directory/bidco.asp* (listing one BIDCO in a directory of BIDCOs). We estimate that each BIDCO would incur on average a one-time burden of 4 hours for a senior business analyst (under board or member delegation) to develop policies and procedures for evaluating credit and liquidity risk (4 hours × $237 per hour = $948). The staff estimates that the internal cost for time spent by a senior business analyst is $237 per hour. This estimate, as well as other internal time cost estimates made in this analysis, are derived from SIFMA's Management and Professional Earnings in the Securities Industry 2011, modified by Commission staff to account for an 1800-hour work week and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. Commission staff believes that additional costs incurred by boards or members for review of procedures would be incorporated into BIDCOs' overall board or member costs and would not add any particular costs. In addition, Commission staff estimates that a BIDCO board or member is likely to delegate the credit risk determinations, and that such determinations would take on average 1 hour of a senior business analyst's time (at $237 per hour) to evaluate the credit quality for each of an average of four investment company or private fund debt securities that a BIDCO would purchase each year (4 hours × $237 per hour) for a total cost of $948 per year. Staff has calculated these estimates using an internal cost estimate for a business analyst's time that is updated from the one used in calculating the estimates in the 2011 Proposing Release.

[23] *See* 2011 Proposing Release, *supra* note 4, at n.114 and accompanying text. Staff estimates that a BIDCO may need up to 16 hours of consulting advice to assist in developing procedures and to make or oversee the proposed determinations. Staff estimates that this advice would cost a BIDCO $500 per hour based on an understanding of the rates typically charged by outside consulting firms resulting in an average cost of $8000 for each BIDCO.

however, believe that the new rule is likely to lead BIDCOs to invest in riskier securities because the standard we are adopting is very similar to the standard articulated by the rating agencies for investment grade securities.[24]

As part of our economic analysis, we considered alternatives to the standard that we are adopting in rule 6a–5. In particular, we considered including specific factors or tests that a fund board must apply in performing its credit analysis in the rule. As noted above, we believe that this alternative could function as a limit to a fund's credit quality analysis [25] and thus might result in a less effective credit quality determination than a BIDCO would perform under the credit quality standard in the new rule, which could result in investments that expose the BIDCO to greater risk.

V. Final Regulatory Flexibility Analysis

The Commission has prepared the following Final Regulatory Flexibility Analysis (''FRFA'') in accordance with section 4(a) of the Regulatory Flexibility Act regarding new rule 6a–5, which we are adopting today to give effect to provisions of the Dodd-Frank Act.[26] We prepared an Initial Regulatory Flexibility Analysis (''IRFA'') in conjunction with the 2011 Proposing Release in March 2011.[27]

A. Need for and Objectives of the Rule and Form Amendments and New Rule

As described more fully in Sections I and II of this Release, the Commission is adopting new rule 6a–5 to set forth a standard of credit-worthiness for purposes of section 6(a)(5)(A)(iv) of the Investment Company Act, as anticipated by section 939(c) the Dodd Frank Act, which eliminates the investment grade standard from section 6(a)(5) of the Investment Company Act.

B. Significant Issues Raised by Public Comment

In the Proposing Release, we requested comment on the IRFA. In particular, we sought comment on how many small entities would be subject to the proposed new rule and whether the effect of the proposed new rule on small entities subject to it would be economically significant. None of the comment letters we received specifically addressed the IRFA. None of the comment letters specifically addressed the effect of the new rule on small BIDCOs.

C. Small Entities Subject to the Rule and Form Amendments and New Rule

New rule 6a–5 under the Investment Company Act would affect BIDCOs, including entities that are considered to be a small business or small organization (collectively, ''small entity'') for purposes of the Regulatory Flexibility Act. Under the standards adopted by the Small Business Administration, small entities in the financial investment industry include entities with $7 million or less in annual receipts.[28] We do not have any data and are not aware of any databases that compile information regarding how many BIDCOs would be small entities under this definition. We also did not receive any comments from BIDCOs.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

Rule 6a–5 imposes no reporting, recordkeeping or other compliance requirements.

E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant adverse effect on small entities. In connection with the new rule, the Commission considered the following alternatives: (i) Establishing different compliance standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance and reporting requirements under the rule for small entities; (iii) use of performance rather than design standards; and (iv) exempting small entities from all or part of the requirements.

We believe that special compliance or reporting requirements for small entities, or an exemption from coverage for small entities, is not appropriate or consistent with investor protection or section 939(c) of the Dodd-Frank Act, which rule 6a–5 implements. With respect to rule 6a–5, we believe that special compliance requirements or timetables for small entities, or an exemption from coverage for small entities, may create a risk that those BIDCOs could acquire debt securities that are not of sufficiently high credit quality that they would be likely to maintain a fairly stable market value or be liquidated easily, as we believe may have been intended for the BIDCO to support its long-term commitments. Further consolidation or simplification of rule 6a–5 for BIDCOs that are small entities is inconsistent with the Commission's goals of fostering investor protection. Finally, rule 6a–5 uses performance rather than design standards for determining the credit quality of specific debt securities.

Statutory Authority

The Commission is adopting new rule 6a–5 under the authority set forth in section 38(a) of the Investment Company Act [15 U.S.C. 80a–37(a)] and section 939 of the Dodd-Frank Act, to be codified at section 6(a)(5)(A)(iv)(I) of the Investment Company Act [15 U.S.C. 80a–6(a)(5)(A)(iv)(I)].

List of Subjects in 17 CFR Part 270

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rule

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

■ 1. The authority citation for part 270 is amended by adding a sub-authority in numerical order to read as follows:

Authority: 15 U.S.C. 80a–1 *et seq.,* 80a–34(d), 80a–37, and 80a–39, unless otherwise noted.

* * * * *

Section 270.6a–5 is also issued under 15 U.S.C. 80a–6(a)(5)(A)(iv)(I).

* * * * *

■ 2. Section 270.6a–5 is added to read as follows:

§ 270.6a–5 Purchase of certain debt securities by companies relying on section 6(a)(5) of the Act.

For purposes of reliance on the exemption for certain companies under section 6(a)(5)(A) of the Act (15 U.S.C. 80a–6(a)(5)(A)), a company shall be deemed to have met the requirement for credit-worthiness of certain debt securities under section 6(a)(5)(A)(iv)(I) of the Investment Company Act (15 U.S.C. 80a–6(a)(5)(A)(iv)(I)) if, at the time of purchase, the board of directors

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[24] *See* Moody's Investor Service, Ratings Symbols and Definitions (June 2012), *http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004,* at 5 (''Obligations rated Baa are judged to be medium-grade and subject to moderate credit risk and as such may possess certain speculative characteristics.''); FitchRatings, Definitions of Ratings and Other Forms of Opinion (Apr. 2012), *http://www.fitchratings.com/web_content/ratings/fitch_ratings_definitions_and_scales.pdf,* at 12 ('''BBB' ratings indicate that expectations of credit risk are currently low. The capacity for payment of financial commitments is considered adequate but adverse business or economic conditions are more likely to impair this capacity.'') The term ''investment grade'' is generally used to describe the categories 'BBB' (or comparable) or above. *See id.,* at 6.

[25] *See supra* paragraph accompanying note 17.

[26] 5 U.S.C. 604(a).

[27] *See* 2011 Proposing Release, *supra* note 4, at Section VIII.

[28] 13 CFR 121.201.

(or its delegate) determines or members of the company (or their delegate) determine that the debt security is:

(a) Subject to no greater than moderate credit risk; and

(b) Sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time.

By the Commission.

Dated: November 19, 2012.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2012–28456 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 100

[Docket No. USCG–2012–0954]

Special Local Regulation; Annual Marine Events on the Colorado River Between Davis Dam (Bullhead City, AZ) and Headgate Dam (Parker, AZ) Within the San Diego Captain of the Port Zone

AGENCY: Coast Guard, DHS.

ACTION: Notice of enforcement of regulation.

SUMMARY: The Coast Guard will enforce special local regulations during the Lake Havasu City Boat Parade of Lights on December 01, 2012 from 5 p.m. to 9 p.m. This event occurs on Lake Havasu on the Bridgwater Channel. These special local regulations are necessary to provide for the safety of the participants, crew, spectators, sponsor vessels of the regatta, and general users of the waterway. During the enforcement period, persons and vessels are prohibited from entering into, transiting through, or anchoring within this safety zone unless authorized by the Captain of the Port, or his designated representative.

DATES: The regulations in 33 CFR 100.1102 will be enforced on December 1, 2012 from 5 p.m. until 9 p.m.

FOR FURTHER INFORMATION CONTACT: If you have questions on this notice, call or email Petty Officer Bryan Gollogly, Waterways Management, U.S. Coast Guard Sector San Diego, CA; telephone (619) 278–7656, email *D11-PF-MarineEventsSanDiego@uscg.mil.*

SUPPLEMENTARY INFORMATION: The Coast Guard will enforce the special local regulations in 33 CFR 100.1102 in support of the Lake Havasu City Boat Parade of Lights (Item 10 on Table 1 of 33 CFR 100.1102). The Coast Guard will enforce the special local regulations between Thompson Bay and Windsor State Beach on December 01, 2012 from 5 p.m. to 9 p.m. The event will include approximately fifty powerboats and sailboats participating in a follow-the-leader style parade. The vessels will be decorated in Christmas lights according to a predetermined theme. The route will begin in Thompson Bay, proceed through the channel, make a large circle in Windsor bay, and return to Thompson Bay along the same route.

Under the provisions of 33 CFR 100.1102, persons and vessels are prohibited from entering into, transiting through, or anchoring within this safety zone unless authorized by the Captain of the Port, or his designated representative. The Coast Guard may be assisted by other Federal, State, or local law enforcement agencies in enforcing this regulation.

This notice is issued under authority of 33 CFR 100.1102 and 5 U.S.C. 552(a). In addition to this notice in the **Federal Register,** the Coast Guard will provide the maritime community with extensive advance notification of this enforcement period via the Local Notice to Mariners, state, or local agencies.

Dated: November 5, 2012.

S.M. Mahoney,

Captain of the Port San Diego, United States Coast Guard.

[FR Doc. 2012–28395 Filed 11–21–12; 8:45 am]

BILLING CODE 9110–04–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R05–OAR–2007–1102; EPA–R05–OAR–2008–0782; FRL–9753–7]

Approval and Promulgation of Air Quality Implementation Plans; Ohio; PBR and PTIO

AGENCY: Environmental Protection Agency (EPA).

ACTION: Withdrawal of direct final rule.

SUMMARY: Due to the approval of certain terms that were not meant to be approved, EPA is withdrawing the October 1, 2012 direct final rule approving a revision to the Ohio State Implementation Plan (SIP). EPA will address the revision in a subsequent final action based upon the proposed rulemaking action, which was also published on October 1, 2012. EPA does not expect to institute a second comment period on this action.

DATES: The direct final rule published at 77 FR 59751 on October 1, 2012, is withdrawn as of November 23, 2012.

FOR FURTHER INFORMATION CONTACT: Kaushal Gupta, Environmental Engineer, Air Permits Section, Air Programs Branch (AR–18J), Environmental Protection Agency, Region 5, 77 West Jackson Boulevard, Chicago, Illinois 60604, (312) 886–6803, *gupta.kaushal@epa.gov.*

SUPPLEMENTARY INFORMATION: EPA is withdrawing the October 1, 2012 direct final rule (77 FR 59751) approving six Permit-by-Rule (PBR) provisions, a Permit to Install and Operate (PTIO) program, two permanent exemptions from the Permit to Install (PTI) requirement and a general permit program as additions to Ohio's SIP. After publication of the direct final rule, it came to EPA's attention that the following had been inadvertently included in the rulemaking action:

- The SIP revision classified municipal incinerators capable of charging more than 250 tons of refuse per day as having a major stationary source emission threshold of 100 tons per year or more. Ohio Administrative Code (OAC) 3745–31–01(LLL)(2)(ix).
- The SIP revision allowed Director's discretion for complying with the public participation notification requirements for Federal Land Managers. OAC 3745–31–06(H)(2)(d).
- The SIP revision allowed Director's discretion and specific exemptions with regard to preconstruction activities. OAC 3745–31–33.

EPA did not intend to act on the above provisions when approving the PBR and PTIO rules and is therefore withdrawing the direct final rule. EPA will publish a subsequent final action based upon the proposed rulemaking action, also published on October 1, 2012 (77 FR 59879), that excludes the above provisions. EPA does not expect to institute a second comment period on this action.

List of Subjects in 40 CFR Part 52

Environmental protection, Air pollution control, Incorporation by reference, Intergovernmental relations, Reporting and recordkeeping requirements.

Authority: 42 U.S.C. 7401 *et seq.*

Dated: November 8, 2012.

Susan Hedman,

Regional Administrator, Region 5.

PART 52——[AMENDED]

Accordingly, the amendments to 40 CFR 52.1870 published in the **Federal Register** on October 1, 2012 (77 FR 59751) on pages 59754–59755 are withdrawn as of November 23, 2012.

[FR Doc. 2012–28329 Filed 11–21–12; 8:45 am]

BILLING CODE 6560–50–P

Proposed Rules

Federal Register
Vol. 77, No. 226
Friday, November 23, 2012

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

NUCLEAR REGULATORY COMMISSION

2 CFR Chapter XX

5 CFR Chapter XLVIII

10 CFR Chapter I

[NRC–2011–0246]

Retrospective Review Under Executive Order 13579

AGENCY: Nuclear Regulatory Commission.

ACTION: Plan for retrospective analysis of existing rules; request for comment.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC or the Commission) is making available its draft Plan for the retrospective analysis of its existing regulations. The draft Plan describes the processes and activities that the NRC uses to determine whether any of its regulations should be modified, streamlined, expanded, or repealed. This action is part of the NRC's voluntary implementation of Executive Order (E.O.) 13579, ''Regulation and Independent Regulatory Agencies,'' issued by the President on July 11, 2011. The NRC is requesting public comment on the draft Plan at this time. This request for comment is solely for information and program-planning purposes. The NRC will consider the comments submitted and may use them, as appropriate, in the preparation of a final retrospective review plan; however, the NRC does not anticipate responding to individual comments.

DATES: Submit comments by February 6, 2013. Comments received after this date will be considered if it is practical to do so, but the Commission is able to only ensure consideration only of comments received before this date. Requests for extension of the comment period will not be granted.

ADDRESSES: You may access information and comment submissions related to this draft plan, which the NRC possesses and is publicly available, by searching on *http://www.regulations.gov* under Docket ID NRC–2011–0246. You may submit comments by the following methods:

- *Federal rulemaking Web site:* Go to *http://www.regulations.gov* and search for Docket ID NRC–2011–0246. Address questions about NRC dockets to Carol Gallagher; telephone: 301–492–3668; email: *Carol.Gallagher@nrc.gov*.
- *Email comments to: Rulemaking.Comments@nrc.gov.* If you do not receive an automatic email reply confirming receipt, then contact us at 301–415–1677.
- *Fax comments to:* Secretary, U.S. Nuclear Regulatory Commission at 301–415–1101.
- *Mail comments to:* Secretary, U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001, ATTN: Rulemakings and Adjudications Staff.
- *Hand deliver comments to:* 11555 Rockville Pike, Rockville, Maryland 20852, between 7:30 a.m. and 4:15 p.m. (Eastern Time) Federal workdays; telephone: 301–415–1677.

For additional direction on accessing information and submitting comments, see ''Accessing Information and Submitting Comments'' in the **SUPPLEMENTARY INFORMATION** section of this document.

The NRC's draft Plan may be viewed online on the NRC's Public Web site at the following locations: 1) On the NRC's Open Government Web page at *http://www.nrc.gov/public-involve/open.html* (under the tabs entitled ''Selected NRC Resources'' and ''Rulemaking''); and 2) on the NRC's plans, budget, and performance Web page at *http://www.nrc.gov/about-nrc/plans-performance.html*). The NRC's draft Plan may also be viewed online at *http://www.regulations.gov*.

FOR FURTHER INFORMATION CONTACT: Cindy Bladey, Chief, Rules, Announcements, and Directives Branch, Office of Administration, U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001; telephone: 301–492–3667 or email: *Cindy.Bladey@nrc.gov*.

SUPPLEMENTARY INFORMATION:

I. Accessing Information and Submitting Comments

A. Accessing Information

Please refer to Docket ID NRC–2011–0246 when contacting the NRC about the availability of information for this draft Plan. You may access information related to this action, which the NRC possesses and is publicly available, by the following methods:

- *Federal Rulemaking Web Site:* Go to *http://www.regulations.gov* and search for Docket ID NRC–2011–0246.
- *NRC's Agencywide Documents Access and Management System (ADAMS):* You may access publicly available documents online in the NRC Library at *http://www.nrc.gov/reading-rm/adams.html.* To begin the search, select ''ADAMS Public Documents'' and then select *''Begin Web-based ADAMS Search.''* For problems with ADAMS, please contact the NRC's Public Document Room (PDR) reference staff at 1–800–397–4209, 301–415–4737, or by email to *pdr.resource@nrc.gov*. The NRC's draft Plan for public comment is in ADAMS under Accession No. ML12305A373.
- *NRC's PDR:* You may examine and purchase copies of public documents at the NRC's PDR, Room O1–F21, One White Flint North, 11555 Rockville Pike, Rockville, Maryland 20852.

B. Submitting Comments

Please include Docket ID NRC–2011–0246 in the subject line of your comment submission in order to ensure that the NRC is able to make your comment submission available to the public in this docket.

The NRC cautions you not to include identifying or contact information that you do not want to be publicly disclosed in your comment submission. The NRC will post all comment submissions at *http://www.regulations.gov* as well as enter the comment submissions into ADAMS. The NRC does not edit comment submissions to remove identifying or contact information.

If you are requesting or aggregating comments from other persons for submission to the NRC, then you should inform those persons not to include identifying or contact information that they do not want to be publicly disclosed in their comment submission. Your request should state that the NRC will not edit comment submissions to remove such information before making the comment submissions available to the public or entering the comment submissions into ADAMS.

II. Background

On January 18, 2011, President Obama issued E.O. 13563, ''Improving

Regulation and Regulatory Review.'' Executive Order 13563 directs Federal agencies to develop and submit a preliminary plan ''under which the agency will periodically review its existing significant regulations to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency's regulatory program more effective or less burdensome in achieving the regulatory objectives.'' Executive Order 13563 did not, however, apply to independent regulatory agencies. Subsequently, on July 11, 2011, the President issued E.O. 13579, which recommends that independent regulatory agencies also develop retrospective plans similar to those required of other agencies under E.O. 13563. In the spirit of cooperation, in November 2011, in response to E.O. 13579, the NRC made available an initial Plan on the NRC's Public Web site. The NRC has now updated its initial Plan and has created a draft Plan. The draft Plan is available at the following locations: (1) On the NRC's Open Government Web page at *http://www.nrc.gov/public-involve/open.html* (under the tabs entitled ''Selected NRC Resources'' and ''Rulemaking''); (2) on the NRC's plans, budget, and performance Web page at *http://www.nrc.gov/about-nrc/plans-performance.html*); and (3) on *http://www.regulations.gov*. The NRC is accepting public comment on this draft Plan.

III. Plan for Retrospective Review

The NRC's draft Plan describes the NRC's processes and activities relating to retrospective review of existing regulations, including discussions of the: (1) Efforts to incorporate risk assessments into regulatory decisionmaking; (2) efforts to address the cumulative effects of regulation; (3) the NRC's methodology for prioritizing its rulemaking activities; (4) rulemaking initiatives arising out of the NRC's ongoing review of its regulations related to the recent events at the Fukushima Dai-ichi Nuclear Power Plant in Japan; and (5) the NRC's previous and ongoing efforts to update its regulations in a systematic, ongoing basis.

For the Nuclear Regulatory Commission.

Dated at Rockville, Maryland, this 16th day of November 2012.

Annette L. Vietti-Cook,

Secretary of the Commission.

[FR Doc. 2012–28436 Filed 11–21–12; 8:45 am]

BILLING CODE 7590–01–P

FEDERAL RESERVE SYSTEM

12 CFR Part 252

[Regulation YY; Docket No. OP–1452]

RIN 7100–AD–86

Policy Statement on the Scenario Design Framework for Stress Testing

AGENCY: Board of Governors of the Federal Reserve System (Board).

ACTION: Proposed policy statement with request for public comment.

SUMMARY: The Board is requesting public comment on a policy statement on the approach to scenario design for stress testing that would be used in connection with the supervisory and company-run stress tests conducted under the Board's Regulations pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act) and the Board's capital plan rule.

DATES: Comments must be received by February 15, 2013.

FOR FURTHER INFORMATION CONTACT: Tim Clark, Senior Associate Director, (202) 452–5264, Lisa Ryu, Assistant Director, (202) 263–4833, or David Palmer, Senior Supervisory Financial Analyst, (202) 452–2904, Division of Banking Supervision and Regulation; Benjamin W. McDonough, Senior Counsel, (202) 452–2036, or Christine Graham, Senior Attorney, (202) 452–3099, Legal Division; or Andreas Lehnert, Deputy Director, (202) 452–3325, or Rochelle Edge, Adviser, (202) 452–2339, Office of Financial Stability Policy and Research.

SUPPLEMENTARY INFORMATION:

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I. Background
II. Administrative Law Matters
A. Use of Plain Language
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I. Background

Stress testing is a tool that helps both bank supervisors and a banking organization measure the sufficiency of capital available to support the banking organization's operations throughout periods of stress.[1] The Board and the other federal banking agencies previously have highlighted the use of stress testing as a means to better understand the range of a banking organization's potential risk exposures.[2]

In particular, as part of its effort to stabilize the U.S. financial system during the 2007–2009 financial crisis, the Board and the Federal Reserve banks, along with other federal financial regulatory agencies, conducted stress tests of large, complex bank holding companies through the Supervisory Capital Assessment Program (SCAP). The SCAP was a forward-looking exercise designed to estimate revenue, losses, and capital needs under an adverse economic and financial market scenario. By looking at the broad capital needs of the financial system and the specific needs of individual companies, these stress tests provided valuable information to market participants, reduced uncertainty about the financial condition of the participating bank holding companies under a scenario that was more adverse than that which was anticipated to occur at the time, and had an overall stabilizing effect.

Building on the SCAP and other supervisory work coming out of the crisis, the Board initiated the annual Comprehensive Capital Analysis and Review (CCAR) in late 2010 to assess the capital adequacy and the internal capital planning processes of the same large, complex bank holding companies

[1] A full assessment of a company's capital adequacy must take into account a range of risk factors, including those that are specific to a particular industry or company.

[2] *See, e.g., Supervisory Guidance on Stress Testing for Banking Organizations With More Than $10 Billion in Total Consolidated Assets,* 77 FR 29458 (May 17, 2012), available at *http://www.federalreserve.gov/bankinforeg/srletters/sr1207a1.pdf;* Supervision and Regulation Letter SR 10–6, *Interagency Policy Statement on Funding and Liquidity Risk Management* (March 17, 2010), available at *http://www.federalreserve.gov/boarddocs/srletters/2010/sr1006a1.pdf;* Supervision and Regulation Letter SR 10–1, *Interagency Advisory on Interest Rate Risk* (January 11, 2010), available at *http://www.federalreserve.gov/boarddocs/srletters/2010/SR1001.pdf;* Supervision and Regulation Letter SR 09–4, *Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies* (revised March 27, 2009), available at *http://www.federalreserve.gov/boarddocs/srletters/2009/SR0904.htm;* Supervision and Regulation Letter SR 07–1, *Interagency Guidance on Concentrations in Commercial Real Estate* (Jan. 4, 2007), available at *http://www.federalreserve.gov/boarddocs/srletters/2007/SR0701.htm;* Supervision and Regulation Letter SR 12–7, *Supervisory Guidance on Stress Testing for Banking Organizations with More Than $10 Billion in Total Consolidated Assets* (May 14, 2012), available at *http://www.federalreserve.gov/bankinforeg/srletters/sr1207.htm;* Supervision and Regulation Letter SR 99–18, *Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles* (July 1, 1999), available at *http://www.federalreserve.gov/boarddocs/srletters/1999/SR9918.htm; Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Framework,* 73 FR 44620 (July 31, 2008); *The Supervisory Capital Assessment Program: SCAP Overview of Results* (May 7, 2009), available at *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf;* and *Comprehensive Capital Analysis and Review: Objectives and Overview* (Mar. 18, 2011), available at *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20110318a1.pdf.*

that participated in SCAP and to incorporate stress testing as part of the Board's regular supervisory program for assessing capital adequacy and capital planning practices at these large bank holding companies. The CCAR represents a substantial strengthening of previous approaches to assessing capital adequacy and promotes thorough and robust processes at large banking organizations for measuring capital needs and for managing and allocating capital resources. The CCAR focuses on the risk measurement and management practices supporting organizations' capital adequacy assessments, including their ability to deliver credible inputs to their loss estimation techniques, as well as the governance processes around capital planning practices. On November 22, 2011, the Board issued an amendment (capital plan rule) to its Regulation Y to require all U.S. bank holding companies with total consolidated assets of $50 billion or more to submit annual capital plans to the Board to allow the Board to assess whether they have robust, forward-looking capital planning processes and have sufficient capital to continue operations throughout times of economic and financial stress.[3]

In the wake of the financial crisis, Congress enacted the Dodd-Frank Act, which requires the Board to implement enhanced prudential supervisory standards, including requirements for stress tests, for covered companies to mitigate the threat to financial stability posed by these institutions.[4] Section 165(i)(1) of the Dodd-Frank Act requires the Board to conduct an annual stress test of each bank holding company with total consolidated assets of $50 billion or more and each nonbank financial company that the Council has designated for supervision by the Board (covered company) to evaluate whether the covered company has sufficient capital, on a total consolidated basis, to absorb losses as a result of adverse economic conditions (supervisory stress tests).[5] The Act requires that the supervisory stress test provide for at least three different sets of conditions—baseline, adverse, and severely adverse conditions—under which the Board would conduct its evaluation. The Act also requires the Board to publish a summary of the supervisory stress test results.

In addition, section 165(i)(2) of the Dodd-Frank Act requires the Board to issue regulations that require covered companies to conduct stress tests semi-annually and require financial companies with total consolidated assets of more than $10 billion that are not covered companies and for which the Board is the primary federal financial regulatory agency to conduct stress tests on an annual basis (collectively, company-run stress tests).[6] The Board issued final rules implementing the stress test requirements of the Act on October 12, 2012 (stress test rules).[7]

The Board's stress test rules provide that the Board will notify covered companies, by no later than November 15 of each year of a set of conditions (each set, a scenario), it will use to conduct its annual supervisory stress tests.[8] The rules further establish that the Board will provide, also by no later than November 15, covered companies and other banking organizations subject to the final rule the scenarios they must use to conduct their annual company-run stress tests.[9] Under the stress test rules, the Board may require certain companies to use additional components in the adverse or severely adverse scenario or additional scenarios.[10] For example, the Board expects to require large banking organizations with significant trading activities to include global market shock components (described in the following sections) in their adverse and severely adverse scenarios. The Board will provide any additional components or scenarios by no later than December 1 of each year.[11] The Board expects that the scenarios it will require the companies to use will be the same as those the Board will use to conduct its supervisory stress tests (together, stress test scenarios).

Stress tests required under the stress test rules and under the Board's capital plan rule require the Board and financial institutions to calculate pro-forma capital levels—rather than ''current'' or actual levels—over a specified planning horizon under baseline and stressed scenarios. This approach integrates key lessons of the 2007–2009 financial crisis into the Board's supervisory framework. In the financial crisis, investor and counterparty confidence in the capitalization of financial institutions eroded rapidly in the face of changes in the current and expected economic and financial conditions, and this loss in market confidence imperiled institutions' ability to access funding, continue operations, serve as a credit intermediary, and meet obligations to creditors and counterparties. Importantly, such a loss in confidence occurred even when a financial institution's capital ratios exceeded the regulatory minimums. This is because the institution's capital ratios were perceived as lagging indicators of its financial condition, particularly when conditions were changing.

The stress tests required under the stress test rules and capital plan rule are a valuable supervisory tool that provides a forward-looking assessment of large financial institutions' capital adequacy under hypothetical economic and financial market conditions. Currently, these stress tests primarily focus on credit risk and market risk—that is, risk of mark-to-market losses associated with firms' trading and counterparty positions—and not on other types of risk, such as liquidity risk or operational risk unrelated to the macroeconomic environment. Pressures stemming from these sources are considered in separate supervisory exercises. No single supervisory tool, including the stress tests, can provide an assessment of an institution's ability to withstand every potential source of risk.

Selecting appropriate scenarios is an especially significant consideration for stress tests required under the capital plan rule, which ties the review of a bank holding company's performance under stress scenarios to its ability to make capital distributions. More severe scenarios, all other things being equal, generally translate into larger projected declines in a company's capital. Thus, a company would need more capital today to meet its minimum capital requirements in more stressful scenarios and have the ability to continue making capital distributions, such as common dividend payments. This translation is far from mechanical; it will depend on factors that are specific to a given company, such as underwriting standards and the banking organization's business model, which would also greatly affect projected revenue, losses, and capital.

To enhance the transparency of the scenario design process, the Board is requesting public comment on a proposed policy statement (Policy Statement) that would be used to develop scenarios for annual supervisory and company-run stress tests under the stress testing rules

[3] *See* Capital Plans, 76 FR 74631 (Dec. 1, 2011) (codified at 12 CFR 225.8).

[4] *See* section 165(i) of the Dodd-Frank Act; 12 U.S.C. 5365(i).

[5] *See* 12 U.S.C. 5365(i)(1).

[6] 12 U.S.C. 5365(i)(2).

[7] 77 FR 62398 (October 12, 2012); 12 CFR part 252, subparts F–H.

[8] *See id.;* 12 CFR 252.134(b).

[9] *See id.;* 12 CFR 252.144(b), 154(b). The annual company-run stress tests use data as of September 30 of each calendar year.

[10] 12 CFR 252.144(b), 154(b).

[11] *Id.*

issued under the Act and the capital plan rule. The Board plans to develop the annual set of scenarios, as outlined below, in consultation with the Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC) to reduce the burden that could arise from having the agencies establish inconsistent scenarios.

The proposed Policy Statement outlines the characteristics of the stress test scenarios and explains the considerations and procedures that underlie the formulation of these scenarios. The considerations and procedures described in this policy statement would apply to the Board's stress testing framework, including to the stress tests required under 12 CFR part 252, subparts F, G, and H, as well as the Board's capital plan rule (12 CFR 225.8). The Board may determine that material modifications to the Policy Statement would be appropriate if the supervisory stress test framework expands materially to include additional components or other scenarios that are currently not captured.[12]

Although the Board does not envision that the approach used to develop scenarios would change from year to year, the characteristics of the scenarios provided to companies would reflect changes in the outlook for economic and financial conditions and changes to specific risks or vulnerabilities that the Board, in consultation with the other federal banking agencies, determines should be considered in the annual stress tests. The stress test scenarios should not be regarded as forecasts; rather, they are hypothetical paths of economic variables that would be used to assess the strength and resilience of the companies' capital in various economic and financial environments.

The proposed Policy Statement is organized as follows. Section 1 provides background on the proposed Policy Statement. Section 2 is an outline of the proposed Policy Statement and describes its scope. Section 3 provides a broad description of the baseline, adverse, and severely adverse scenarios and describes the types of variables that the Board expects to include in the macro scenarios and the market shock component of the stress test scenarios applicable to firms with significant trading activity.[13] The proposed approach for the macro scenarios differs considerably from that for the market shocks, and, therefore, they are described separately. Section 4 describes the Board's proposed approach for developing the macro scenarios, and section 5 describes the proposed approach for the market shock components. Section 6 describes the relationship between the macro scenario and the market shock components. Section 7 provides a timeline for the formulation and publication of the macroeconomic assumptions and market shocks.

Consistent with the stress testing rules and the Act, the Board will issue a minimum of three different scenarios, including baseline, adverse, and severely adverse scenarios, for use under the stress test rules. Specific circumstances or vulnerabilities, over which the Board determines, in any given year, require particular vigilance to ensure the resilience of the banking sector, will be captured in either the adverse or severely adverse scenarios. A greater number of scenarios could be needed in some years—for example, because the Board identifies a large number of unrelated and uncorrelated but nonetheless significant risks.

While the Board generally expects to use the same scenarios for all companies subject to the stress testing rules, it may require a subset of companies—depending on a company's financial condition, size, complexity, risk profile, scope of operations, or activities, or risks to the U.S. economy—to include additional scenario components or additional scenarios that are designed to capture different effects of adverse events on revenue, losses, and capital. One example of such components is the market shock that applies only to trading companies. Additional components or scenarios may also include other stress factors that may not necessarily be directly correlated to macroeconomic or financial assumptions but nevertheless can materially affect companies' risks, such as the unexpected default of a major counterparty.

Early in each stress testing cycle, the Board plans to publish the macro scenarios along with a brief narrative summary that explains how these scenarios have changed relative to the previous year. In cases where scenarios are modified to reflect particular risks and vulnerabilities, the narrative would also explain the underlying motivation for these changes. The Board also plans to release a broad description of the market shock component.

The Board seeks comment on all aspects of the proposed Policy Statement. The Board notes that it will not revise the baseline, adverse, and severely adverse scenarios or market shock component that were recently issued under the Board's stress test rules and the capital plan rule for CCAR 2013 in light of any comments on the proposed policy statement but will consider the comments in developing future macro scenarios.

Question 1. In what ways could the Board improve its approach to scenario design? What additional economic or financial variables should the Board consider in developing scenarios?

Question 2. In addition to the trading shock, what additional components should the Board include in its stress testing framework? What additional scenarios should the Board consider using in connection with the stress testing framework?

Question 3. The policy statement proposes a number of different methods for developing the adverse scenarios. What additional ways might the Board consider specifying the adverse scenario?

Question 4. Does the approach for specifying the severely adverse scenarios—specifically, that of featuring a severe recession along with any salient risks to the economic and financial outlook—capture the relevant macroeconomic risks that firms face? Should there be additional features added to the scenario, either in specific circumstances or more generally?

II. Administrative Law Matters

A. Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. 106–102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board has sought to present the proposed rule in a simple and straightforward manner, and invites comment on the use of plain language.

B. Paperwork Reduction Act Analysis

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3506), the Board has reviewed the proposed policy statement to assess any information collections. There are no collections of information as defined by the Paperwork Reduction Act in the proposal.

[12] Before requiring a company to include additional components or other scenarios in its company-run stress tests, the Board would follow the notice procedures set forth in the stress test rules. *See* 12 CFR 252.144(b), 154(b).

[13] Currently, the firms subject to the market shock component include the six bank holding companies that are subject to the market risk rule and have total consolidated assets greater than $500 billion, as reported on their FR Y–9C. However, the set of companies subject to the market shock could change over time as the size, scope, and complexity of the banking organization's trading activities evolve.

C. Regulatory Flexibility Act Analysis

In accordance with section 3(a) of the Regulatory Flexibility Act (RFA), the Board is publishing an initial regulatory flexibility analysis of the proposed policy statement. The RFA, 5 U.S.C. 601 *et seq.,* requires each federal agency to prepare an initial regulatory flexibility analysis in connection with the promulgation of a proposed rule, or certify that the proposed rule will not have a significant economic impact on a substantial number of small entities.[14] The RFA requires an agency either to provide an initial regulatory flexibility analysis with a proposed rule for which a general notice of proposed rulemaking is required or to certify that the proposed rule will not have a significant economic impact on a substantial number of small entities. Based on its analysis and for the reasons stated below, the Board believes that the proposed policy statement will not have a significant economic impact on a substantial number of small entities.

Under regulations issued by the Small Business Administration (SBA), a ''small entity'' includes those firms within the ''Finance and Insurance'' sector with asset sizes that vary from $7 million or less in assets to $175 million or less in assets.[15] The Board believes that the Finance and Insurance sector constitutes a reasonable universe of firms for these purposes because such firms generally engage in actives that are financial in nature. Consequently, bank holding companies or nonbank financial companies with assets sizes of $175 million or less are small entities for purposes of the RFA.

As discussed in the **SUPPLEMENTARY INFORMATION**, the proposed policy statement generally would affect the scenario design framework used in regulations that apply to bank holding companies with $50 billion or more in total consolidated assets and nonbank financial companies that the Council has determined under section 113 of the Dodd-Frank Act must be supervised by the Board and for which such determination is in effect. Companies that are affected by the proposed policy statement therefore substantially exceed the $175 million asset threshold at which a banking entity is considered a ''small entity''' under SBA regulations.[16] The proposed policy statement would affect a nonbank financial company designated by the Council under section 113 of the Dodd-Frank Act regardless of such a company's asset size. Although the asset size of nonbank financial companies may not be the determinative factor of whether such companies may pose systemic risks and would be designated by the Council for supervision by the Board, it is an important consideration.[17] It is therefore unlikely that a financial firm that is at or below the $175 million asset threshold would be designated by the Council under section 113 of the Dodd-Frank Act because material financial distress at such firms, or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities, are not likely to pose a threat to the financial stability of the United States.

As noted above, because the proposed policy statement is not likely to apply to any company with assets of $175 million or less, if adopted in final form, it is not expected to affect any small entity for purposes of the RFA. The Board does not believe that the proposed policy statement duplicates, overlaps, or conflicts with any other Federal rules. In light of the foregoing, the Board does not believe that the proposed policy statement, if adopted in final form, would have a significant economic impact on a substantial number of small entities supervised. Nonetheless, the Board seeks comment on whether the proposed policy statement would impose undue burdens on, or have unintended consequences for, small organizations, and whether there are ways such potential burdens or consequences could be minimized in a manner consistent its purpose.

List of Subjects in 12 CFR Part 252

Administrative practice and procedure, Banks, Banking, Federal Reserve System, Holding companies, Nonbank Financial Companies Supervised by the Board, Reporting and recordkeeping requirements, Securities, Stress Testing.

Authority and Issuance

For the reasons stated in the **SUPPLEMENTARY INFORMATION**, the Board of Governors of the Federal Reserve System proposes to add the Policy Statement as set forth at the end of the **SUPPLEMENTARY INFORMATION** as part 252 to 12 CFR chapter II as follows:

PART 252—ENHANCED PRUDENTIAL STANDARDS (Regulation YY)

1. The authority citation for part 252 would continue to read as follows:

Authority: 12 U.S.C. 321–338a, 1467a(g), 1818, 1831p–1, 1844(b), 1844(c), 5361, 5365, 5366.

2. Appendix A to part 252 would be added to read as follows:

Appendix A—Policy Statement on the Scenario Design Framework for Stress Testing

1. Background

The Board has imposed stress testing requirements through its regulations implementing section 165(i) of the Dodd-Frank Act (stress test rules) and through its capital plan rule (12 CFR 225.8). Under the stress test rules issued under section 165(i)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act), the Board conducts an annual stress test (supervisory stress tests), on a consolidated basis, of each bank holding company with total consolidated assets of $50 billion or more and each nonbank financial company that the Financial Stability Oversight Council has designated for supervision by the Board (together, covered companies).[18] In addition, under the stress test rules issued under section 165(i)(2) of the Act, covered companies must conduct stress tests semi-annually and other financial companies with total consolidated assets of more than $10 billion and for which the Board is the primary regulatory agency must conduct stress tests on an annual basis (together company-run stress tests).[19] The Board will provide for at least three different sets of conditions (each set, a scenario), including baseline, adverse, and severely adverse scenarios for both supervisory and company-run stress tests.[20]

[14] *See* 5 U.S.C. 603, 604 and 605.

[15] 13 CFR 121.201.

[16] The Dodd-Frank Act provides that the Board may, on the recommendation of the Council, increase the $50 billion asset threshold for the application of certain of the enhanced standards. *See* 12 U.S.C. 5365(a)(2)(B). However, neither the Board nor the Council has the authority to lower such threshold.

[17] *See* 76 FR 4555 (January 26, 2011).

[18] 12 U.S.C. 5365(i)(1); 77 FR 62378 (October 12, 2012), to be codified at 12 CFR part 252, subpart F.

[19] 12 U.S.C. 5365(i)(2); 77 FR 62378, 62396 (October 12, 2012), to be codified at 12 CFR part 252, subparts G and H.

[20] The stress test rules define scenarios as ''those sets of conditions that affect the U.S. economy or the financial condition of a [company] that the Board annually determines are appropriate for use in stress tests, including, but not limited to, baseline, adverse, and severely adverse scenarios.'' The stress test rules define baseline scenario as a ''set of conditions that affect the U.S. economy or the financial condition of a company and that reflect the consensus views of the economic and financial outlook.'' The stress test rules define adverse scenario a ''set of conditions that affect the U.S. economy or the financial condition of a company that are more adverse than those associated with the baseline scenario and may include trading or other additional components.'' The stress test rules define severely adverse scenario as a ''set of conditions that affect the U.S. economy or the financial condition of a company and that overall are more severe than those associated with the adverse scenario and may include trading or other additional components.'' *See* 12 CFR 252.132(a), (d), (m), and (n); 12 CFR 252.142(a), (d), (o), and (p); 12 CFR 252.152(a), (e), (o), and (p).

The stress test rules provide that the Board will notify covered companies by no later than November 15 of each year scenarios it will use to conduct its annual supervisory stress tests and provide, also by no later than November 15, covered companies and other banking organizations subject to the final rules the set of scenarios they must use to conduct their annual company-run stress tests.[21] Under the stress test rules, the Board may require certain companies to use additional components in the adverse or severely adverse scenario or additional scenarios.[22] For example, the Board expects to require large banking organizations with significant trading activities to include a global market shock component (described in the following sections) in their adverse and severely adverse scenarios. The Board will provide any additional components or scenario by no later than December 1 of each year.[23] The Board expects that the scenarios it will require the companies to use will be the same as those the Board will use to conduct its supervisory stress tests (together, stress test scenarios).

In addition, section 225.8 of the Board's Regulation Y (capital plan rule) requires all U.S. bank holding companies with total consolidated assets of $50 billion or more to submit annual capital plans, including stress test results, to the Board to allow the Board to assess whether they have robust, forward-looking capital planning processes and have sufficient capital to continue operations throughout times of economic and financial stress.[24]

Stress tests required under the stress test rules and under the capital plan rule require the Board and banking organizations to calculate pro-forma capital levels—rather than ''current'' or actual levels—over a specified planning horizon under baseline and stressful scenarios. This approach integrates on key lessons of the 2007–2009 financial crisis into the Board's supervisory framework. During the financial crisis, investor and counterparty confidence in the capitalization of financial institutions eroded rapidly in the face of changes in the current and expected economic and financial conditions, and this loss in market confidence imperiled institutions' ability to access funding, continue operations, serve as a credit intermediary, and meet obligations to creditors and counterparties. Importantly, such a loss in confidence occurred even when a financial institution's capital ratios were in excess of regulatory minimums. This is because the institution's capital ratios were perceived as lagging indicators of its financial condition, particularly when conditions were changing.

The stress tests required under the stress test rules and capital plan rule are a valuable supervisory tool that provides a forward-looking assessment of large financial institutions' capital adequacy under hypothetical economic and financial market conditions. Currently, these stress tests primarily focus on credit risk and market risk—that is, risk of mark-to-market losses associated with firms' trading and counterparty positions—and not on other types of risk, such as liquidity risk or operational risk unrelated to the macroeconomic environment. Pressures stemming from these sources are considered in separate supervisory exercises. No single supervisory tool, including the stress tests, can provide an assessment of an institution's ability to withstand every potential source of risk.

Selecting appropriate scenarios is an especially significant consideration, for stress tests required under the capital plan rule, which ties the review of a bank holding company's performance under stress scenarios to its ability to make capital distributions. More severe scenarios, all other things being equal, generally translate into larger projected declines in banks' capital. Thus, a company would need more capital today to meet its minimum capital requirements in more stressful scenarios and have the ability to continue making capital distributions, such as common dividend payments. This translation is far from mechanical; it will depend on factors that are specific to a given company, such as underwriting standards and the company's business model, which would also greatly affect projected revenue, losses, and capital.

2. Overview and Scope

This policy statement provides more detail on the characteristics of the stress test scenarios and explains the considerations and procedures that underlie the approach for formulating these scenarios. The considerations and procedures described in this policy statement apply to the Board's stress testing framework, including to the stress tests required under 12 CFR part 252, subparts F, G, and H, as well as the Board's capital plan rule (12 CFR 225.8).[25]

Although the Board does not envision that the broad approach used to develop scenarios will change from year to year, the stress test scenarios will reflect changes in the outlook for economic and financial conditions and changes to specific risks or vulnerabilities that the Board, in consultation with the other federal banking agencies, determines should be considered in the annual stress tests. The stress test scenarios should not be regarded as forecasts; rather, they are hypothetical paths of economic variables that will be used to assess the strength and resilience of the companies' capital in various economic and financial environments.

The remainder of this policy statement is organized as follows. Section 3 provides a broad description of the baseline, adverse, and severely adverse scenarios and describes the types of variables that the Board expects to include in the macro scenarios and the market shock component of the stress test scenarios applicable to firms with significant trading activity. Section 4 describes the Board's approach for developing the macro scenarios, and section 5 describes the approach for the market shocks. Section 6 describes the relationship between the macro scenario and the market shock components. Section 7 provides a timeline for the formulation and publication of the macroeconomic assumptions and market shocks.

3. Content of the Stress Test Scenarios

The Board will publish a minimum of three different scenarios, including baseline, adverse, and severely adverse conditions, for use in stress tests required in the stress test rules.[26] In general, the Board anticipates that it will not issue additional scenarios. Specific circumstances or vulnerabilities that in any given year the Board determines require particular vigilance to ensure the resilience of the banking sector will be captured in either the adverse or severely adverse scenarios. A greater number of scenarios could be needed in some years—for example, because the Board identifies a large number of unrelated and uncorrelated but nonetheless significant risks.

While the Board generally expects to use the same scenarios for all companies subject to the final rule, it may require a subset of companies—depending on a company's financial condition, size, complexity, risk profile, scope of operations, or activities, or risks to the U.S. economy—to include additional scenario components or additional scenarios that are designed to capture different effects of adverse events on revenue, losses, and capital. One example of such components is the market shock that applies only to companies with significant trading activity. Additional components or scenarios may also include other stress factors that may not necessarily be directly correlated to macroeconomic or financial assumptions but nevertheless can materially affect companies' risks, such as the unexpected default of a major counterparty.

Early in each stress testing cycle, the Board plans to publish the macro scenarios along with a brief narrative summary that explains how these scenarios have changed relative to the previous year. In cases where scenarios are changed to reflect particular risks and vulnerabilities, the narrative will also explain the underlying motivation for these changes. The Board also plans to release a broad description of the market shock components.

3.1 Macro Scenarios

The macro scenarios will consist of the future paths of a set of economic and financial variables.[27] The economic and financial variables included in the scenarios will likely comprise those included in the 2012 Comprehensive Capital Analysis and Review (CCAR).[28] The domestic U.S.

[21] 12 CFR 252.144(b), 12 CFR 252.154(b). The annual company-run stress tests use data as of September 30 of each calendar year.

[22] 12 CFR 252.144(b), 154(b).

[23] *Id.*

[24] *See* Capital plans, 76 FR 74631 (Dec. 1, 2011) (codified at 12 CFR 225.8).

[25] The Board may determine that modifications to the approach are appropriate, for instance, to address a broader range of risks, such as, operational risk.

[26] 12 CFR 252.134(b), 12 CFR 252.144(b), 12 CFR 252.154(b).

[27] The future path of a variable refers to its specification over a given time period. For example, the path of unemployment can be described in percentage terms on a quarterly basis over the stress testing time horizon.

[28] *See* Appendix III of the 2012 CCAR Instructions and Guidance *(www.federalreserve.gov/newsevents/press/bcreg/bcreg20111122d1.pdf).*

variables provided for in the 2012 CCAR included:

- Five measures of economic activity and prices: real and nominal gross domestic product (GDP) growth, the unemployment rate of the civilian non-institutional population aged 16 and over, nominal disposable personal income growth, and the Consumer Price Index (CPI) inflation rate;
- Four measures of developments in equity and property markets: The Core Logic National House Price Index, the National Council for Real Estate Investment Fiduciaries Commercial Real Estate Price Index, the Dow Jones Total Stock Market Index, and the Chicago Board Options Exchange Market Volatility Index; and
- Four measures of interest rates: the rate on the three-month Treasury bill, the yield on the 10-year Treasury bond, the yield on a 10-year BBB corporate security, and the interest rate associated with a conforming, conventional, fixed-rate, 30-year mortgage.

The international variables provided for in the 2012 CCAR included, for the euro area, the United Kingdom, developing Asia, and Japan:

- Percent change in real GDP;
- Percent change in the Consumer Price Index or local equivalent; and
- The U.S./foreign currency exchange rate.[29]

The economic variables included in the scenarios influence key items affecting banking organizations' net income, including pre-provision net revenue and credit losses on loans and securities. Moreover, these variables exhibit fairly typical trends in adverse economic climates that can have unfavorable implications for banks' net income and, thus, capital positions.

The economic variables included in the scenario may change over time. For example, the Board may add variables to a scenario if the international footprint of companies that are subject to the stress testing rules changed notably over time such that the variables already included in the scenario no longer sufficiently capture the material risks of these companies. Alternatively, historical relationships between macroeconomic variables could change over time such that one variable (*e.g.,* disposable personal income growth) that previously provided a good proxy for another (*e.g.,* light vehicle sales) in modeling banks' pre-provision net revenue or credit losses ceases to do so, resulting in the need to create a separate path, or alternative proxy, for the other variable. However, recognizing the amount of work required for companies to incorporate the scenario variables into their stress testing models, the Board expects to eliminate variables from the scenarios only in rare instances.

The Board expects that the company may not use all of the variables provided in the scenario, if those variables are not appropriate to the company's line of business, or may add additional variables, as appropriate.[30] The Board expects the companies will ensure that the paths of such additional variables are consistent with the scenarios the Board provided. For example, the companies may use, as part of their internal stress test models, local-level, such as state-level unemployment rates or city-level house prices. While the Board does not plan to include local-level macro variables in the stress test scenarios it provides, it expects the companies to evaluate the paths of local-level macro variables as needed for their internal models, and ensure internal consistency between these within-country variables and their aggregate, macro-economic counterparts. The Board will provide the macro scenario component of the stress test scenarios for a period that spans a minimum of 13 quarters. The scenario horizon reflects the supervisory stress test approach that the Board plans to use. Under the stress test rules, the Board will assess the effect of different scenarios on the consolidated capital of each company over a forward-looking planning horizon of at least nine quarters.

3.2 Market Shock Component

The market shock component of the stress test scenarios will only apply to companies with significant trading activity and their subsidiaries.[31] The component consists of large moves in market prices and rates that would be expected to generate losses. Market shocks differ from macro scenarios in a number of ways, both in their design and application. For instance, market shocks that might typically be observed over an extended period (*e.g.,* 6 months) are assumed to be an instantaneous event which immediately affects the market value of the companies' trading assets and liabilities. In addition, under the stress test rules, the as-of date for market shocks will differ from the quarter-end, and the Board will provide the as-of date for market shocks no later than December 1 of each year. Finally, as described in section 4, market shocks include a much larger set of risk factors than the set of economic and financial variables included in macro scenarios. Broadly, these risk factors include shocks to financial market variables that affect asset prices, such as a credit spread or the yield on a bond, and, in some cases, the value of the position itself (*e.g.,* the market value of private equity positions).

The Board envisions that the market shocks will include shocks to a broad range of risk factors that are similar in granularity to those risk factors trading companies use internally to produce profit and loss estimates, under stressful market scenarios, for all asset classes that are considered trading assets, including equities, credit, interest rates, foreign exchange rates, and commodities. For example, risk factor shocks for interest rates would capture changes in the level, correlation, and volatility, by country and maturity. Risk factors will be specified separately by currency or geographic region, and include key sub-categories relevant to each asset class. For example, the risk factor shocks applied to credit spreads will differ by risk category and the risk factor shocks for spot oil prices will vary by grade and type of crude oil.

Examples of risk factors include, but are not limited to:

- Equity indices of all developed markets, and of developing and emerging market nations to which companies with significant trading activity may have exposure, along with term structures of implied volatilities;
- Cross-currency FX rates of all major and many minor currencies, along term structures of implied volatilities;
- Term structures of government rates (*e.g.,* U.S. Treasuries), interbank rates (*e.g.,* swap rates) and other key rates (*e.g.,* commercial paper) for all developed markets and for developing and emerging market nations to which banks may have exposure;
- Term structures of implied volatilities that are key inputs to the pricing of interest rate derivatives;
- Term structures of futures prices for energy products including crude oil (differentiated by country of origin), natural gas, and power;
- Term structures of futures prices for metals and agricultural commodities;
- ''Value-drivers'' (credit spreads or instrument prices themselves) for credit-sensitive product segments including: Corporate bonds, credit default swaps, and collateralized debt obligations by risk; non-agency residential mortgage-backed securities and commercial mortgage-backed securities by risk and vintage; sovereign debt; and, municipal bonds; and
- Shocks to the values of private equity positions.

4. Approach for Formulating the Macroeconomic Assumptions for Scenarios

This section describes the Board's approach for formulating macroeconomic assumptions for each scenario. The methodologies for formulating this part of each scenario differ by scenario, so these methodologies for the baseline, severely adverse, and the adverse scenarios are described separately in each of the following subsections.

In general, the baseline scenario will reflect the most recently available consensus views of the macroeconomic outlook expressed by professional forecasters, government agencies, and other public-sector organizations as of the beginning of the annual stress-test cycle. The severely adverse scenario will consist of a set of economic and financial conditions that reflect the conditions of post-war U.S. recessions. The adverse scenario will consist of a set of economic and financial conditions that are more adverse than those associated with the baseline scenario but less severe than those associated with the severely adverse scenario.

[29] The Board may increase the range of countries or regions included in future scenarios, as appropriate.

[30] The Board expects banking organizations will ensure that the paths of such additional variables are consistent with the scenarios the Board provided.

[31] Currently, companies with significant trading activity include the six bank holding companies that are subject to the market risk rule and have total consolidated assets greater than $500 billion, as reported on their FR Y–9C. The Board may also subject a state member bank subsidiary of any such bank holding company to the market shock component. The set of companies subject to the market shock component could change over time as the size, scope, and complexity of banking organization's trading activities evolve.

Each of these scenarios is described further in sections below as follows: Baseline (subsection 4.1), severely adverse (subsection 4.2), and adverse (subsection 4.3).

4.1 Approach for Formulating Macroeconomic Assumptions in the Baseline Scenario

The stress test rules define the baseline scenario as a set of conditions that affect the U.S. economy or the financial condition of a banking organization, and that reflect the consensus views of the economic and financial outlook. Projections under a baseline scenario are used to evaluate how companies would perform in more likely economic and financial conditions. The baseline serves also as a point of comparison to the severely adverse and adverse scenarios, giving some sense of how much of the company's capital decline could be ascribed to the scenario as opposed to the company's capital adequacy under expected conditions.

The baseline scenario will be developed around a macroeconomic projection that captures the prevailing views of private-sector forecasters (*e.g.* Blue Chip Consensus Forecasts and the Survey of Professional Forecasters), government agencies, and other public-sector organizations (*e.g.,* the International Monetary Fund and the Organization for Economic Co-operation and Development) near the beginning of the annual stress-test cycle. The baseline scenario is designed to represent a consensus expectation of certain economic variables over the time period of the tests and it is not the Board's internal forecast for those economic variables. For example, the baseline path of short-term interest rates is constructed from consensus forecasts and may differ from that implied by the FOMC's *Summary of Economic Projections*.

For some scenario variables—such as U.S. real GDP growth, the unemployment rate, and the consumer price index—there will be a large number of different forecasts available to project the paths of these variables in the baseline scenario. For others, a more limited number of forecasts will be available. If available forecasts diverge notably, the baseline scenario will reflect an assessment of the forecast that is deemed to be most plausible. In setting the paths of variables in the baseline scenario, particular care will be taken to ensure that, together, the paths present a coherent and plausible outlook for the U.S. and global economy, given the economic climate in which they are formulated.

4.2 Approach for Formulating the Macroeconomic Assumptions in the Severely Adverse Scenario

The stress test rules define a severely adverse scenario as a set of conditions that affect the U.S. economy or the financial condition of a banking organization and that overall are more severe than those associated with the adverse scenario. The banking organization will be required to publicly disclose a summary of the results of its stress test under the severely adverse scenario, and the Board intends to publicly disclose the results of its analysis of the banking organization under the severely adverse scenario.

4.2.1 General Approach: The Recession Approach

The Board intends to use a recession approach to develop the severely adverse scenario. In the recession approach, the Board will specify the future paths of variables to reflect conditions that characterize post-war U.S. recessions, generating either a typical or specific recreation of a post-war U.S. recession. The Board chose this approach because it has observed that the conditions that typically occur in recessions—such as increasing unemployment, declining asset prices, and contracting loan demand—can put significant stress on companies' balance sheets. This stress can occur through a variety of channels, including higher loss provisions due to increased delinquencies and defaults; losses on trading positions through sharp moves in market prices; and lower bank income through reduced loan originations. For these reasons, the Board believes that the paths of economic and financial variables in the severely adverse scenario should, at a minimum, resemble the paths of those variables observed during a recession.

This approach requires consideration of the type of recession to feature. All post-war U.S. recessions have not been identical: some recessions have been associated with very elevated interest rates, some have been associated with sizable asset price declines, and some have been relatively more global. The most common features of recessions, however, are increases in the unemployment rate and contractions in aggregate incomes and economic activity. For this and the following reasons, the Board intends to use the unemployment rate as the primary basis for specifying the severely adverse scenario. First, the unemployment rate is likely the most representative single summary indicator of adverse economic conditions. Second, in comparison to GDP, labor market data have traditionally featured more prominently than GDP in the set of indicators that the National Bureau of Economic Research reviews to inform its recession dates.[32] Third and finally, the growth rate of potential output can cause the size of the decline in GDP to vary between recessions. While changes in the unemployment rate can also vary over time due to demographic factors, this seems to have more limited implications over time relative to changes in potential output growth. The unemployment rate used in the severely adverse scenario will reflect an unemployment rate that has been observed in *severe* post-war U.S. recessions, measuring severity by the absolute level of and relative increase in the unemployment rate.[33]

After specifying the unemployment rate, the Board will specify the paths of other macroeconomic variables based on the paths of unemployment, income, and activity. However, many of these other variables have taken wildly divergent paths in previous recessions (*e.g.,* house prices), requiring the Board to use its informed judgment in selecting appropriate paths for these variables. In general, the path for these other variables will be based on their underlying structure at the time that the scenario is designed (*e.g.,* the relative fragility of the housing finance system).

The Board considered alternative methods for scenario design of the severely adverse scenario, including a probabilistic approach. The probabilistic approach constructs a baseline forecast from a large-scale macroeconomic model and identifies a scenario that would have a specific probabilistic likelihood given the baseline forecast. The Board believes that, at this time, the recession approach is better suited for developing the severely adverse scenario than a probabilistic approach because it guarantees a recession of some specified severity. In contrast, the probabilistic approach requires the choice of an extreme tail outcome—relative to baseline—to characterize the severely adverse scenario (*e.g.,* a 5 percent or a 1 percent. tail outcome). In practice, this choice is difficult as adverse economic outcomes are typically thought of in terms of how variables evolve in an absolute sense rather than how far away they lie in the probability space away from the baseline. In this sense, a scenario featuring a recession may be somewhat clearer and more straightforward to communicate. Finally, the probabilistic approach relies on estimates of uncertainty around the baseline scenario and such estimates are in practice model-dependent.

4.2.2 Setting the Unemployment Rate Under the Severely Adverse Scenario

The Board anticipates that the severely adverse scenario will feature an unemployment rate that increases between 3 to 5 percentage points from its initial level over the course of 6 to 8 calendar quarters.[34] The initial level will be set based on the conditions at the time that the scenario is designed. However, if a 3 to 5 percentage point increase in the unemployment rate does not raise the level of the unemployment rate to at least 10 percent—the average level to which it has increased in the most recent three severe recessions—the path of the unemployment rate in most cases will be specified so as to raise the unemployment rate to at least 10 percent.

This methodology is intended to generate scenarios that feature stressful outcomes but

[32] More recently, a monthly measure of GDP has been added to the list of indicators.

[33] Even though all recessions feature increases in the unemployment rate and contractions in incomes and economic activity, the size of this change has varied over post-war U.S. recessions. Table 1 documents the variability in the depth of post-war U.S. recessions. Some recessions—labeled mild in Table 1—have been relatively modest with GDP edging down just slightly and the unemployment rate moving up about a percentage point. Other recessions—labeled severe in Table 1—have been much harsher with GDP dropping 3¾ percent and the unemployment rate moving up a total of about 4 percentage points.

[34] Six to eight quarters is the average number of quarters for which a severe recession lasts plus the average number of subsequent quarters over which the unemployment rate continues to rise. The variable length of the timeframe reflects the different paths to the peak unemployment rate depending on the severity of the scenario.

do not induce greater procyclicality in the financial system and macroeconomy. When the economy is in the early stages of a recovery, the unemployment rate in a baseline scenario generally trends downward, resulting in a larger difference between the path of the unemployment rate in the severely adverse scenario and the baseline scenario and a severely adverse scenario that is relatively more intense. Conversely, in a sustained strong expansion—when the unemployment rate may be below the level consistent with full employment—the unemployment in a baseline scenario generally trends upward, resulting in a smaller difference between the path of the unemployment rate in the severely adverse scenario and the baseline scenario and a severely adverse scenario that is relatively less intense. Historically, a 3 to 5 percentage point increase in unemployment rate is reflective of stressful conditions. As illustrated in Table 1, over the last half-century, the U.S. economy has experienced four severe post-war recessions. In all four of these recessions the unemployment rate increased 3 to 5 percentage points and in the three most recent of these recessions the unemployment rate reached a level between 9 percent and 11 percent.

Under this method, if the initial unemployment rate were low—as it would be after a sustained long expansion—the unemployment rate in the scenario would increase to a level as high as what has been seen in past severe recessions. However, if the initial unemployment rate were already high—as would be the case in the early stages of a recovery—the unemployment rate would exhibit a change as large as what has been seen in past severe recessions.

The Board believes that the typical increase in the unemployment rate in the severely adverse scenario would be about 4 percentage points. However, the Board would calibrate the increase in unemployment based on its views of the status of cyclical systemic risk. The Board intends to set the unemployment rate at the higher end of the range if the Board believed that cyclical systemic risks were high (as it would be after a sustained long expansion), and to the lower end of the range if cyclical systemic risks were low (as it would be in the earlier stages of a recovery). This may result in a scenario that is slightly more intense than normal if the Board believed that cyclical systemic risks were increasing in a period of robust expansion.[35] Conversely, it would allow the Board to specify a scenario that is slightly less intense than normal in an environment where systemic risks appeared subdued, such as in the early stages of an expansion. However, even at the lower end of the range of unemployment-rate increases, the scenario would still feature an increase in the unemployment rate similar to what has been seen in about half of the severe recessions of the last 50 years.

As indicated previously, if a 3 to 5 percentage point increase in the unemployment rate does not raise the level of the unemployment rate to 10 percent—the average level to which it has increased in the most recent three severe recessions—the path of the unemployment rate will be specified so as to raise the unemployment rate to 10 percent. Setting a floor for the unemployment rate at 10 percent recognizes the fact that not only do cyclical systemic risks build up at financial intermediaries during robust expansions but that these risks are also easily obscured by the buoyant environment.

In setting the increase in the unemployment rate, the Board would consider the extent to which analysis by economists, supervisors, and financial market experts finds cyclical systemic risks to be elevated (but difficult to be captured more precisely in one of the scenario's other variables). In addition, the Board—in light of impending shocks to the economy and financial system—would also take into consideration the extent to which a scenario of some increased severity might be necessary for the results of the stress test and the associated supervisory actions to sustain confidence in financial institutions.

While the approach to specifying the severely adverse scenario is designed to avoid adding sources of procyclicality to the financial system, it is not designed to explicitly offset any existing procyclical tendencies in the financial system. The purpose of the stress test scenarios is to make sure that the banks are properly capitalized to withstand severe economic and financial conditions, not to serve as an explicit countercyclical offset to the financial system.

In developing the approach to the unemployment rate, the Board also considered a method that would increase the unemployment rate to some fairly elevated fixed level over the course of 6 to 8 quarters. This would result in scenarios being more severe in robust expansions (when the unemployment rate is low) and less severe in the early stages of a recovery (when the unemployment rate is high) and so would not result in pro-cyclicality. Depending on the initial level of the unemployment rate, this approach could lead to only a very modest increase in the unemployment rate—or even a decline. As a result, this approach—while not procyclical—could result in scenarios not featuring stressful macroeconomic outcomes.

4.2.3 Setting the Other Variables in the Severely Adverse Scenario

Generally, all other variables in the severely adverse scenario will be specified to be consistent with the increase in the unemployment rate. The approach for specifying the paths of these variables in the scenario will be a combination of (1) how economic models suggest that these variables should evolve given the path of the unemployment rate, (2) how these variables have typically evolved in past U.S. recessions, and (3) and evaluation of these and other factors.

Economic models—such as medium-scale macroeconomic models—should be able to generate plausible paths consistent with the unemployment rate for a number of scenario variables, such as real GDP growth, CPI inflation and short-term interest rates, which have relatively stable (direct or indirect) relationships with the unemployment rate (*e.g.,* Okun's Law, the Phillips Curve, and interest rate feedback rules). For some other variables, specifying their paths will require a case-by-case consideration. For example, declining house prices, which are an important source of stress to a bank's balance sheet, are not a steadfast feature of recessions, and the historical relationship of house prices with the unemployment rate or any other variable that deteriorates in recessions is not strong. Simply adopting their typical path in a severe recession would likely underestimate risks stemming from the housing sector. In this case, some modified approach—in which perhaps recessions in which house prices declined were judgmentally weighted more heavily—would be appropriate.

4.2.4 Adding Salient Risks to the Severely Adverse Scenario

The severely adverse scenario will be developed to reflect specific risks to the economic and financial outlook that are especially salient but would feature minimally in the scenario if the Board were only to use approaches that looked to past recessions or relied on historical relationships between variables.

There are some important instances when it would be appropriate to augment the recession approach with salient risks. For example, if an asset price were especially elevated and thus potentially vulnerable to an abrupt and potentially destabilizing decline, it would be appropriate to include such a decline in the scenario even if such a large drop were not typical in a severe recession. Likewise, if economic developments abroad were particularly unfavorable, assuming a weakening in international conditions larger than what typically occurs in severe U.S. recessions would likely also be appropriate.

Clearly, while the recession component of the severely adverse scenario is within some predictable range, the salient risk aspect of the scenario is far less so, and therefore, needs an annual assessment. Each year, the Board will identify the risks to the financial system and the domestic and international economic outlooks that appear more elevated than usual, using its internal analysis and supervisory information and in consultation with the FDIC and the OCC. Using the same information, the Board will then calibrate the paths of the macroeconomic and financial variables in the scenario to reflect these risks.

Detecting risks that have the potential to weaken the banking sector is particularly difficult when economic conditions are buoyant, as a boom can obscure the weaknesses present in the system. In sustained robust expansions, therefore, the selection of salient risks to augment the scenario will err on the side of including risks of uncertain significance.

The Board will factor in particular risks to the domestic and international macroeconomic outlook identified by its

[35] Note, however, that the severity of the scenario would not exceed an implausible level: even at the upper end of the range of unemployment-rate increases, the path of the unemployment rate would still be consistent with severe post-war U.S. recessions.

economists, bank supervisors, and financial market experts and make appropriate adjustments to the paths of specific economic variables. These adjustments will not be reflected in the general severity of the recession and, thus, all macroeconomic variables; rather, the adjustments will apply to a subset of variables to reflect co-movements in these variables that are historically less typical. The Board plans to discuss the motivation for the adjustments that it makes to variables to highlight systemic risks in the narrative describing the scenarios.[36]

4.3 Approach for Formulating Macroeconomic Assumptions in the Adverse Scenario

The adverse scenario can be developed in a number of different ways, and the selected approach will depend on a number of factors, including how the Board intends to use the results of the adverse scenario.[37] Generally, the Board believes that the companies should consider multiple adverse scenarios for their internal capital planning purposes, and likewise, it is appropriate that the Board consider more than one adverse scenario to assess a company's ability to withstand stress. Accordingly, the Board does not identify a single approach for specifying the adverse scenario. Rather, the adverse scenario will be formulated according to one of the possibilities listed below. The Board may vary the approach it uses for the adverse scenario each year so that the results of the scenario provide the most value to supervisors, in light of current condition of the economy and the financial services industry.

The simplest method to specify the adverse scenario is to develop a less severe version of the severely adverse scenario. For example, the adverse scenario could be formulated such that the deviations of the paths of the variables relative to the baseline were simply one-half of or two-thirds of the deviations of the paths of the variables relative to the baseline in the severely adverse scenario. *A priori,* specifying the adverse scenario in this way may appear unlikely to provide the greatest possible informational value to supervisors—given that it is just a less severe version of the severely adverse scenario. However, to the extent that the effect of macroeconomic variables on bank loss positions and incomes are nonlinear, there could be potential value from this approach.

Another method to specify the adverse scenario is to capture risks in the adverse scenario that the Board believes should be understood better or should be monitored, but does not believe should be included in the severely adverse scenario, perhaps because these risks would render the scenario implausibly severe. For instance, the adverse scenario could feature sizable increases in oil or natural gas prices or shifts in the yield curve that are atypical in a recession. The adverse scenario might also feature less acute, but still consequential, adverse outcomes, such as a disruptive slowdown in growth from emerging-market economies.

Under the Board's stress test rules, covered companies are required to develop their own scenarios for mid-cycle company-run stress tests.[38] A particular combination of risks included in these scenarios may inform the design of the adverse scenario for annual stress tests. In this same vein, another possibility would be to use modified versions of the circumstances that firms describe in their living wills as being able to cause their failures.

It might also be informative to periodically use a stable adverse scenario, at least for a few consecutive years. Even if the scenario used for the stress test does not change over the credit cycle, if companies tighten and relax lending standards over the cycle, their loss rates under the adverse scenario—and indirectly the projected changes to capital—would decrease and increase, respectively. A consistent scenario would allow the direct observation of how capital fluctuates to reflect growing cyclical risks.

Finally, the Board may consider specifying the adverse scenario using the probabilistic approach described in section 3.2.1 (that is, with a specified lower probability of occurring than the severely adverse scenario but a greater probability of occurring than the baseline scenario). The approach has some intuitive appeal despite its shortcomings. For example, using this approach for the adverse scenario could allow the Board to explore an alternative approach to develop stress testing scenarios and their effect on a company's net income and capital.

With the exception of cases in which the probabilistic approach is used to generate the adverse scenario, the adverse scenario would at a minimum contain a mild to moderate recession. This is because most of the value from investigating the implications of the risks described above is likely to be obtained from considering them in the context of balance sheets of covered companies and large banks that are under some stress.

5. Approach for Formulating Scenario Market Price and Rate Shocks

This section discusses the approach the Board proposes to adopt for developing the stress scenario component appropriate for companies with significant trading activities. The design and specification of the stress components for trading differ from that of the macro scenarios because profits and losses from the trading are measured in mark-to-market terms, while revenues and losses from traditional banking are generally measured using the accrual method. As noted above, another critical difference is the time-evolution of the trading stress tests. The trading stress component consists of an instantaneous ''shock'' to a large number of risk factors that determine the mark-to-market value of trading positions, while the macro scenarios supply a projected path of economic variables that affect traditional banking activities over the entire planning period.

The development of the scenarios in the final rules that are detailed in this section are as follows: baseline (subsection 5.1), severely adverse (subsection 5.2), and adverse (subsection 5.3).

5.1 Approach for Formulating the Scenario for Trading Variables Under the Baseline Scenario

By definition, market shocks are large, previously unanticipated moves in asset prices and rates. Because asset prices should, broadly speaking, reflect consensus opinions about the future evolution of the economy, large price movements, as envisioned in the market shock, should not occur along the baseline path. As a result, market shocks will not be included in the baseline scenario.

5.2 Approach for Formulating the Market Shock Component Under the Severely Adverse Scenario

This section addresses possible approaches to designing market shocks in the severely adverse scenario, including important considerations for scenario design, possible approaches to designing scenarios, and a development strategy for implementing the preferred approach.

5.2.1 Design Considerations for Market Shocks

The general market practice for stressing a trading portfolio is to specify market shocks either in terms of extreme moves in observable, broad market indicators and risk factors or directly as large changes to the mark-to-market values of financial instruments. These moves can be specified either in relative terms or absolute terms. Supplying values of risk factors after a ''shock'' is roughly equivalent to the macro scenarios, which supply values for a set of economic and financial variables; however, trading stress testing differs from macroeconomic stress testing in several critical ways.

In the past, the Board used one of two approaches to specify market shocks. During SCAP and CCAR in 2011, the Board used a very general approach to market shocks and required companies to stress their trading positions using changes in market prices and rates experienced during the second half of 2008, without specifying risk factor shocks. This broad guidance resulted in inconsistency across companies both in terms of the severity and the application of shocks. In certain areas companies were permitted to use their own experience during the second half of 2008 to define shocks. This resulted in significant variation in shock severity across companies.

To enhance the consistency and comparability in market shocks for CCAR in 2012, the Board provided to each trading company more than 35,000 specific risk

[36] The means of effecting an adjustment to the severely adverse scenario to address salient systemic risks differs from the means used to adjust the unemployment rate. For example, in adjusting the scenario for an increased unemployment rate, the Board would modify all variables such that the future paths of the variables are similar to how these variables have moved historically. In contrast, to address salient risks, the Board may only modify a small number of variables in the scenario and, as such, their future paths in the scenario would be somewhat more atypical, albeit not implausible, given existing risks.

[37] For example, in the context of CCAR, the Board currently uses the adverse scenario as one consideration in evaluating a bank holding company's capital adequacy.

[38] 12 CFR 252.145.

factor shocks, primarily based on market moves in the second half of 2008. While the number of risk factors used in companies' pricing and stress-testing models still typically exceed that provided in the Board's scenarios, the greater specificity resulted in more consistency in the scenario across companies. The benefit of the comprehensiveness of risk factor shocks is at least partly offset by potential difficulty in creating shocks that are coherent and internally consistent, particularly as the framework for developing market shocks deviates from historical events.

Also importantly, the ultimate losses associated with a given market shock will depend on a company's trading positions, which can make it difficult to rank order, *ex ante,* the severity of the scenarios. In certain instances, market shocks that include large market moves may not be particularly stressful for a given company. Aligning the market shock with the macro scenario for consistency may result in certain companies actually benefiting from risk factor moves of larger magnitude in the market scenario if the companies are hedging against salient risks to other parts of their business. Thus, the severity of market shocks must be calibrated to take into account how a complex set of risks, such as directional risks and basis risks, interacts with each other, given the companies' trading positions at the time of stress. For instance, a large depreciation in a foreign currency would benefit companies with net short positions in the currency while hurting those with net long positions. In addition, longer maturity positions may move differently from shorter maturity positions, adding further complexity.

The instantaneous nature of market shocks and the immediate recognition of mark-to-market losses add another element to the design of market shocks, and to determining the appropriate severity of shocks. For instance, in both SCAP and CCAR, the Board assumed that market moves that occurred over the six-month period in late 2008 would occur instantaneously. The design of the market shocks must factor in appropriate assumptions around the period of time during which market events would unfold and any associated market responses.

5.2.2 Approaches to Trading Stress Component Design

For each scenario, the Board plans to use a standardized set of market shocks that apply to all companies with significant trading activity. The market shocks could be based on a single historical episode, multiple historical periods, hypothetical (but plausible) events, or some combination of historical episodes and hypothetical events (hybrid approach). Depending on the type of hypothetical events, a scenario based on such events may result in changes in risk factors that were not previously observed. In 2012 CCAR, the shocks were largely based on relative moves in asset prices and rates during the second half of 2008, but also included some additional considerations to factor in the widening of spreads for European sovereigns and financial companies based on actual observation during the latter part of 2011.

For the severely adverse scenario, the Board plans to use the hybrid approach to develop shocks. The hybrid approach allows the Board to maintain certain core elements of consistency in market shocks each year while providing flexibility to add hypothetical elements based on market conditions at the time of the stress tests. In addition, this approach will help ensure internal consistency in the scenario because of its basis in historical episodes; however, combining the historical episode and hypothetical events may require tweaks to ensure mutual consistency of the joint moves. In general, the hybrid approach provides considerable flexibility in developing scenarios that are relevant each year, and by introducing variations in the scenario, the approach will also reduce the ability of companies with significant trading activity to modify or shift their portfolios to minimize expected losses in the severely adverse scenario.

The Board has considered a number of alternative approaches for the design of market shocks. For example, the Board explored an option of providing tailored market shocks for each trading company, using information on the companies' portfolio gathered through ongoing supervision or other means. By specifically targeting known or potential vulnerabilities in a company's trading position, this approach would be useful in assessing each company's capital adequacy as it relates to the company's idiosyncratic risk. However, the Board does not believe this approach to be well-suited for the stress tests required by regulation. Consistency and comparability are key features of annual supervisory stress tests and annual company-run stress tests required in the stress test rules. It would be difficult to use the information on the companies' portfolio to design a common set of shocks that are universally stressful for all covered companies. As a result, this approach would be better suited to more customized, tailored stress tests that are part of the company's internal capital planning process or to other supervisory efforts outside of the stress tests conducted under the stress test rules.

5.2.3 Development of the Trading Stress Scenario

Consistent with the approach describe above, the market shock component for the severely adverse scenario will incorporate key elements of market developments during the second half of 2008, but also incorporate observations from other periods or price and rate movements in certain markets that the Board deems to be plausible though such movements may not have been observed historically. The Board also expects to rely less on market events of the second half of 2008 and more on hypothetical events or other historical episodes to develop the market shock, particularly as the bank holding company's portfolio changes over time and a different combination of events would better capture material risk in bank holding company's portfolio in the given year.

The developments in the credit markets during the second half of 2008 were unprecedented, providing a reasonable basis for market shocks in the severely adverse scenario. During this period, key risk factors in virtually all asset classes experienced extremely large shocks; the collective breadth and intensity of the moves have no parallels in modern financial history and, on that basis, it seems likely that this episode will continue to be the dominant historical scenario, although experience during other historical episodes may also guide the severity of the market shock component of the severely adverse scenario. Moreover, the risk factor moves during this episode are directly consistent with the ''recession'' approach that underlies the macroeconomic assumptions. However, market shocks based only on historical events could become stale and less relevant over time as the company's positions change, particularly if more salient features are not added each year.

While the market shocks based on the second half of 2008 are of unparalleled magnitude, the shocks may become less relevant over time as the companies' trading positions change. In addition, more recent events could highlight the companies' vulnerability to certain market events. For example, in 2011, Eurozone credit spreads in the sovereign and financial sectors surpassed those observed during the second half of 2008, necessitating the modification of the stress scenario for the CCAR 2012 to reflect a salient source of stress to trading positions. As a result, it is important to incorporate both historical and hypothetical outcomes in market shocks for the severely adverse scenario. For the time being, the development of market shocks in the severely adverse scenario will begin with the risk factor movements in the particular historical period, such as the second half of 2008. The Board will then consider hypothetical but plausible outcomes, based on financial stability reports, supervisory information, and internal and external assessments of market risks and potential flash points. The hypothetical outcomes could originate from major geopolitical, economic, or financial market events with potentially significant impacts on market risk factors. The severity of these hypothetical moves will likely be guided by similar historical events, assumptions embedded in the companies' internal stress tests or market participants, and other available information.

For the time being, the development of market shocks in the severely adverse scenario will begin with the risk factor movements in the particular historical period, such as the second half of 2008. The Board will then develop hypothetical but plausible scenarios, based on financial stability reports, supervisory information, and internal and external assessments of market risks and potential flash points. Once broad market scenarios are agreed upon, specific risk factor groups will be targeted as the source of the trading stress. For example, a scenario involving the failure of a large, interconnected globally active financial institution could begin with a sharp increase in credit default swaps spreads and a precipitous decline in asset prices across multiple markets, as investors become more risk averse and market liquidity evaporates.

These broad market movements would be extrapolated to the granular level for all risk factors by examining transmission channels and the historical relationships between variables, though in some cases, the movement in particular risk factors may be amplified based on theoretical relationships, market observations, or the saliency to company trading books. If there is a disagreement between the risk factor movements in the historical event used in the scenario and the hypothetical event, the Board will reconcile the differences by assessing consistency with the macro scenario, *a priori* expectation based on financial and economic theory, and the importance of the risk factors to the trading positions of the covered companies.

5.3 Approach for Formulating the Scenario for Trading Variables Under the Adverse Scenario

The market shock component included in the adverse scenario will be designed to be generally less severe than the severely adverse scenario while providing useful information to supervisors. As in the case of the macro scenario, the market shock component in the adverse scenario can be developed in a number of different ways.

The adverse scenario could be differentiated from the severely adverse scenario by the absolute size of the shock, the scenario design process (*e.g.,* historical events versus hypothetical events), or some other criteria. As discussed above, due to differences in companies' trading positions, it can be difficult to know *ex ante* whether the adverse scenario or severely adverse scenario would result in greater losses for a given company. However, the Board anticipates that the adverse scenario would generally result in lower aggregate trading losses than the severely adverse scenario, particularly given the importance of credit-related losses. The Board expects that as the market shock component of the adverse scenario may differ qualitatively from the market shock component of the severely adverse scenario, the results of adverse scenarios may be useful in identifying a particularly vulnerable area in a trading company's positions.

There are several possibilities for the adverse scenario and the Board may use a different approach each year to better explore the vulnerabilities of companies with significant trading activity. One approach is to use a scenario based on some combination of historical events. This approach is similar to the one used for 2012 CCAR, where the market shock component was largely based on the second half of 2008, but also included a number of risk factor shocks that reflected the significant widening of spreads for European sovereigns and financials in late 2011. This approach would provide some consistency each year and provide an internally consistent scenario with minimal implementation burden. Having a relatively consistent adverse scenario may be useful as it potentially serves as a benchmark against the results of the severely adverse scenario and can be compared to past stress tests.

Another approach is to have an adverse scenario that is identical to the severely adverse scenario, except that the shocks are smaller in magnitude (*e.g.,* 100 basis points for adverse versus 200 basis points for severely adverse). This ''scaling approach'' generally fits well with an intuitive interpretation of ''adverse'' and ''severely adverse.'' Moreover, since the nature of the moves will be identical between the two classes of scenarios, there will be at least directional consistency in the risk factor inputs between scenarios. While under this approach the adverse scenario would be superficially identical to the severely adverse, the logic underlying the severely adverse scenario may not be applicable. For example, if the severely adverse scenario was based on a historical scenario, the same could not be said of the adverse scenario. It is also remains possible, although unlikely, that a scaled adverse scenario actually would result in greater losses, for some companies, than the severely adverse scenario with similar moves of greater magnitude. For example, if some companies are hedging against tail outcomes then the more extreme trading book dollar losses may not correspond to the most extreme market moves.

Alternatively, the market shock component of an adverse scenario could differ substantially from the severely adverse scenario with respect to the sizes and nature of the shocks. Under this approach, the market shock component could be constructed using some combination of historical and hypothetical events, similar to the severely adverse scenario. As a result, the market shock component of the adverse scenario could be viewed more as an alternative to the severely adverse scenario and, therefore, it is possible that the adverse scenario could have larger losses for some companies than the severely adverse scenario. However, this approach would provide valuable information to supervisors, by focusing on different facets of potential vulnerabilities.

Finally, the design of the adverse scenario for annual stress tests could be informed by the companies' own market shock components used for their mid-cycle company-run stress tests.[39]

6. Consistency Between the Economic and Financial Variable Scenarios and the Market Price and Rate Shock Scenarios

As discussed earlier, the market shock comprises a set of movements in a very large number of risk factors that are realized instantaneously. Among the risk factors specified in the market shock are several variables also specified in the macro scenarios, such as short- and long-maturity interest rates on Treasury and corporate debt, the level and volatility of U.S. stock prices, and exchange rates.

Generally, the market shock scenario will be directionally consistent with the macro scenario, though the magnitude of moves in broad risk factors, such as interest rates, foreign exchange rates, and prices, may differ. Because the market shock is designed, in part, to mimic the effects of a sudden market dislocation, while the macro scenarios are designed to provide a description of the evolution of the real economy over two or more years, assumed economic conditions can move in significantly different ways. However, such differences should not be viewed as inconsistency in scenarios as long as the macro scenario and the market shock component of the scenario are directionally consistent. In effect, the market shock can simulate a market panic, during which financial asset prices move rapidly in unexpected directions, and the macroeconomic assumptions can simulate the severe recession that follows. Indeed, the pattern of a financial crisis, characterized by a short period of wild swings in asset prices followed by a prolonged period of moribund activity, and a subsequent severe recession is familiar and plausible.

As discussed in section 4.2.4, the Board may feature a particularly salient risk in the macroeconomic assumptions for the severely adverse scenario, such as a fall in an elevated asset price. In such instances, the Board would also seek to reflect the same risk in one of the market shocks. For example, if the macro scenario were to feature a substantial decline in house price, it would seem plausible for the market shock to also feature a significant decline in market values of any securities that are closely tied to the housing sector or residential mortgages.

In addition, as discussed in section 4.3, the Board may specify the macroeconomic assumptions in the adverse scenario in such a way as to explore risks qualitatively different from those in the severely adverse scenario. Depending on the nature and type of such risks, the Board may also seek to reflect these risks in one of the market shocks as appropriate.

7. Timeline for Scenario Publication

The Board will provide a description of the macro scenarios by no later than November 15 of each year. During the period immediately preceding the publication of the scenarios, the Board will collect and consider information from academics, professional forecasters, international organizations, domestic and foreign supervisors, and other private-sector analysts that regularly conduct stress tests based on U.S. and global economic and financial scenarios, including analysts at the covered companies. In addition, the Board will consult with the FDIC and the OCC on the salient risks to be considered in the scenarios. The Board expects to conduct this process in July and August of each year and to update the scenarios based on incoming macroeconomic data releases and other information through the end of October.

Currently, the Board does not plan to publish the details of the market shock component. The Board expects to provide a broad overview of the market shock component.

[39] 12 CFR 252.145.

TABLE 1—CLASSIFICATION OF U.S. RECESSIONS

Peak	Trough	Severity	Duration (quarters)	Decline in real GDP	Change in the unemployment rate during the recession	Total change in the unemployment rate (incl. after the recession)
1957Q3	1958Q2	Severe	4 (Medium)	−3.1	3.2	3.2
1960Q2	1961Q1	Typical	4 (Medium)	−0.5	1.6	1.8
1969Q4	1970Q4	Typical	5 (Medium)	−0.1	2.2	2.4
1973Q4	1975Q1	Severe	6 (Long)	−3.1	3.4	4.1
1980Q1	1980Q3	Typical	3 (Short)	−2.2	1.4	1.4
1981Q3	1982Q4	Severe	6 (Long)	−2.6	3.3	3.3
1990Q3	1991Q1	Mild	3 (Short)	−1.3	0.9	1.9
2001Q1	2001Q4	Mild	4 (Medium)	0.7	1.3	2.0
2007Q4	2009Q2	Severe	7 (Long)	[−4.7]	4.5	5.1
Average		Severe	6	−3.8	3.7	3.9
Average		Moderate	4	−1.0	1.8	1.8
Average		Mild	3	−0.3	1.1	1.9

By order of the Board of Governors of the Federal Reserve System, November 15, 2012.

Margaret McCloskey Shanks,

Deputy Secretary of the Board.

[FR Doc. 2012–28207 Filed 11–21–12; 8:45 am]

BILLING CODE 6210–01–P

Notices

Federal Register
Vol. 77, No. 226
Friday, November 23, 2012

This section of the FEDERAL REGISTER contains documents other than rules or proposed rules that are applicable to the public. Notices of hearings and investigations, committee meetings, agency decisions and rulings, delegations of authority, filing of petitions and applications and agency statements of organization and functions are examples of documents appearing in this section.

AGENCY FOR INTERNATIONAL DEVELOPMENT

Privacy Act of 1974, System of Records

AGENCY: United States Agency for International Development.

ACTION: Altered system of records.

SUMMARY: The United States Agency for International Development (USAID) is issuing public notice of its intent to alter a system of records maintained in accordance with the Privacy Act of 1974 (5 U.S.C. 552a), as amended, entitled ''USAID–33, Phoenix Financial Management System''. This action is necessary to meet the requirements of the Privacy Act to publish in the **Federal Register** notice of the existence and character of record systems maintained by the agency (5 U.S.C. 522a(e)(4)).

DATES: Public comments must be received on or before January 10, 2013. Unless comments are received that would require a revision; this update to the system of records will become effective on January 10, 2013.

ADDRESSES: You may submit comments:

Paper Comments

- *Fax:* (703) 666–5670.
- *Mail:* Chief Privacy Officer, United States Agency for International Development, 2733 Crystal Drive, 11th Floor, Arlington, Va. 22202.

Electronic Comments

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions on the Web site for submitting comments.
- *Email: privacy@usaid.gov.*

FOR FURTHER INFORMATION CONTACT: For general questions, please contact, USAID Privacy Office, United States Agency for International Development, 2733 Crystal Drive, 11th Floor, Arlington, Va. 22202. Email: *privacy@usaid.gov.*

SUPPLEMENTARY INFORMATION: The Phoenix Financial Management System was established as an Agency-wide system of record since it is required to collect, maintain or store personal data requiring protection under the Privacy Act. It is USAID's core financial management system and accounting system of record. Phoenix enables USAID to effectively and efficiently analyze, allocate and report on US foreign assistance funds. Phoenix includes modules such as General Ledger, Accounts Payable, Accounts Receivables, and Budget Execution, which are required to perform necessary accounting operations. Phoenix falls under strict regulatory audit requirements from the Office of Management and Budget, as well as the General Accountability Office.

Dated: November 15, 2012.

William Morgan,

Chief Information Security Officer—Chief Privacy Officer.

USAID–33

SYSTEM NAME:

Phoenix Financial Management System.

SECURITY CLASSIFICATION:

Sensitive But Unclassified.

SYSTEM LOCATION:

Terremark, 50 NE 9th Street, Miami, FL 33132.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

This system contains records of current employees, contractors, personal service contractors (PSCs), consultants, partners, and those receiving foreign assistance funds.

CATEGORIES OF RECORDS COVERED BY THE SYSTEM:

This system contains USAID organizational information. Phoenix imports the following data elements from NFC Payroll files for Personnel Services Contractors (PSC) and direct hires: name, social security number, details of payroll transactions and work phone numbers. Phoenix imports the following data elements from the E2 Travel system for each traveler: name, date of travel (month/year) and destination.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

Privacy Act of 1974 (Pub. L. 93–579), sec. 552a (c), (e), (f), and (p).

PURPOSE(S):

Records in this system will be used:

(1) The payroll information is used to associate PSC payroll-related payments with their contracts and track direct hire payroll payments in the system in order to produce 1099 files. If this information is not imported form NFC to Phoenix, then USAID cannot comply with IRS regulations to maintain and produce 1099s.

(2) The travel information is used to associate E2 travel records with Phoenix accounting information regarding travel authorization and funding.

ROUTINE USE OF RECORDS MAINTAINED IN THE SYSTEM, INCLUDING CATEGORIES OF USERS AND THE PURPOSES OF SUCH USES:

USAID may disclose relevant system records in accordance with any current and future blanket routine uses established for its record systems. These may be for internal communications or with external partners.

DISCLOSURE TO CONSUMER REPORTING AGENCIES:

These records are not disclosed to consumer reporting agencies

POLICIES AND PRACTICES FOR STORING, RETRIEVING, ACCESSING, RETAINING, AND DISPOSING OF RECORDS IN THE SYSTEM:

STORAGE:

Electronic records are maintained in user-authenticated, password-protected systems.

RETRIEVABILITY:

All records are accessed only by authorized personnel who have a need to access the records in the performance of their official duties. Information is retrieved by name or by a system specific ID (Vendor ID, Traveller ID, etc.). SSN is not employed as a key, but only present for tax reporting purposes.

SAFEGUARDS:

Administrative, managerial and technical controls are in place. Phoenix has a current C&A in place. Phoenix is secured through access control provided to only those individuals with a need to know within the Agency. Further, access to the PII is limited to the staff within the CMP and CAR divisions. Phoenix is maintained by the US government, not contractors.

RETENTION AND DISPOSAL:

Records are retained using the appropriate, approved National Archives Records Administration—Schedules for the type of record being maintained.

SYSTEM MANAGER(S) AND ADDRESS:

David Ostermeyer, United States Agency for International Development, U.S. Department of State Annex 44, 455, 301 4th Street SW., Washington, DC 20547.

NOTIFICATION PROCEDURES:

Individuals requesting notification of the existence of records on them must send the request in writing to the Chief Privacy Officer, USAID, 2733 Crystal Drive, 11th Floor, Arlington, Va. 22202. The request must include the requestor's full name, his/her current address and a return address for transmitting the information. The request shall be signed by either notarized signature or by signature under penalty of perjury and reasonably specify the record contents being sought.

RECORD ACCESS PROCEDURES:

Individuals wishing to request access to a record must submit the request in writing according to the ''Notification Procedures'' above. An individual wishing to request access to records in person must provide identity documents, such as government-issued photo identification, sufficient to satisfy the custodian of the records that the requester is entitled to access.

CONTESTING RECORD PROCEDURES:

An individual requesting amendment of a record maintained on himself or herself must identify the information to be changed and the corrective action sought. Requests must follow the ''Notification Procedures'' above.

RECORD SOURCE CATEGORIES:

The records contained in this system will be provided by and updated by the individual who is the subject of the record.

EXEMPTIONS CLAIMED FOR THE SYSTEM:

None.

Meredith Snee,

Privacy Analyst.

[FR Doc. 2012–28412 Filed 11–21–12; 8:45 am]

BILLING CODE P

DEPARTMENT OF AGRICULTURE

Forest Service

Okanogan-Wenatchee National Forest, Okanogan County, WA; Bannon, Aeneas, Revis, and Tunk Grazing Allotments Environmental Impact Statement

AGENCY: Forest Service, USDA.

ACTION: Notice of Intent to prepare an Environmental Impact Statement.

SUMMARY: The USDA Forest Service will prepare an Environmental Impact Statement (EIS) to disclose the environmental effects of issuing Term Grazing Permits to continue authorizing cattle grazing on all or portions of four existing grazing allotments: Bannon, Aeneas, Revis, and Tunk; herein after referred to as BART. The issuance of Term Grazing Permits would continue to authorize grazing at current permitted cattle numbers and seasons of use.

DATES: Comments concerning the scope of the analysis should be received by January 7, 2013. The draft environmental impact statement is expected to be filed with the Environmental Protection Agency and made available for public review in January 2013. The final environmental impact statement is expected to be available for review in February 2013.

ADDRESSES: Submit written comments and suggestions concerning the scope of the analysis to Christina Bauman, Project Lead, Tonasket District, 1 West Winesap, Tonasket, Washington 98855, or phone 509–486–5112. Comments may also be sent via emailed to *comments-pacificnorthwest-okanogan-tonasket@fs.fed.us* with ''BART Grazing Allotment Management Plan'' in the subject line or via facsmile to 509–486–1922. Electronic comments must be part of an email message or as an attachment in either MS Word format (.doc or .docx), Rich Text Format (.rtf), Plain Text (.txt), or Portable Document Format (.pdf). Electronic comments containing viruses will be rejected.

FOR FURTHER INFORMATION CONTACT: Christina Bauman, Project Leader, Tonasket District, Okanogan-Wenatchee National Forest, 1 West Winesap, Tonasket, Washington 98855 or call 509–486–5112.

Individuals who use telecommunication devices for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1–800–877–8339 between 8 a.m. and 8 p.m., Eastern Time, Monday through Friday.

SUPPLEMENTARY INFORMATION: The assessment area covers about 36,803 acres of National Forest System lands within T. 35 N., R. 28 & 29 E., and T. 36 N., R. 28 & 29 E., Willamette Meridian. Landmark locations include, Bannon Mountain, Tunk Mountain, Crawfish Lake, Aeneas, Barnell, Lost, Cole, Bench and Jungle Creeks, and Barnell Meadows.

Purpose and Need for Action

The purpose of this assessment is to authorize continued grazing in the project area consistent with Forest Plan standards and guidelines as amended providing forage for permitted livestock grazing is proposed because of the following:

- Public Law 104–19 Section 504 of the 1995 Rescissions Act, as amended, requires each National Forest to establish and adhere to a schedule for completing NEPA analysis and updating allotment management plans for all rangeland allotments on National Forest System lands.
- Where consistent with other multiple use goals and objectives, there is congressional intent to allow livestock grazing on suitable lands (Multiple Use Sustained Yield Act of 1960; Forest and Rangeland Renewable Resources Planning Act of 1974; Federal Land Policy and Management Act of 1976; and the National Forest Management Act of 1976.
- It is Forest Service policy to make forage available to qualified livestock operators from lands suitable for grazing consistent with land management plans (CFR 222.2(c); and Forest Service Manual [FSM] 2203.1).
- Recent surveys of the analysis area identified some areas that are of concern or are currently not meeting or moving toward desired conditions in a manner that is consistent with the Okanogan Forest Land and Resource Management Plan as amended. There is a need to modify range infrastructure and livestock management to move toward desired conditions for soils, vegetation and riparian resources. Livestock grazing is one of the factors that contribute to these altered resource conditions.

Proposed Action

The proposed action authorizes continued livestock grazing at current levels using a combination of range improvements and adaptive management strategies to meet or move toward meeting Forest Plan Standards and to attain resource specific desired conditions.

This alternative would implement adaptive management strategies analyzed in detail to provide management options if changes to the Proposed Action grazing strategy are

needed. Monitoring would be designed for early detection of resource conditions that would trigger management changes. Triggers would be developed to identify when a specific threshold is about to be reached and cattle need to be moved. The length of time each pasture is grazed and whether additional fences would be installed would be determined by monitoring results. Adaptive management strategies include installation of water developments in the first stage and may include construction of additional fences in subsequent years if needed, where the permittee and the Forest Service agree that additional fencing would improve livestock management and riparian areas. A monitoring plan would be implemented to determine progress in attainment of Forest Plan standards and guidelines.

Range improvement proposals include:

- Removal of approximately 3 miles of fence no longer needed for livestock management and 2 non-functioning water developments.
- Relocation of 4 troughs and one corral outside of the Riparian Habitat Conservation Area (RHCA) and 1 fence approximately 1.5 miles long.
- Development of 16 springs including exclosures around spring source.
- Reconstruction of 3 existing spring developments.
- Construction of 2 new corrals.
- Construction of 1 hardened crossing on Aeneas Creek.
- Possible construction of approximately 13 miles of new pasture fence for rested areas.

More detailed information about the proposed action and maps can be accessed on the Okanogan-Wenatchee National Forest internet site *http://data.ecosystem-management.org/nepaweb/nepa_project_exp.php?project=38873.*

Possible Alternatives

In addition to the Proposed Action and any alternative that is developed following the scoping effort, the project interdisciplinary team will analyze the effects of:

- *No Action alternative:* No grazing permits would be reauthorized; cattle would be removed from all allotments within two years. There would be no change of allotment management in this two year period. All structural improvements currently in place would be allowed to deteriorate over time or be removed if funding is available.
- *Accelerated improvement:* This alternative would reauthorize grazing at current numbers with the implementation of a four-year strategy that includes installation of water developments in the first year, the construction of fences in the second, third year and fourth years. This alternative would rest from livestock grazing these newly created pastures with the most sensitive riparian areas.

Range improvement proposals include:

- Removal of approximately 3 miles of fence no longer needed for livestock management and 2 non-functioning water developments.
- Relocation of 4 troughs and one corral outside the RHCA and 1 fence approximately 1.5 miles long.
- Development of 16 springs including exclosures around spring source.
- Reconstruction of 3 existing spring developments.
- Construction of 2 new corrals.
- Construction of 1 hardened crossing on Aeneas Creek.
- Construction of approximately 13 miles of new pasture fence for rested areas.

Additional grazing alternatives may be considered in response to scoping issues and other resource values.

Responsible Official

The responsible official will be the Forest Supervisor, Okanogan-Wenatchee National Forest, 215 Melody Lane, Wenatchee, Washington 98801.

Nature of Decision To Be Made

An environmental analysis will evaluate site-specific issues, consider management alternatives and analyze the potential effects of the proposed action and alternatives. An environmental impact statement will provide the Responsible Official with the information needed to decide whether to adopt and implement the proposed action, or an alternative to the proposed action, or take no action to reauthorize grazing in the Bannon, Aeneas, Revis, and Tunk grazing Allotments.

This EIS will tier to the Okanogan National Forest Land and Resource Management Plan and its subsequent amendments, which provide overall guidance for land management activities on the Okanogan-Wenatchee National Forest.

Preliminary Issues

Preliminary issues identified include the effects of livestock grazing on riparian resources such as stream bank and channel instability, high stream width/depth ratio, lack of diverse riparian vegetation, high stream sedimentation, and soil compaction, displacement or erosion.

Scoping Process

This notice of intent initiates the scoping process, which guides the development of the Environmental Impact Statement. Public comments about this proposal are requested in order to assist in identifying issues, and determining how to best manage the resources, and focus the analysis.

It is important that reviewers provide their comments at such times and in such manner that they are useful to the agency's preparation of the environmental impact statement. Therefore, comments should be provided prior to the close of the comment period and should clearly articulate the reviewer's concerns and contentions.

Comments received in response to this solicitation, including names and addresses of those who comment, will become part of the public record for this proposal and will be available for public inspection. Comments submitted anonymously will be accepted and considered; however, anonymous comments will not provide the agency with the ability to provide the commenter with subsequent environmental documents.

Rebecca Lockett Heath,

Forest Supervisor, Okanogan-Wenatchee National Forest.

[FR Doc. 2012–28420 Filed 11–21–12; 8:45 am]

BILLING CODE 3410–75–P

DEPARTMENT OF COMMERCE

Submission for OMB Review; Comment Request

The Department of Commerce will submit to the Office of Management and Budget (OMB) for clearance the following proposal for collection of information under the provisions of the Paperwork Reduction Act (44 U.S.C. Chapter 35).

Agency: National Oceanic and Atmospheric Administration (NOAA).

Title: Mandatory Shrimp Vessel and Gear Characterization Survey.

OMB Control Number: 0648–0542.

Form Number(s): NA.

Type of Request: Regular submission (extension of a current information collection).

Number of Respondents: 1,563.

Average Hours per Response: 20 minutes.

Burden Hours: 521.

Needs and Uses: This request is for extension of a current information collection.

The Magnuson-Stevens Fishery Conservation and Management Act

(Magnuson-Stevens Act) authorizes the Gulf of Mexico Fishery Management Council (Council) to prepare and amend fishery management plans for any fishery in waters under its jurisdiction. National Marine Fisheries Service (NMFS) manages the shrimp fishery in the waters of the Gulf of Mexico under the Shrimp Fishery Management Plan (FMP). The regulations for the Gulf Shrimp Vessel and Gear Characterization Form may be found at 50 CFR 622.5(a)(1)(iii)(C).

Owners or operators of vessels applying for or renewing a commercial vessel moratorium permit for Gulf shrimp must complete an annual Gulf Shrimp Vessel and Gear Characterization Form. The form will be provided by NMFS at the time of permit application and renewal. Compliance with this reporting requirement is required for permit issuance and renewal.

Through this form, NMFS is collecting census-level information on fishing vessel and gear characteristics in the Gulf of Mexico Exclusive Economic Zone (EEZ) shrimp fishery to conduct analyses that will improve fishery management decision-making in this fishery; ensure that national goals, objectives, and requirements of the Magnuson-Stevens Act, National Environmental Policy Act (NEPA), Regulatory Flexibility Act (RFA), Endangered Species Act (ESA), and Executive Order (E.O.) 12866 are met; and quantify achievement of the performance measures in the NMFS' Operating Plans. This information is vital in assessing the economic, social, and environmental effects of fishery management decisions and regulations on individual shrimp fishing enterprises, fishing communities, and the nation as a whole.

Affected Public: Business or other for-profit organizations.

Frequency: Annually.

Respondent's Obligation: Mandatory.

OMB Desk Officer: *OIRA_Submission@omb.eop.gov*.

Copies of the above information collection proposal can be obtained by calling or writing Jennifer Jessup, Departmental Paperwork Clearance Officer, (202) 482–0336, Department of Commerce, Room 6616, 14th and Constitution Avenue NW., Washington, DC 20230 (or via the Internet at *JJessup@doc.gov*).

Written comments and recommendations for the proposed information collection should be sent within 30 days of publication of this notice to *OIRA_Submission@omb.eop.gov.*

Dated: November 16, 2012.

Gwellnar Banks,

Management Analyst, Office of the Chief Information Officer.

[FR Doc. 2012–28343 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

Submission for OMB Review; Comment Request

The Department of Commerce will submit to the Office of Management and Budget (OMB) for clearance the following proposal for collection of information under the provisions of the Paperwork Reduction Act (44 U.S.C. Chapter 35).

Agency: National Oceanic and Atmospheric Administration (NOAA).

Title: Vessel Monitoring System Requirements under the Western and Central Pacific Fisheries Convention.

OMB Control Number: 0648–0596.

Form Number(s): None.

Type of Request: Regular submission (extension of a current information collection).

Number of Respondents: 78.

Average Hours per Response: Activation reports and on/off notifications, 5 minutes each; installation and maintenance, 1 hour each.

Burden Hours: 191.

Needs and Uses: This request is for an extension of a currently approved information collection.

National Marine Fisheries Service (NMFS) has issued regulations under authority of the Western and Central Pacific Fisheries Convention Implementation Act (WCPFCIA; 16 U.S.C. 6901 *et seq.*) to carry out the obligations of the United States under the Convention on the Conservation and Management of Highly Migratory Fish Stocks in the Western and Central Pacific Ocean (Convention), including implementing the decisions of the Commission for the Conservation and Management of Highly Migratory Fish Stocks in the Western and Central Pacific Ocean (Commission). The regulations include a requirement for the owners and operators of U.S. vessels that fish for highly migratory species on the high seas in the Convention Area to carry and operate near real-time satellite-based position-fixing transmitters (''VMS units'') at all times except when the vessel is in port. As part of this requirement, vessel owners and operators must transmit: (1) ''On/off reports'' to NMFS whenever the VMS unit is turned off while the vessel is in port, (2) ''activation reports'' to NMFS prior to the first use of a VMS unit, and (3) automatic ''position reports'' from the VMS unit to NOAA and the Commission as part of a vessel monitoring system (VMS) operated by the Commission (50 CFR 300.45). Under this information collection, it is expected that vessel owners and operators would also need to purchase, install, and occasionally maintain the VMS units.

The information collected from the vessel position reports is used by NOAA and the Commission to help ensure compliance with domestic laws and the Commission's conservation and management measures, and are necessary in order for the United Stated to satisfy its obligations under the Convention.

Affected Public: Business or other for-profit organizations.

Frequency: Annually and on occasion.

Respondent's Obligation: Mandatory.

OMB Desk Officer: *OIRA_Submission@omb.eop.gov.*

Copies of the above information collection proposal can be obtained by calling or writing Jennifer Jessup, Departmental Paperwork Clearance Officer, (202) 482–0336, Department of Commerce, Room 6616, 14th and Constitution Avenue NW., Washington, DC 20230 (or via the Internet at *JJessup@doc.gov*).

Written comments and recommendations for the proposed information collection should be sent within 30 days of publication of this notice to *OIRA_Submission@omb.eop.gov.*

Dated: November 16, 2012.

Gwellnar Banks,

Management Analyst, Office of the Chief Information Officer.

[FR Doc. 2012–28346 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

Foreign-Trade Zones Board

[B–55–2012]

Foreign-Trade Zone 8—Toledo, OH; Authorization of Production Activity; Whirlpool Corporation (Washing Machines); Clyde and Green Springs, OH

On July 20, 2012 the Toledo-Lucas County Port Authority, grantee of FTZ 8, submitted a notification of proposed production activity to the Foreign-Trade Zones (FTZ) Board on behalf of Whirlpool Corporation, within Subzone 8I, in Clyde and Green Springs, Ohio.

The notification was processed in accordance with the regulations of the

FTZ Board (15 CFR part 400), including notice in the **Federal Register** inviting public comment (77 FR 46024, 8/2/2012). The FTZ Board has determined that no further review of the activity is warranted at this time. The production activity described in the notification is authorized, subject to the FTZ Act and the Board's regulations, including Section 400.14.

Dated: November 19, 2012.

Andrew McGilvray,

Executive Secretary.

[FR Doc. 2012–28479 Filed 11–21–12; 8:45 am]

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DEPARTMENT OF COMMERCE

Bureau of Industry and Security

Emerging Technology and Research Advisory Committee; Notice of Partially Closed Meeting

The Emerging Technology and Research Advisory Committee (ETRAC) will meet on December 12, 2012, 8:30 a.m., Room 6527, (closed session) and December 13, 2012, 8:30 a.m., Room 3884, (open session) at the Herbert C. Hoover Building, 14th Street between Pennsylvania and Constitution Avenues NW., Washington, DC. The Committee advises the Office of the Assistant Secretary for Export Administration on emerging technology and research activities, including those related to deemed exports.

Agenda

Wednesday, December 12

Closed Session: 8:30 a.m.–5:30 p.m.

1. Discussion of matters determined to be exempt from the provisions relating to public meetings found in 5 U.S.C. app. 2 sections 10(a)(1) and l0(a)(3).

Thursday, December 13

Open Session: 8:30 a.m.–4:00 p.m.

1. Open remarks from BIS and Chairs
2. Public comments
3. BIS overview on export controls for new members
4. BIS on 521 Provision
5. 3D Bio-printing
6. NAS study on Nanotech Initiative ''tentative''
7. Rare Earths Study
8. Additive Manufacturing ''tentative''

The open sessions will be accessible via teleconference to 40 participants on a first come, first serve basis. To join the conference, submit inquiries to Ms. Yvette Springer at *Yvette.Springer@bis.doc.gov* no later than, December 5, 2012.

A limited number of seats will be available for the public session. Reservations are not accepted. To the extent that time permits, members of the public may present oral statements to the Committee. The public may submit written statements at any time before or after the meeting. However, to facilitate the distribution of public presentation materials to the Committee members, the Committee suggests that presenters forward the public presentation materials prior to the meeting to Ms. Springer via email.

The Assistant Secretary for Administration, with the concurrence of the delegate of the General Counsel, formally determined on October 4, 2012, pursuant to Section l0(d) of the Federal Advisory Committee Act, as amended, that the portion of the meeting dealing with matters of which would be likely to frustrate significantly implementation of a proposed agency action as described in 5 U.S.C. 552b(c)(9)(B) shall be exempt from the provisions relating to public meetings found in 5 U.S.C. app. 2 sections 10(a)1 and 10(a)(3). The remaining portions of the meeting will be open to the public.

For more information, call Yvette Springer at (202) 482–2813.

Dated: November 19, 2012.

Yvette Springer,

Committee Liaison Officer.

[FR Doc. 2012–28497 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–JT–P

DEPARTMENT OF COMMERCE

International Trade Administration

[A–449–804; A–455–803; A–560–811; A–570–860; A–822–804; A–823–809; A–841–804]

Steel Concrete Reinforcing Bars From Belarus, Indonesia, Latvia, Moldova, Poland, People's Republic of China and Ukraine: Final Results of the Expedited Second Sunset Reviews of the Antidumping Duty Orders

AGENCY: Import Administration, International Trade Administration, Department of Commerce.

DATES: *Effective Date:* November 23, 2012.

SUMMARY: On July 2, 2012, the Department of Commerce (''Department'') initiated the second Sunset Reviews of the antidumping duty orders on steel concrete reinforcing bars from Belarus, Indonesia, Latvia, Moldova, Poland, the People's Republic of China and Ukraine. The Department finds that revocation of these antidumping duty orders would be likely to lead to continuation or recurrence of dumping at the margins identified in the ''Final Results of Reviews'' section of this notice.

FOR FURTHER INFORMATION CONTACT: Mahnaz Khan or David Layton, AD/CVD Operations, Office 1, Import Administration, International Trade Administration, U.S. Department of Commerce, 14th Street and Constitution Avenue NW., Washington, DC 20230; telephone (202) 482–0914 and (202) 482–0371, respectively.

SUPPLEMENTARY INFORMATION:

Background

The antidumping duty orders on steel concrete reinforcing bars from Belarus, Indonesia, Latvia, Moldova, the People's Republic of China (''PRC''), Poland, and Ukraine were published on September 7, 2001. *See Antidumping Duty Orders: Steel Concrete Reinforcing Bars From Belarus, Indonesia, Latvia, Moldova, People's Republic of China, Poland, Republic of Korea and Ukraine,* 66 FR 46777 (September 7, 2001).[1]

On July 2, 2012, the Department initiated the second sunset reviews of these orders, pursuant to section 751(c) of the Tariff Act of 1930, as amended (''the Act''). *See Initiation of Five-Year (''Sunset'') Reviews,* 77 FR 39218 (July 2, 2012) (''notice of initiation''). The Department received a notice of intent to participate from the following domestic parties: The Rebar Trade Action Coalition (''RTAC'') and its individual members, Nucor Corporation, Gerdau Long Steel North America, Cascade Steel Rolling Mills, Inc., and Commercial Metals Company (collectively, ''domestic interested parties''), within the deadline specified in 19 CFR 351.218(d)(1)(i). Each individual member of the RTAC is a manufacturer of a domestic-like product in the United States and, accordingly, is a domestic interested party pursuant to section 771(9)(C) of the Act.

On July 30, 2012, the Department received adequate substantive responses to the notice of initiation from the domestic interested parties within the 30-day deadline specified in 19 CFR 351.218(d)(3)(i). We received no responses from respondent interested parties with respect to any of the orders covered by these sunset reviews. As a result, pursuant to 19 CFR 351.218(e)(1)(ii)(C)(2), the Department is conducting expedited (120-day) sunset

[1] On August 9, 2007, the Department revoked the antidumping duty order on steel concrete reinforcing bars with respect to the Republic of Korea. *See Steel Concrete Reinforcing Bars From South Korea: Revocation of Antidumping Duty Order,* 72 FR 44830 (August 9, 2007).

reviews of the antidumping duty orders for Belarus, Indonesia, Latvia, Moldova, Poland, the PRC, and Ukraine.

Scope of the Orders

The product covered by the orders is all steel concrete reinforcing bars sold in straight lengths, currently classifiable in the Harmonized Tariff Schedule of the United States (''HTSUS'') under item numbers 7214.20.00, 7228.30.8050, 7222.11.0050, 7222.30.0000, 7228.60.6000, 7228.20.1000, or any other tariff item number. Specifically excluded are plain rounds (*i.e.,* non deformed or smooth bars) and rebar that has been further processed through bending or coating.

Although the HTSUS item numbers are provided for convenience and customs purposes, the written description of the scope of the orders remains dispositive.

Analysis of Comments Received

All issues raised in these reviews are addressed in the Issues and Decision Memorandum (''Decision Memorandum'') from Christian Marsh, Deputy Assistant Secretary for Antidumping and Countervailing Duty Operations, to Paul Piquado, Assistant Secretary for Import Administration, dated November 1, 2012, which is hereby adopted by this notice. The issues discussed in the Decision Memorandum include the likelihood of continuation or recurrence of dumping and the magnitude of the margins likely to prevail if the orders were revoked. Parties can find a complete discussion of all issues raised in these reviews and the corresponding recommendations in this public memorandum, which is on file electronically via Import Administration's Antidumping and Countervailing Duty Centralized Electronic Service System (''IA ACCESS''). IA ACCESS is available to registered users at *http://iaaccess.trade.gov* and in the Central Records Unit in Room 7046 of the main Commerce building. In addition, a complete version of the Decision Memorandum can be accessed directly on the Internet at *http://ia.ita.doc.gov/ia/*. The signed Decision Memorandum and electronic versions of the Decision Memorandum are identical in content.

Final Results of Reviews

Pursuant to sections 752(c)(1) and (3) of the Act, we determine that revocation of the antidumping duty orders on steel concrete reinforcing bars from Belarus, Indonesia, Latvia, Moldova, Poland, the PRC and Ukraine would be likely to lead to continuation or recurrence of dumping at the following weighted-average percentage margins:

Manufacturers/exporters/producers	Weighted-average margin (percent)
Belarus	
Belarus-Wide Rate	114.53
Indonesia	
PT Gunung Gahapi Sakti	71.01
PT Bhirma Steel	71.01
Krakatau Wajatama	71.01
PT Jakarta Steel Perdana Industri	71.01
PT Hanil Jaya Metal Works	71.01
PT Pulogadung Steel	71.01
PT Jakarta Cakra Tunggal	71.01
PT The Master Steel Manufacturing Co.	71.01
All Others Rate	60.46
Latvia	
Joint Stock Company Liepajas Metalurgs	16.99
All Others Rate	16.99
Moldova	
Moldova-Wide Rate	232.86
Poland	
Stalexport	52.07
All Others Rate	47.13
PRC	
Laiwu Steel Group	133.00
PRC-Wide Rate	133.00
Ukraine	
All Others Rate	41.69

This notice also serves as the only reminder to parties subject to administrative protective order (''APO'') of their responsibility concerning the return or destruction of proprietary information disclosed under APO in accordance with 19 CFR 351.305. Timely notification of the return or destruction of APO materials or conversion to judicial protective orders is hereby requested. Failure to comply with the regulations and terms of an APO is a violation which is subject to sanction.

We are issuing and publishing the final results and notice in accordance with sections 751(c), 752(c), and 777(i)(1) of the Act.

Dated: November 1, 2012.

Paul Piquado,

Assistant Secretary for Import Administration.

[FR Doc. 2012–28480 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–DS–P

DEPARTMENT OF COMMERCE

International Trade Administration

Application(s) for Duty-Free Entry of Scientific Instruments

Pursuant to Section 6(c) of the Educational, Scientific and Cultural Materials Importation Act of 1966 (Pub. L. 89–651, as amended by Pub. L. 106–36; 80 Stat. 897; 15 CFR part 301), we invite comments on the question of whether instruments of equivalent scientific value, for the purposes for which the instruments shown below are intended to be used, are being manufactured in the United States.

Comments must comply with 15 CFR 301.5(a)(3) and (4) of the regulations and be postmarked on or before December 13, 2012. Address written comments to Statutory Import Programs Staff, Room 3720, U.S. Department of Commerce, Washington, DC 20230. Applications may be examined between 8:30 a.m. and 5:00 p.m. at the U.S. Department of Commerce in Room 3720.

Docket Number: 12–048. *Applicant:* Howard Hughes Medical Institute, 4000 Jones Bridge Rd., Chevy Chase, MD 20815. *Instrument:* Micro-litre and nanolitre dispensing system. *Manufacturer:* TTP Labtech Ltd, United Kingdom. *Intended Use:* The instrument will be used to obtain crystals of biological macromolecules and complexes such as ribonucleic acid, proteins, and ribosomes to enable the determination of their three-dimensional atomic resolution structures. The unique features of this instrument which are required for the experiments are that it has a disposable tip system, its speed of operation, and its ability to deliver the small drops required to perform the experiments. *Justification for Duty-Free Entry:* There are no instruments of the same general category manufactured in the United States. *Application accepted by Commissioner of Customs:* October 23, 2012.

Docket Number: 12–049. *Applicant:* Howard Hughes Medical Institute, 4000 Jones Bridge Rd., Chevy Chase, MD 20815. *Instrument:* Micro-litre and nanolitre dispensing system. *Manufacturer:* TTP Labtech Ltd, United Kingdom. *Intended Use:* The instrument will be used to obtain crystals of biological macromolecules and complexes such as ribonucleic acid, proteins, and ribosomes to enable the determination of three-dimensional atomic resolution structures. The unique features of this instrument which are required for the experiments are that it has a disposable tip system, its speed of operation, and its ability to deliver the small drops required to perform the experiments. *Justification for Duty-Free Entry:* There are no instruments of the same general category manufactured in the United States. *Application accepted by Commissioner of Customs:* October 18, 2012.

Docket Number: 12–050. *Applicant:* North Carolina State University, Campus Box 7212, Raleigh, NC 27695. *Instrument:* Twin-screw Microcompounder. *Manufacturer:* DSM, Netherlands. *Intended Use:* The instrument will be used to study biomaterials such as starches, lignin, and proteins, and compare them with styrenics and petroleum based materials. The behavior of these materials before, during, and after physical or chemical modification, in excess or limited water, without shear or at high shear, as well as their hydration, plasiticization or blending with other oligomers will be investigated. Moreover, foams will be generated by the use of blending a suitable blowing agent and/or the carbonization of the materials to determine their density, foam structure and tensile and compression properties. The goal of this project will be to identify suitable technologies for producing moldable biomass based materials for applications presently occupied by conventional plastics. The core of this research will use rheology, spectroscopies and thermal techniques to follow macromolecular structures and functions on the biopolymers after applying the extruder. The unique features of this instrument are its recirculation loop and its ability to connect to a fiber spinner. *Justification for Duty-Free Entry:* There are no instruments of the same general category manufactured in the United States. *Application accepted by Commissioner of Customs:* October 22, 2012.

Docket Number: 12–051. *Applicant:* University of Central Florida, 4000 Central Florida Blvd., Orlando, FL 32816. *Instrument:* Near Ambient Pressure Scanning Probe Microscope. *Manufacturer:* SPECS Surface Nano Analysis, GmbH, Germany. *Intended Use:* The instrument will be used to determine the relationships between nanoparticle size, shape and chemical state and their catalytic activity in various chemical reactions, by investigating solid cataltically-active materials such as transition metals and examining their chemical states and chemical reactivity before and after applying a specified pressure and temperature inside a vacuum chamber inside the instrument. The unique features of this instrument include its small volume (0.045 L) reaction cell in which the sample and STM scanner are placed, which can maintain a pressure of up to 100 mbar while the surrounding large volume (>100 L) Ultra-High Vacuum (UHV) chamber maintains a pressure lower than 10^{-6} mbar, allowing the sample to be held at a controlled pressure ranging from UHV up to 100 mbar while measurements are recorded, and can be easily integrated into a system of other UHV measurement instruments to transfer the sample to other measurement chambers. In addition to pressure control, another unique feature of the instrument is its ability to control the temperature from room temperature to 300 degrees Celsius in a gaseous environment (up to 10 mbar). *Justification for Duty-Free Entry:* There are no instruments of the same general category manufactured in the United States. *Application accepted by Commissioner of Customs:* October 25, 2012.

Dated: November 14, 2012.

Gregory W. Campbell,

Director of Subsidies Enforcement, Import Administration.

[FR Doc. 2012–28523 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–DS–P

DEPARTMENT OF COMMERCE

International Trade Administration

[A–821–809]

Initialed Draft Revision to the Agreement Suspending the Antidumping Investigation on Certain Hot-Rolled Flat-Rolled Carbon Quality Steel Products From the Russian Federation; Request for Comment

AGENCY: Import Administration, International Trade Administration, Department of Commerce.

SUMMARY: The Department of Commerce (''the Department'') and the Russian Federation's Ministry of Economic Development (''MED'') have initialed a draft revision to the Agreement Suspending the Antidumping Investigation on Certain Hot-Rolled Flat-Rolled Carbon Quality Steel Products (''Suspension Agreement''). The proposed revision will update the reference prices provided under the Suspension Agreement applicable to October 1, 2012 through December 31, 2012, to bring them into alignment with current U.S. prices. The Department is now inviting interested parties to comment on the text of the proposed revision.

DATES: Comments must be submitted by no later than November 23, 2012.

FOR FURTHER INFORMATION CONTACT: Sally C. Gannon at (202) 482–0162 or Anne D'Alauro (202) 482–4830, Import Administration, International Trade Administration, U.S. Department of Commerce, 14th Street & Constitution Avenue NW., Washington, DC 20230.

Background

On July 12, 1999, the Department and the Ministry of Trade (''MOT'') of the Russian Federation signed an agreement under section 734*(l)* of the Tariff Act of 1930, as amended (''the Act''), suspending the antidumping duty (''AD'') investigation on hot-rolled flat-rolled carbon-quality steel products (''hot-rolled steel'') from the Russian Federation. *See Suspension of Antidumping Duty Investigation: Hot-Rolled Flat-Rolled Carbon-Quality Steel Products From the Russian Federation,* 64 FR 38642 (July 19, 1999). Upon the request of the petitioners, the investigation was continued and the Department made an affirmative final determination of sales at less than fair value. *See Notice of Final Determination of Sales at Less Than Fair Value: Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from the Russian Federation,* 64 FR 38626 (July 19, 1999). Likewise, the International Trade Commission (''ITC'') continued its investigation and made an affirmative determination of material injury to an industry in the United States. *See Certain Hot-Rolled Steel Products from Brazil and Russia,* 64 FR 46951 (August 27, 1999). MOT was the predecessor to MED, which is now the relevant agency representing the Government of the Russian Federation for purposes of this Suspension Agreement.

On August 1, 2011, Nucor Corporation (''Nucor'') submitted a request for an administrative review pursuant to *Antidumping or Countervailing Duty Order, Finding, or Suspended Investigation; Opportunity to Request Administrative Review,* 76 FR 38609 (July 1, 2011). On August 26, 2011, the Department initiated an administrative review of the Suspension Agreement. *See Initiation of Antidumping and Countervailing Duty Administrative Reviews and Requests for Revocation in Part,* 76 FR 53404 (August, 26, 2011). On April 2, 2012, the Department postponed the preliminary results of this review until May 24, 2012. *See Notice of Extension of Time Limit for the Preliminary Results of Administrative Review of the Suspension Agreement on Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from the Russian Federation,* 77 FR 19619 (April 2, 2012).

On June 1, 2012, the preliminary results of the administrative review were published. *See Notice of Preliminary Results of the Administrative Review of the Suspension Agreement on Hot-Rolled*

Flat-Rolled Carbon-Quality Steel Products from the Russian Federation, 77 FR 32513 (June 1, 2012) (''*Preliminary Results''*). Section 751(a)(1)(C) of the Act specifies that, in an administrative review of a suspension agreement, the Department shall ''review the current status of, and compliance with, any agreement by reason of which an investigation was suspended.'' In this case, the Department and MOT (the predecessor to MED) of the Russian Federation signed the Suspension Agreement, which suspended the underlying AD investigation on July 12, 1999. Because the Department determined that the Russian Federation was a non-market economy at that time, the Suspension Agreement was entered into under section 734(*l*) of the Act, which applies to non-market-economy countries.[1] This section provides that the Department may suspend an investigation upon acceptance of an agreement with a non-market-economy country to restrict the volume of imports into the United States, if the Department determines that the agreement: is in the public interest, effective monitoring is possible, and the agreement ''will prevent the suppression or undercutting of price levels of domestic products by imports of the merchandise under investigation.'' *See* Section 734(*l*)(1) of the Act. For this purpose, the Suspension Agreement's terms established annual quota limits and a reference price mechanism to provide minimum prices for sales of Russian hot-rolled steel imports into the U.S. market. The reference price mechanism relies on quarterly adjustments, based on the average unit prices of fairly-traded imports as reported by the U.S. Bureau of the Census, as specified under Section III.E of the Agreement.

In evaluating the information on the record of the administrative review with respect to the current status of, and compliance with, the Suspension Agreement, the Department preliminarily determined that the Suspension Agreement's reference price mechanism, in its current form, was no longer preventing price undercutting by Russian imports of hot-rolled steel into the U.S. market, and, as a result, also preliminarily determined that the Suspension Agreement was no longer fulfilling its statutory requirement. The record evidence indicated that the adjustments made quarterly within the Suspension Agreement's current reference price mechanism have failed to keep pace with changes in U.S. prices. Further, once the reference prices became too low relative to U.S. market prices, the subsequent quarterly adjustments were no longer effective in providing new reference prices that were reflective of U.S. market prices for hot-rolled steel. In addition, the record evidence and the Department's analysis indicated that the failing reference price mechanism, as described, has led to the undercutting of domestic hot-rolled steel price levels by Russian hot-rolled steel imports during the period of review (''POR''). In its *Preliminary Results,* the Department separately determined that the Government of the Russian Federation did not violate the terms of the Suspension Agreement during the POR.

In the *Preliminary Results,* the Department stated that, in February 2012, it had entered into consultations with MED to discuss the issues raised in the administrative review and the ineffective reference price mechanism and that it intended to move forward with additional consultations with MED during this administrative review, as mutually agreed, in an attempt to resolve these concerns and to bring the Suspension Agreement back into alignment with its statutory requirement to prevent the undercutting of domestic price levels for hot-rolled steel. *See Preliminary Results,* at 32516. Since the preliminary results were issued, MED and the Department negotiated and initialed a revision to the Suspension Agreement to address the concerns with the ineffective reference price mechanism in the current agreement.

Initialed Draft Revision

On November 14, 2012, and November 15, 2012, respectively, the Department and MED initialed a draft revision to the Suspension Agreement. The proposed revision updates the reference prices provided within the Suspension Agreement for the October 1, 2012 through December 31, 2012, period in order to bring them into alignment with U.S. market prices and also modifies the existing mechanism for calculating percentage changes going forward. The text of the draft revision follows in Annex 1 to this notice.

On November 15, 2012, the Department released the initialed draft revision and a request for comments to interested parties. *See* Memorandum to All Interested Parties from Sally C. Gannon re ''Draft Revision to the Agreement Suspending the Antidumping Investigation on Certain Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from the Russian Federation'' (November 15, 2012) (''Request for Comments''). The Department noted in the Request for Comments that, although the draft revision and request for comments would be published in the **Federal Register**, the Request for Comments constituted the official notice to all known interested parties of this opportunity and that comments were due to be submitted to the Department by close-of-business on November 23, 2012. As also noted in the Request for Comments, any comments submitted to the Department must be filed both on the Suspension Agreement and Administrative Review segments of this proceeding.

With this additional notice, the Department reiterates that interested parties are invited to submit comments to the Department on the draft revision to the Suspension Agreement no later than November 23, 2012. Comments from interested parties must be filed electronically using Import Administration's Antidumping and Countervailing Duty Centralized Electronic Service System (''IA ACCESS'') and must be received by IA ACCESS by 5 p.m. Eastern Time by November 23, 2012. All information provided to the Department will be subject to release under Administrative Protective Order (''APO'') and should be submitted in accordance with 19 CFR 351.103 and 19 CFR 351.105 of the Department's regulations, including the service of copies of comments on interested parties to this proceeding. The APO and public service lists in this proceeding can be found at the following Web site address: *http://ia.ita.doc.gov/apo/apo-svc-lists.html.* The Department will consider all comments received by the close of the comment period. Any finalized revision to the Agreement must be signed by the Department and MED by November 30, 2012.

Dated: November 16, 2012.

Ronald K. Lorentzen,

Deputy Assistant Secretary for Import Administration.

Annex 1

Draft Dated November 14, 2012

Revision to the Antidumping Suspension Agreement On Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from the Russian Federation

The Agreement Suspending the Antidumping Investigation on Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from the Russian Federation,

[1] In a memorandum dated June 6, 2002, based on the evidence of Russian economic reforms to that date, the Department revoked Russia's status as a non-market-economy under section 771(18)(B) of the Act, with such revocation effective as of April 1, 2002.

signed on July 12, 1999, is revised as set forth below.

The Preamble is revised by adding the following paragraph to the end:

The Ministry of Economic Development of the Russian Federation (''MED'') and the Department of Commerce (''DOC'') acknowledge that, for purposes of the Agreement Suspending the Antidumping Investigation on Hot-Rolled Flat-Rolled Carbon-Quality Steel Products from the Russian Federation, as revised (''Agreement''), the successor in interest to MOT is MED. All references to MOT in this Agreement shall be understood to indicate MED.

Section III.C is revised, as follows:

III.C. The Reference Prices for the fourth quarter of the 2012 Export Limit Period, corresponding to October 1, 2012 through December 31, 2012, shall be updated by using the following procedure:

1. To update the Reference Price for Group One products, DOC shall average FOB U.S. mill (East of the Mississippi) prices for hot-rolled band (''HRB'') from the public source *SteelBenchmarker* for the two months, September and October 2012, resulting in $684 per metric ton.[2]

2. DOC shall decrease the two-month average price resulting from Section III.C.1 by two percent to account for the percentage difference between the average *SteelBenchmarker* price and the average unit value of fairly-traded imports for the July 2010 through July 2012 period, resulting in $670.32 per metric ton.

3. DOC shall adjust the price resulting from Section III.C.2 for freight and transportation expenses, using the following methodology. DOC shall calculate the freight and transportation expenses using publicly-available import statistics from the U.S. Bureau of the Census (from the International Trade Commission's Dataweb) for January–June 2012. Based on the difference between the CIF values of Russian hot-rolled steel imports relative to the Customs values for the same entries during this period, DOC shall calculate the percentage ratio to be used as a deduction for freight and transportation expenses. DOC shall then subtract the resulting percentage amount of 10.23 percent from the price calculated in Step 2 above to determine the updated Reference Price of $601.75 per metric ton for Group One products for the October 1, 2012, through December 31, 2012, quarterly period.

4. DOC shall calculate the Reference Prices for products in Groups Two and Three for the October 1, 2012, through December 31, 2012, quarterly period based on a 10 and 28 percent increase, respectively, to the Reference Price calculated for Group One, as set forth above.[3]

5. The resulting updated Reference Prices for the October 1, 2012 through December 31, 2012, quarterly period are as follows:

Group	Q4 2012 Reference price
One—Commercial and Structural Quality	
A36, A1011–CS; A1011–SS–Grades 30, 33, 36, 40; A1018–SS–Grades 30, 33, 36, 40; API 5L Grades A & B	$601.75
Two—HSLA & HSLA–F Quality	
Grades: A572, A1011–HSLAS; A1018–HSLAS, A1011–HSLAS–F; A1018–HSLAS–F; API 5L Gr. X42, X46, X52, X56, X60; API 5CT Grades J55 and K55	$661.92
Three—High Grade Coils and Sheets for Pipes and Casings	
API 5L Gr. X65, X70, and X80	$770.24

Section III.E is replaced with:

III.E. Thirty days before the start of each quarter of each Export Limit Period (beginning with the first quarter, or January 1, 2013, through March 31, 2013), DOC shall calculate the new quarterly Reference Prices, based on the percentage increase or decrease in the weighted-average unit import values for hot-rolled steel from all countries not subject to antidumping duty orders or investigations over the most recent three months for which data is available, compared to the three preceding months. The source of the unit import values will be publicly-available import statistics from the U.S. Bureau of the Census (International Trade Commission's Dataweb). DOC will provide MED with the worksheets supporting its calculation of the quarterly Reference Prices at the time it provides the Reference Prices to MED. For the first calculation only, *i.e.,* for the quarterly reference prices effective for January 1, 2013, through March 31, 2013, the Department shall delay issuance of the reference prices to MED until the U.S. Bureau of the Census releases data for October 2012 which shall be incorporated into this calculation.

To the extent that there are any inconsistencies between this revision and the Agreement, the provisions of the Agreement are superseded, and the provisions of this revision shall govern. All other provisions of the Agreement and their applicability continue with full force.

Ronald K Lorentzen,
Deputy Assistant Secretary for Import Administration.

For the United States Department of Commerce.

Initialed by Ronald K Lorentzen on 11/14/12.

Date:

Alexey Likhachev,
Deputy Minister.

For the Ministry of Economic Development of the Russian Federation.

Initialed by Alexey Likhachev on 11/15/12.

Date:

[FR Doc. 2012–28452 Filed 11–20–12; 11:15 am]

BILLING CODE 3510–DS–P

[2] Group One corresponds to the original grades in the reference price calculation under Section III.C of the Agreement, including modifications to that grade grouping made pursuant to administrative proceedings conducted over the course of the administration of the Agreement. *See http://ia.ita.doc.gov/reference-price/refprice-a821809.html* for the October 1, 2004–December 31, 2004 quarter.

[3] Groups Two (including modifications) and Three were added to the reference price calculation, in accordance with Section III.D of the Agreement, and as a result of administrative proceedings conducted over the course of the administration of the Agreement. *See http://ia.ita.doc.gov/reference-price/refprice-a821809.html* for the October 1, 2005–December 31, 2005 quarter.

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

RIN 0648–XC275

Notice of Availability of a Draft Environmental Impact Statement/ Program Timberland Environmental Impact Report Associated With an Application for an Incidental Take Permit for Mendocino Redwood Company's Habitat Conservation Plan and Natural Community Conservation Plan, Mendocino County, CA

AGENCY: National Marine Fisheries Service (NMFS), National Oceanic and Atmospheric Administration (NOAA), Commerce; Fish and Wildlife Service (USFWS), Interior.

ACTION: Notice of availability and receipt of application.

SUMMARY: This notice announces the availability of the draft Mendocino Redwood Company Habitat Conservation Plan and Natural Community Conservation Plan (Proposed Plan), draft Implementing Agreement, and draft Environmental Impact Statement/Program Timberland Environmental Impact Report (EIS/PTEIR) for public review and comment. In response to receipt of an application from The Mendocino Redwood Company (MRC; Applicant), the National Marine Fisheries Service and the U.S. Fish and Wildlife Service (Services) are considering the proposed action of issuing an 80-year incidental take permit for nine federally listed species and two currently unlisted species. The proposed permit would authorize take of individual members of species listed under section 10 of the Endangered Species Act (ESA) of 1973 (16 U.S.C. 1531–1544, 87 Stat. 884), as amended. The permit is needed because take of species could occur during timber harvest, forest management, and related activities within the 213,244-acre Proposed Plan Area in western Mendocino County, CA.

DATES: Two public meetings will be held: Tuesday, December 11, 2012, from 7 p.m. to 9 p.m. (Ukiah, California), and Wednesday, December 12, 2012, from 7 p.m. to 9 p.m. (Fort Bragg, California). Written comments should be received on or before February 21, 2013.

ADDRESSES: The public meetings will be held at: Redwood Empire Fair Fine Arts Building, 1055 North State Street, Ukiah, CA 95482; and at C.V. Starr Center, 300 S. Lincoln St., Fort Bragg, CA 95437. Send comments by mail or facsimile to: (1) Eric Shott, National Marine Fisheries Service, 777 Sonoma Avenue, Room 325, Santa Rosa, CA 95404, facsimile (707) 578–3435; or (2) John Hunter, Fish and Wildlife Biologist, Fish and Wildlife Service, Arcata Fish and Wildlife Office, 1655 Heindon Road, Arcata, California 95521, facsimile (707) 822–8411. Send comments by email to *mrc.hcpitp@noaa.gov*. Copies of all email comments will be routed to the U.S. Fish and Wildlife Service.

FOR FURTHER INFORMATION CONTACT: Eric Shott, National Marine Fisheries Service (see **ADDRESSES**, above, or at 707–575–6089), or John Hunter, U.S. Fish and Wildlife Service (see **ADDRESSES**, above, or at 707–822–7201).

SUPPLEMENTARY INFORMATION:

Availability of Documents

Copies of the draft Proposed Plan, draft Implementing Agreement and draft EIS/PTEIR are available for public review during regular business hours from 9 a.m. to 5 p.m. at the National Marine Fisheries Service (see **FOR FURTHER INFORMATION CONTACT**); the U.S. Fish and Wildlife Service, Arcata Fish and Wildlife Office (see **FOR FURTHER INFORMATION CONTACT**); Mendocino County Library, Fort Bragg Branch Library, 499 Laurel Street, Fort Bragg, CA 95437; and Mendocino County Library, Main Branch Library, 105 North Main Street, Ukiah, CA 95482. Individuals wishing to obtain copies of the draft Proposed Plan, draft Implementing Agreement, and draft EIS/PTEIR should contact either of the Services by telephone (see **FOR FURTHER INFORMATION CONTACT**) or by letter (see **ADDRESSES**). These documents also are available on the NMFS' Southwest Region Web site at *http://swr.nmfs.noaa.gov/nepa.htm* and the Arcata Fish and Wildlife Office Web site at *http://www.fws.gov/arcata/*.

Public Involvement

The initial Notice of Intent to prepare an draft EIS/EIR for this project was published in the **Federal Register** on June 6, 2002 (67 FR 38932), and public scoping meetings were held on June 25, June 26, and June 27, 2002.

Background Information

Section 9 of the Endangered Species Act of 1973, as amended (ESA; 16 U.S.C. 1531 *et seq.*), and Federal regulations prohibit the take of fish and wildlife species listed as endangered or threatened by either of the Services (16 U.S.C. 1538). The ESA defines the term ''take'' as to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any such conduct (16 U.S.C. 1532). Harm includes significant habitat modification or degradation that actually kills or injures listed wildlife by significantly impairing essential behavioral patterns, including breeding, feeding, and sheltering [50 CFR 17.3(c)]. Pursuant to section 10(a)(1)(B) of the ESA, the Services may issue permits to authorize incidental take of listed fish or wildlife; i.e., take that is incidental to, and not the purpose of, otherwise lawful activity. Regulations governing incidental take permits for threatened and endangered species are found in 50 CFR 17.32 and 17.22, respectively.

Although take of listed plant species is not prohibited under the ESA, and therefore cannot be authorized under an incidental take permit, plant species may be included on a permit in recognition of the conservation benefits provided to them under a Habitat Conservation Plan (HCP). All species included on an incidental take permit would receive assurances under the Services ''No Surprises'' regulation 50 CFR 17.22(b)(5) and 17.32(b)(5).

The application for an incidental take permit was prepared and submitted by Mendocino Redwood Company (Applicant). The Applicant has prepared an HCP to satisfy the application requirements for a section 10(a)(1)(B) permit under the ESA, a section 2835 permit under the California Natural Community Conservation Planning Act of 2002 (NCCPA), and for compliance with California Code of Regulations 14 §§ 916.9(w)(3)–(4), 919.9(d), 919.11, and 1092.21(d) under the California Forest Practice Rules (FPRs). Thus, the Proposed Plan constitutes an HCP pursuant to the ESA, and a Natural Community Conservation Plan pursuant to the California NCCPA.

The Applicant seeks an 80-year incidental take permit for covered activities within a proposed 213,244 acre Plan Area located entirely in Mendocino County, California. The Proposed Plan Area includes commercial timberlands owned by Mendocino Redwood Company that are located west of U.S. Route 101, and includes portions of the Albion, Big, Garcia, South Fork Eel, Navarro, Noyo, and upper Russian River river watersheds, as well as portions of Cottaneva, Howard, Hardy, Juan, Alder, Elk, Greenwood, and Mallo Pass creek watersheds.

The Applicant has requested permits that will authorize take of nine animals listed as threatened or endangered under the ESA and two species that are

not currently listed under the Act. The following five listed species are proposed for coverage under the NMFS permit: Coho salmon (Southern Oregon/Northern California Coast Evolutionary Significant Unit [ESU]) (*Oncorhynchus kisutch*); coho salmon (Central California Coast ESU) (*O. kisutch*); Chinook salmon (California Coastal ESU) (*O. tshawytscha*); steelhead (Northern California Distinct Population Segment [DPS]) (*O. mykiss*); and steelhead (Central California Coast DPS) (*O. mykiss*). The following four listed species are proposed for coverage under the USFWS permit: California red-legged frog (*Rana draytonii*); northern spotted owl (*Strix occidentalis caurina*); marbled murrelet (*Brachyramphus marmoratus*); and Point Arena mountain beaver (*Aplodontia rufa nigra*). The proposed USFWS permit would also cover two animal species that are not currently listed under the ESA: Northern red-legged frog (*R. aurora*); and coastal tailed frog (*Ascaphus truei*).

If the Proposed Plan is approved and the permits are issued, take authorization of covered listed species would be effective at the time of permit issuance. Take of the currently nonlisted covered species would be authorized concurrent with the species' listing under the ESA, should they be listed during the permit period. The Proposed Plan is intended to be a comprehensive document, providing for species conservation and habitat planning, while allowing the Applicant to better manage ongoing forestry operations. The Proposed Plan also is intended to provide a coordinated process for permitting and mitigating the take of covered species as an alternative to the current project-by-project approach.

In order to comply with the requirements of the ESA, California Endangered Species Act, the California Natural Community Conservation Act (NCCPA), and the California Forest Practice Rules (FPRs), the Proposed Plan addresses a number of required elements, including: Species and habitat goals and objectives; evaluation of the effects of covered activities on covered species, including indirect and cumulative effects; a conservation strategy; a monitoring and adaptive management program; descriptions of changed circumstances and remedial measures; identification of funding sources; and an assessment of alternatives to take of listed species.

Proposed covered activities within the Proposed Plan are all related to forestry operations and include timber felling, transportation, road and landing construction, maintenance, development and operation of rock pits and water drafting sites, site preparation, tree planting, thinning and other silvicultural activities, prescribed burning, habitat restoration and improvement, and monitoring and research in the Proposed Plan Area.

The Proposed Plan's conservation strategy was designed to maintain or improve habitat conditions for listed and nonlisted covered species. The Proposed Plan includes minimization measures, such as disturbance buffers and sediment control measures that would avoid or minimize take of covered species from ongoing operations. The Proposed Plan also includes mitigation for take of covered species, including maintenance and enhancement of riparian areas, wetland areas, hardwood stands, and late successional coniferous forest stands. A 1,237-acre Lower Alder Creek Management area also would be established at the outset of the Proposed Plan. The only forest management that would be permitted within this management area would enhance habitat conditions for the marbled murrelet in order to offset any loss of any occupied marbled murrelet habitat that occurs elsewhere in the proposed Plan Area during the permit term. Habitat protected under the Proposed Plan would be monitored, and annual reports documenting the status of the species and compliance with the Proposed Plan would be submitted to the Services.

National Environmental Policy Act Compliance

Proposed permit issuance triggers the need for compliance with the National Environmental Policy Act (NEPA) and the California Environmental Quality Act (CEQA). Accordingly, a joint NEPA/CEQA document has been prepared. As co-lead Federal agencies, the Services have responsibility for compliance under NEPA and are providing notice of the availability of the draft EIS/PTEIR, which evaluates the impacts of proposed issuance of the permit and implementation of the Proposed Plan, as well as a reasonable range of alternatives.

The draft EIS/PTEIR analyzes five alternatives, including the Proposed Plan, described above. The five alternatives being considered by the Services are the following:

Proposed Plan Alternative: Under this alternative, the Proposed Plan as described above would be adopted. The Applicant would receive an 80-year incidental take permit for 11 species under Section 10(a)(1)(B) of the ESA and Section 2835 of the NCCPA.

No Action Alternative: Under this alternative, the Proposed Plan would not be adopted, and permits pursuant to Section 10(a)(1)(B) of the ESA and Section 2835 of the NCCPA would not be issued by the Services and California Department of Fish and Game, respectively. The Applicant would operate under existing California Forest Practice Rules and seek compliance with Federal and California ESAs on a case-by-case basis.

Alternative A: Under this enhanced HCP alternative, the permit term and species covered would be the same as under the Proposed Plan, but there would be additional measures to enhance conservation of key aquatic and terrestrial habitats. Additional measures would include some larger protective streamside buffers and higher tree retention standards.

Alternative B: Under this terrestrial reserves alternative, the permit term would be the same as under the Proposed Plan, but only two terrestrial species (northern spotted owl and marbled murrelet) would be covered, and the minimization and mitigation for the take of covered species would be largely achieved via a system of species-specific no-harvest reserves. Unlike the other alternatives, non-reserve lands would be managed in a manner that emphasizes even-aged management of timber stands. Under this alternative, the California permit issued would not be under the NCCPA, but rather under Section 2080.1 or 2081 of the California Fish and Game Code.

Alternative C: Under this alternative, the Federal and California permits would be issued for only 40 years, during which time lands would be managed as under the Proposed Plan. After 40 years, land would be managed as under the No Action Alternative. Point Arena mountain beaver, northern red-legged frog, and coastal tailed frog would not be included as covered species on the take permits. Under this alternative, the California permit issued would not be under the NCCPA, but rather under Section 2080.1 or 2081 of the California Fish and Game Code.

Public Comments

The Services invite the public to comment on the draft Proposed Plan, draft implementing agreement, and draft EIS/PTEIR during a 90-day public comment period beginning on the date of this notice. All comments received, including names and addresses, will become part of the administrative record and may be made available to the public.

Comments submitted in an email will be accepted provided they do not exceed 6 megabytes in size and are virus free. Hypertext email links to other Web pages or publications shall not be deemed the equivalent of written comment.

The Services will evaluate the applications, associated documents, and comments submitted to them to prepare a final EIS/PTEIR. A permit decision will be made no sooner than 30 days after the publication of the final EIS/PTEIR.

This notice is provided pursuant to section 10(a) of the ESA and Service regulations for implementing NEPA, as amended (40 CFR 1506.6). We provide this notice in order to allow the public, agencies, or other organizations to review and comment on these documents.

Dated: November 19, 2012.

Alexander Pitts,

Deputy Regional Director, Pacific Southwest Region, USFWS.

Dated: November 19, 2012.

Angela Somma,

Chief, Endangered Species Division, Office of Protected Resources, National Marine Fisheries Service.

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BILLING CODE 3510–22–P; 4310–55–P

DEPARTMENT OF THE INTERIOR

National Oceanic and Atmospheric Administration

Fish and Wildlife Service 0648–XB088

Environmental Impact Statement; Availability: Authorization for Incidental Take and Implementation of the Stanford University Habitat Conservation Plan

AGENCY: National Marine Fisheries Service (NMFS), National Oceanic and Atmospheric Administration (NOAA), Commerce; Fish and Wildlife Service (USFWS), Interior.

ACTION: Notice of availability of final environmental impact statement, multi-species habitat conservation plan, and implementing agreement.

SUMMARY: This notice announces the availability for public review of the Final Environmental Impact Statement (FEIS) for Authorization for Incidental Take and Implementation of the Stanford University Habitat Conservation Plan; the Stanford University Habitat Conservation Plan (HCP); and the Implementing Agreement (IA). Pursuant to the National Environmental Policy Act (NEPA), this notice advises the public that we, the USFWS and NMFS (collectively the Services), have received applications for 50-year Incidental Take Permits (ITPs) pursuant to the Endangered Species Act of 1973, as amended (ESA) from the Board of Trustees of Leland Stanford Junior University (Stanford; Applicant). The Applicant seeks the ITPs to authorize incidental take of the covered species that could occur as a result of the proposed covered activities.

DATES: Written comments on the FEIS, HCP, and IA, must be received by 5 p.m. Pacific Time on December 24, 2012.

ADDRESSES: Comments concerning the FEIS, HCP, and IA can be sent by U.S. Mail, facsimile, or email to (1) Mike Thomas, Division Chief, Conservation Planning Division, Fish and Wildlife Service, Sacramento Fish and Wildlife Office, 2800 Cottage Way, Room W–2605, Sacramento, CA 95825, facsimile (916) 414–6713; (2) *FW8Stanford_HCP@fws.gov*. Include the document identifier: Stanford HCP; (3) Gary Stern, San Francisco Bay Branch Supervisor, National Marine Fisheries Service, North Central California Office, 777 Sonoma Avenue, Room 325, Santa Rosa, CA 95404, facsimile (707) 578–3435; or (4) *Stanford.HCP@noaa.gov*. Include the document identifier: Stanford HCP.

FOR FURTHER INFORMATION CONTACT: Gary Stern, San Francisco Bay Branch Supervisor, NMFS, telephone (707) 575–6060, Sheila Larsen, Senior Staff Biologist, USFWS; telephone (916) 414–6685, or Mike Thomas, Chief, Conservation Planning Division, USFWS; telephone (916) 414–6600.

SUPPLEMENTARY INFORMATION: This notice is provided pursuant to the ESA and regulations for implementing NEPA, as amended (40 CFR 1506.6), to inform the public that the FEIS and HCP, and the Services' responses to public comments are available for review, and that the Services have filed a FEIS with the U.S. Environmental Protection Agency (EPA) for public notice. The decision on whether to issue ITPs to Stanford will be made by the Services no sooner than 30 days after the publication of the EPA's public notice. Copies of the FEIS, HCP and IA are available for public review during regular business hours from 9 a.m. to 5 p.m. at the USFWS, Sacramento Fish and Wildlife Office (see **ADDRESSES**), and the NMFS, North Central California Office (see **ADDRESSES**). Additionally, hard bound copies of the FEIS, HCP, and IA are available for viewing, or for partial or complete duplication, at the following locations:

1. Social Sciences Resource Center, Green Library, Room 121, Stanford, CA 94305.

2. Palo Alto Main Library, 1213 Newell Road, Palo Alto, CA 94303.

Individuals wishing to obtain copies of the FEIS, HCP, or IA should contact either of the Services by telephone (see **FOR FURTHER INFORMATION CONTACT**) or by letter (see **ADDRESSES**). These documents are also available electronically for review on the NMFS Southwest Region Web site at: *http://swr.nmfs.noaa.gov* or the USFWS, Sacramento Fish and Wildlife Office Web site at *http://www.fws.gov/sacramento/*.

Background

Section 9 of the Federal Endangered Species Act (ESA) of 1973, as amended, and Federal regulations prohibit the take of fish and wildlife species listed as endangered or threatened (16 U.S.C. 1538). The term ''take'' means to harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any such conduct (16 U.S.C. 1532(19)). Harm includes significant habitat modification or degradation that actually kills or injures listed wildlife by significantly impairing essential behavioral patterns, including breeding, feeding, and sheltering (50 CFR 17.3(c)). NMFS further defines harm as an act which actually kills or injures fish or wildlife, and expands the list of essential behavioral patterns that can be impaired by habitat modification or degradation to include breeding, spawning, rearing, migrating, feeding or sheltering (50 CFR 222.102). Pursuant to section 10(a)(1)(B) of the ESA, the Services may issue ITPs authorizing the take of listed species if, among other things, such taking is incidental to, and not the purpose of, otherwise lawful activities. Regulations governing ITPs for threatened and endangered species are found in 50 CFR 17.22, 17.32, and 222.307.

Each of the Services has received an application for an ITP for implementation of the HCP. The applications were prepared and submitted by The Board of Trustees of Leland Stanford Junior University. The Applicant has prepared the HCP to satisfy the application requirements for a section 10(a)(1)(B) permit under the ESA .

The Applicant seeks a 50-year incidental take permit for Covered Activities within a proposed 8,180-acre permit area located in southern San Mateo and northern Santa Clara counties. The permit area includes approximately 8,000 acres of Stanford's lands. Located on portions of the Santa

Cruz Mountains and at the base of the San Francisco Peninsula, Stanford University is within two main watersheds, Matadero/Deer Creek and San Francisquito Creek watersheds. The San Francisquito Creek watershed spans San Mateo and Santa Clara counties, and encompasses an area of approximately 45 square miles. This watershed includes San Francisquito, Los Trancos, Corte Madera, Bear, Dennis Martin, Sausal, and Alambique creeks, and portions of San Francisquito, Los Trancos, Corte Madera, and Bear creeks flow through Stanford lands. The Matadero/Deer Creek watershed is entirely within Santa Clara County, and portions of Matadero and Deer creeks flow through Stanford lands. In addition to significant riparian areas associated with the creeks, the permit area includes foothills, and most of the main campus that is located on an alluvial plain located between the foothills and San Francisco Bay.

The Applicant has requested permits that will authorize the take of four animal species, which are currently listed as threatened or endangered under the ESA, and one animal species that may become listed under the ESA. The Applicant has requested coverage from the USFWS for the California tiger salamander (*Ambystoma californiense*), California red-legged frog (*Rana draytonii*), and San Francisco garter snake (*Thamnophis sirtalis tetrataenia*), and from NMFS for the Central California Coast steelhead (*Oncorhynchus mykiss*). The Applicant has also requested coverage from the USFWS for the western pond turtle (*Clemmys marmorata*), which is not listed under the ESA at the current time. Collectively these species are referred to as ''Covered Species.''

If the proposed HCP is approved and the permits issued, take authorization of listed Covered Species would be effective at the time of permit issuance. Take of the currently non-listed Covered Species would be authorized concurrent with the species' listing under the ESA, should it be listed during the duration of the permit.

The proposed HCP is intended to be a comprehensive document, providing for species conservation and habitat planning, while allowing the Applicant to better manage ongoing operations and future growth. The proposed HCP also is intended to provide a coordinated process for permitting and mitigating the take of Covered Species as an alternative to a project-by-project approach.

The proposed HCP addresses a number of required elements, including: Species and biological goals and objectives; evaluation of the effects of Covered Activities on Covered Species, including indirect and cumulative effects; a conservation strategy; a monitoring and adaptive management program; descriptions of changed circumstances and remedial measures; identification of funding sources; and an assessment of alternatives to take of listed species.

The HCP divides the permit area into four ''zones.'' Zone 1 supports one or more of the Covered Species or provides critical resources for the species. Zone 2 areas are occasionally occupied by a Covered Species and provide some of the resources used by the species, or buffers between occupied habitat and urbanized areas. Zone 3 consists of generally undeveloped land that provides only limited and indirect benefit to the Covered Species. Zone 4 includes urbanized areas that do not support the covered species. The covered activities described in the HCP include the ongoing operation and maintenance of several existing University facilities, and a limited amount of future development. Ongoing operations and maintenance are divided into the following categories of activities: Water management; creek maintenance; academic activities; utility installation and maintenance; general infrastructure; recreation and athletics; grounds and vegetation; agricultural and equestrian leaseholds; and commercial and institutional leaseholds. Up to 180 acres of development in Zones 1, 2, and 3 are also covered by the HCP, but the HCP does not supersede any permitting or entitlement required by other regulations. The HCP does not cover ongoing operations and maintenance associated with Searsville Dam, Searsville Reservoir and other facilities directly related to Searsville Reservoir

Stanford's proposed conservation strategy in the HCP is designed to minimize and mitigate the impacts of Covered Activities, improve habitat conditions for listed Covered Species, and protect populations of the non-listed Covered Species. The HCP includes minimization measures that would avoid and minimize the take of Covered Species from ongoing operation and maintenance of most University facilities and future development. The HCP also includes mitigation for the loss of habitat, and proposes to conserve approximately 360 acres of riparian habitat with conservation easements within one year of issuance of the permits. Additional riparian habitat would be preserved as needed. A 315-acre ''California Tiger Salamander Reserve'' (Reserve) also would be established at the outset of the HCP. No development would be permitted within the Reserve for the term of the permits, and a portion of habitat within the 315-acre Reserve would be permanently protected to offset any loss of California tiger salamander habitat that occurs during the permit term. Habitat protected under the HCP would be managed and monitored, and annual reports documenting the status of the species and compliance with the HCP would be submitted to the Services. In addition to the minimization measures and mitigation for the loss of habitat, the HCP includes a number of potential habitat enhancements that Stanford may perform during the term of the permits. Other conservation activities include a California tiger salamander management plan that covers 95 acres, including Lagunita Reservoir and habitat around Lagunita Reservoir.

National Environmental Policy Act Compliance

Proposed permit issuance triggers the need for compliance with the NEPA. As co-lead agencies, the Services prepared a Draft EIS which evaluated the impacts of the proposed issuance of the permit and implementation of the HCP, as well as a reasonable range of alternatives. The Draft EIS and Draft HCP were circulated for public review and comment. The public review period was initiated with the publication of a Notice of Availability (NOA) in the **Federal Register** on April 12, 2010 (75 FR 18482). The official comment period began with publication of the NOA and initially was scheduled to end on July 12, 2010. At the request of the public, the Services published a notice in the **Federal Register** on July 15, 2010 (75 FR 41157) extending the public comment period an additional 45 days to August 30, 2010.

During the comment period, 30 comment letters were received from Federal and local agencies, environmental organizations, and the general public, including over 3000 form email messages. The primary issues raised in the comment letters and email messages were related to Searsville Dam and Reservoir. Many commenters requested Stanford revise the HCP and the Services prepare a supplemental DEIS for public review and comment. Comments received on the Draft EIS and Draft HCP and responses can be found in Volume II of the FEIS. Following the public comment period, in January 2011, Stanford revised the HCP to remove Covered Activities related to Searsville Dam, Reservoir, and Diversion. Accordingly, minimization measures for Searsville-related activities have also been

removed from the HCP. Volume I of the FEIS incorporates all changes to the text, tables, and figures that were completed following the public review and comment period.

The FEIS analyzes three alternatives including the issuance of ITPs and the implementation of the proposed HCP described above. The issuance of 50-year take permits and Applicant implementation of the proposed HCP is considered the Preferred Alternative. Two other alternatives being considered by the Services include the following:

Under the No Action Alternative, the Services would not issue incidental take permits for implementation of the HCP. As a result, the Applicant would likely seek individual incidental take authorization as needed for new projects and ongoing operations that would result in the take of federally listed species.

Under the California Tiger Salamander Only Alternative, Stanford would prepare a HCP only for the California tiger salamander, and obtain section 10 authorization only for the take of California tiger salamander. Future development and ongoing activities that would result in the take of other listed species would be permitted individually, as needed.

Public Comments

The Services invite the public to review the final HCP, final IA, and FEIS during a 30-day public waiting period [see **DATES** and **SUPPLEMENTARY INFORMATION**]. All comments and materials received, including names and addresses, will become part of the administration record and may be released to the public. Our practice is to make comments, including names, home addresses, home telephone numbers, and email addresses of respondents available for public review. Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment—including your personal identifying information—may be made publicly available at any time. While you may ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so. This notice is provided pursuant to section 10(c) of the ESA and regulations for implementing NEPA, as amended (40 CFR 1506.6). We provide this notice in order to allow the public, agencies, or other organizations to review and comment on these documents.

Next Steps

The Services will evaluate the applications, associated documents, and public comments submitted to them to prepare their respective Records of Decision (RODs). Any comments received during this 30-day period will be considered during the Services' decision-making process. A permit decision will be made no sooner than 30 days after the publication of EPA's notice of the FEIS and completion of the RODs.

Dated: November 5, 2012.

Richard Kearney,

Acting Deputy Regional Director, Pacific Southwest Region, Sacramento, California, U.S. Fish and Wildlife Service.

Dated: November 13, 2012.

Angela Somma,

Chief, Endangered Species Division, Office of Protected Resources, National Marine Fisheries Service.

[FR Doc. 2012–28488 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–22–P 4310–55–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XC328

Fisheries of the Gulf of Mexico; Southeast Data, Assessment, and Review (SEDAR); Public Meetings

AGENCY: National Marine Fisheries Service (NMFS), National Oceanic and Atmospheric Administration (NOAA), Commerce.

ACTION: Notice of Cancellation of SEDAR 28 Gulf of Mexico Spanish mackerel and cobia assessment Webinar.

SUMMARY: The SEDAR 28 assessment of the Gulf of Mexico Spanish mackerel and cobia fisheries will consist of a series of workshops and supplemental Webinars. This notice is for a Cancellation of a Webinar associated with the Assessment portion of the SEDAR process. See **SUPPLEMENTARY INFORMATION**.

DATES: The SEDAR 28 Assessment Workshop Webinar scheduled to be held on November 26, 2012, from 1 p.m. until 5 p.m. EDT has been cancelled.

FOR FURTHER INFORMATION CONTACT: Ryan Rindone, SEDAR Coordinator, 2203 N. Lois Ave., Suite 1100, Tampa FL 33607; telephone: (813) 348–1630; email: *ryan.rindone@gulfcouncil.org.*

SUPPLEMENTARY INFORMATION: The original notice published in the **Federal Register** on November 7, 2012 (77 FR 66818).

The Gulf of Mexico Fishery Management Council (GMFMC), in conjunction with NOAA Fisheries, has implemented the Southeast Data, Assessment and Review (SEDAR) process, a multi-step method for determining the status of fish stocks in the Southeast Region. SEDAR is a three-step process including: (1) Data Workshop; (2) Assessment Process, including a workshop and Webinars; and (3) Review Workshop. The product of the Data Workshop is a data report which compiles and evaluates potential datasets and recommends which datasets are appropriate for assessment analyses. The product of the Assessment Process is a stock assessment report which describes the fisheries, evaluates the status of the stock, estimates biological benchmarks, projects future population conditions, and recommends research and monitoring needs. The assessment is independently peer reviewed at the Review Workshop. The product of the Review Workshop is a summary documenting panel opinions regarding the strengths and weaknesses of the stock assessment and input data. Participants for SEDAR Workshops are appointed by the GMFMC, NOAA Fisheries Southeast Regional Office, and the NOAA Southeast Fisheries Science Center. Participants include: data collectors and database managers; stock assessment scientists, biologists, and researchers; constituency representatives including fishermen, environmentalists, and non-governmental organizations (NGOs); international experts; and staff of Councils, Commissions, and state and federal agencies.

Dated: November 19, 2012.

Tracey L. Thompson,

Acting Deputy Director, Office of Sustainable Fisheries, National Marine Fisheries Service.

[FR Doc. 2012–28389 Filed 11–21–12; 8:45 am]

BILLING CODE 3410–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

Mid-Atlantic Fishery Management Council (MAFMC); Public Meetings

AGENCY: National Marine Fisheries Service (NMFS), National Oceanic and Atmospheric Administration (NOAA), Commerce.

ACTION: Notice of public meetings.

SUMMARY: The Mid-Atlantic Fishery Management Council (Council) and its Visioning and Strategic Planning

Working Group will hold public meetings.

DATES: The meetings will be held Monday, December 10, 2012 through Thursday, December 13, 2012. See **SUPPLEMENTARY INFORMATION** for specific dates and times.

ADDRESSES: The meetings will be held at Pier V, 711 Eastern Avenue, Baltimore, MD 21202; telephone: (410) 539–2000.

Council Address: Mid-Atlantic Fishery Management Council, 800 N. State St., Suite 201, Dover, DE 19901; telephone: (302) 674–2331.

FOR FURTHER INFORMATION CONTACT: Christopher M. Moore, Ph.D. Executive Director, Mid-Atlantic Fishery Management Council; telephone: (302) 526–5255.

SUPPLEMENTARY INFORMATION: On Monday, December 10—The Visioning and Strategic Planning Working Group will meet from 9 a.m. until 5 p.m. On Tuesday, December 11—The Visioning and Strategic Planning Working Group will meet from 9 a.m. until 5 p.m. On Wednesday, December 12—The Executive Committee will meet from 8 a.m. to 9 a.m. The Council will convene at 9 a.m. From 9 a.m. until 11:30 a.m., the Council will hold its regular Business Session to approve the October 2012 minutes and receive liaison, organizational, Executive Director, Science, and Committee Reports. From 11:30 a.m. until 12 p.m., the proposed rule on Amendment 5 to the Highly Migratory Species (HMS) Fishery Management Plan (FMP) regarding shark rebuilding and management measures will be presented. From 1 p.m. until 2:30 p.m., Mackerel, Squid, Butterfish, River Herring, and Shad will be discussed. From 2:30 p.m. until 3:30 p.m., Special Management Zone (SMZ) Alternatives will be discussed. From 3:30 p.m. until 5 p.m.,. Black Sea Bass issues will be discussed. There will be a Public Listening Session from 5 p.m. until 6 p.m. on Wednesday evening with discussion of impacts from Hurricane Sandy. On Thursday December 13—The Demersal Committee will meet as a Committee of the Whole with the Atlantic States Marine Fisheries Commission's (ASMFC) Summer Flounder, Scup, and Black Sea Board. From 9 a.m. until 10:30 a.m., summer flounder 2013 recreational management measures will be finalized with the Board. From 10:30 a.m. until 12 p.m., scup 2013 recreational management measures with the Board will be finalized. From 1 p.m. until 4 p.m., the black sea bass 2013 recreational management measures with the Board will be finalized. From 4 p.m. until 5 p.m., the Council will conduct any continuing and/or new business.

Agenda items by day for the Council's Committees and the Council itself are: On Monday, December 10—The Visioning and Strategic Planning Working Group will discuss the next steps for completing the draft strategic plan, finalize Science and Data and Ecosystems goal sequences, review top themes from the Visioning Project, and discuss objectives, strategies, and tactics for one strategic goal sequence. On Tuesday, December 11—The Visioning and Strategic Planning Working Group will review the outcomes from Monday and discuss objectives, strategies, and tactics for up to three strategic goals. On Wednesday, December 12—The Executive Committee will meet to identify the 2013 Council priorities and discuss the nominations for the Ricks E. Savage Award. The Council will hold its regular Business Session to approve the October minutes, and receive liaison, organizational, Executive Director, Science, and Committee Reports. The Council will receive a presentation from NMFS regarding Amendment 5 to the HMS FMP. The Council will hold its second meeting of Framework 8 to Mackerel, Squid, and Butterfish (MSB). MSB Amendment 15 scoping results will be presented and confirmation on scope of Amendment for the Fishery Management Action Team (FMAT) will be discussed along with an update on the January 15–17, 2013 Squid Management Workshop. The Council will discuss SMZ Alternatives. The Council will discuss Black Sea Bass issues with regard to the 2012 overages and review accountability measures and black sea bass data. The Council will hold a public listening session to discuss fishery impacts from Hurricane Sandy. On Thursday, December 13—the Council in conjunction with the ASMFC's Summer Flounder, Scup, and Black Sea Bass Boards will review and discuss the associated Monitoring Committee's and Advisory Panel's recommendations and develop and approve 2013 recreational management measures for summer flounder, scup, and black sea bass. The Council will also discuss an update on Amendment 17 to the Summer Flounder, Scup, and Black Sea Bass FMP. The ASMFC Board will discuss an Addendum to enable State-by-State Black Sea Bass Recreational Management Measures. The Council will conduct any continuing and/or new business.

Although non-emergency issues not contained in this agenda may come before this group for discussion, those issues may not be the subject of formal action during these meetings. Action will be restricted to those issues specifically listed in this notice and any issues arising after publication of this notice that require emergency action under section 305(c) of the Magnuson-Stevens Fishery Conservation and Management Act, provided the public has been notified of the Council's intent to take final action to address the emergency.

Special Accommodations

These meetings are physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aid should be directed to M. Jan Saunders, (302) 526–5251, at least 5 days prior to the meeting date.

Dated: November 19, 2012.

Tracey L. Thompson,

Acting Deputy Director, Office of Sustainable Fisheries, National Marine Fisheries Service.

[FR Doc. 2012–28438 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XC357

Fisheries of the Exclusive Economic Zone Off Alaska; Recordkeeping and Reporting Requirements; Public Workshops

AGENCY: National Marine Fisheries Service (NMFS), National Oceanic and Atmospheric Administration (NOAA), Commerce.

ACTION: Notice of workshop.

SUMMARY: NMFS, Alaska Region, will present a workshop on seaLandings, a consolidated electronic means of reporting landings and production of commercial groundfish to multiple management agencies for Federal and State fisheries off Alaska, and 2013 recordkeeping and reporting requirements for the Alaska groundfish fisheries and Individual Fishing Quota fisheries.

DATES: The workshop will be held on November 29, 2012, from 9:00 a.m. to 1:00 p.m., Pacific Standard Time.

ADDRESSES: The workshop will be held at the Swedish Cultural Center located at 1920 Dexter Ave N., Seattle, WA. Directions to the center can be found on its Web site, *http://www.swedishculturalcenter.org/contacts.htm.*

FOR FURTHER INFORMATION CONTACT: Susan Hall, 907–586–7462.

SUPPLEMENTARY INFORMATION: The workshop will include a discussion of

2013 recordkeeping and reporting requirements for Alaska groundfish fisheries and Individual Fishing Quota fisheries and instructions for completing and submitting required reports and logbooks using seaLandings.

The final rule for monitoring and enforcement requirements in the Bering Sea and Aleutian Islands freezer longline fleet (77 FR 59053) mandates that vessel operators who opt into the program will be required to use an electronic logbook beginning in 2013.

NMFS will provide a demonstration of the latest version of seaLandings for at-sea catcher/processors and motherships, and training on how to submit daily production reports and landing reports with and without Individual Fishing Quota. NMFS will also provide a demonstration of the freezer longline catcher/processor electronic logbook in seaLandings.

Special Accommodations

This workshop will be physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be directed to Susan Hall, 907–586–7462, at least 5 working days prior to the meeting date.

Dated: November 19, 2012.

Lindsay Fullenkamp,

Acting Deputy Director, Office of Sustainable Fisheries, National Marine Fisheries Service.

[FR Doc. 2012–28490 Filed 11–21–12; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal Nos. 12–56]

36(b)(1) Arms Sales Notification

AGENCY: Department of Defense, Defense Security Cooperation Agency.

ACTION: Notice.

SUMMARY: The Department of Defense is publishing the unclassified text of a section 36(b)(1) arms sales notification. This is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996.

FOR FURTHER INFORMATION CONTACT: Ms. B. English, DSCA/DBO/CFM, (703) 601–3740.

The following is a copy of a letter to the Speaker of the House of Representatives, Transmittals 12–56 with attached transmittal, policy justification, and Sensitivity of Technology.

Dated: November 19, 2012.

Aaron Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

DEFENSE SECURITY COOPERATION AGENCY
201 12TH STREET SOUTH, STE 203
ARLINGTON VA 22202-5408

NOV 15 2012

The Honorable John A. Bochner
Speaker of the House
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

Pursuant to the reporting requirements of Section 36(b)(1) of the Arms Export Control Act, as amended, we are forwarding herewith Transmittal No. 12-56, concerning the Department of the Army's proposed Letter(s) of Offer and Acceptance to Indonesia for defense articles and services estimated to cost $60 million. After this letter is delivered to your office, we plan to issue a press statement to notify the public of this proposed sale.

Sincerely,

William E. Landay, III
Vice Admiral, USN
Director

Enclosures:
1. Transmittal
2. Policy Justification
3. Sensitivity of Technology

Transmittal No. 12–56

Notice of Proposed Issuance of Letter of Offer Pursuant to Section 36(b)(1) of the Arms Export Control Act, as amended

(i) *Prospective Purchaser:* Indonesia.

(ii) *Total Estimated Value:*

Major Defense Equipment *	$51 million.
Other	9 million.
Total	60 million.

* As defined in Section 47(6) of the Arms Export Control Act.

(iii) *Description and Quantity or Quantities of Articles or Services under Consideration for Purchase:* 180 Block I Javelin Missiles, 25 Command Launch Units (CLU), Missile Simulation Rounds (MSR), Battery Coolant Units (BCU), support equipment, spare and repair parts, personnel training and training equipment, publications and technical data, U.S. Government and contractor technical assistance and other related logistics support.

(iv) *Military Department:* Army (UAK).

(v) *Prior Related Cases, if any:* None.

(vi) *Sales Commission, Fee, etc., Paid, Offered, or Agreed to be Paid:* None.

(vii) *Sensitivity of Technology Contained in the Defense Article or Defense Services Proposed to be Sold:* See Attached Annex.

(viii) *Date Report Delivered to Congress:* 15 Nov 2012.

POLICY JUSTIFICATION

Government of Indonesia—Javelin Missiles

The Government of Indonesia has requested a possible purchase of 180 Block I Javelin Missiles, 25 Command Launch Units (CLU), Missile Simulation Rounds (MSR), Battery Coolant Units (BCU), Enhanced Basic Skills Trainer, Weapon Effects Simulator, batteries, battery chargers, support equipment, spare and repair parts, personnel training and training equipment, publications and technical data, U.S. Government and contractor technical assistance and other related logistics support. The estimated cost is $60 million.

This proposed sale will contribute to the foreign policy and national security of the United States by helping to improve the security of a friendly country which has been, and continues to be, an important force for the political stability and economic progress in Southeast Asia.

The proposed sale provides Indonesia with assets vital to protect its sovereign territory and deter potential threats. The acquisition of the Javelin system is part of the Indonesia Army's overall military modernization program. The proposed sale will foster continued cooperation between the U.S. and Indonesia, making Indonesia a more valuable regional partner in an important area of the world.

The proposed sale of the missiles and support will not alter the basic military balance in the region.

The principal contractors will be Raytheon/Lockheed Martin Javelin Joint Venture (JJV) in Tucson, Arizona and Orlando, Florida. There are no known offset agreements proposed in connection with this potential sale.

Implementation of this proposed sale will not require the assignment of any additional U.S. Government or contractor representatives to Indonesia.

There will be no adverse impact on U.S. defense readiness as a result of this proposed sale.

Transmittal No. 12–56

Notice of Proposed Issuance of Letter of Offer Pursuant to Section 36(b)(1) of the Arms Export Control Act

Annex

Item No. vii

(vii) *Sensitivity of Technology:*

1. The Javelin Weapon System's hardware and the documentation provided are unclassified. However, sensitive technology is contained within the system itself. The sensitivity is primarily in the software programs that instruct the system how to operate in the presence of countermeasures. Programs are contained in the system in the form of microprocessors with Read Only Memory (ROM) maps, which do not provide the software program itself. The overall hardware is considered sensitive in that the modulation frequency and infrared wavelengths could be used in countermeasure development.

2. If a technologically advanced adversary were to obtain knowledge of the specific hardware and software elements, the information could be used to develop countermeasures that might reduce weapon system effectiveness or be used in the development of a system with similar or advanced capabilities.

[FR Doc. 2012–28415 Filed 11–21–12; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal No. 12–64]

36(b)(1) Arms Sales Notification

AGENCY: Department of Defense, Defense Security Cooperation Agency.

ACTION: Notice.

SUMMARY: The Department of Defense is publishing the unclassified text of a section 36(b)(1) arms sales notification. This is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996.

FOR FURTHER INFORMATION CONTACT: Ms. B. English, DSCA/DBO/CFM, (703) 601–3740.

The following is a copy of a letter to the Speaker of the House of Representatives, Transmittal 12–64 with attached transmittal, policy justification, and Sensitivity of Technology.

Dated: November 19, 2012.

Aaron Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

DEFENSE SECURITY COOPERATION AGENCY
201 12TH STREET SOUTH, STE 203
ARLINGTON, VA 22202-5408

NOV 15 2012

The Honorable John A. Boehner
Speaker of the House
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

Pursuant to the reporting requirements of Section 36(b)(1) of the Arms Export Control Act, as amended, we are forwarding herewith Transmittal No. 12-64, concerning the Department of the Army's proposed Letter(s) of Offer and Acceptance to Oman for defense articles and services estimated to cost $96 million. After this letter is delivered to your office, we plan to issue a press statement to notify the public of this proposed sale.

Sincerely,

FOR William E. Landay III
Vice Admiral, USN
Director

Enclosures:
1. Transmittal
2. Policy Justification
3. Sensitivity of Technology
4. Regional Balance (Classified Document Provided Under Separate Cover)

Transmittal No. 12–64

Notice of Proposed Issuance of Letter of Offer Pursuant to Section 36(b)(1) of the Arms Export Control Act, as amended

(i) *Prospective Purchaser:* Oman

(ii) *Total Estimated Value:*

Major Defense Equipment *	$ 90 million
Other	$ 6 million
TOTAL	$ 96 million

(iii) *Description and Quantity or Quantities of Articles or Services under Consideration for Purchase:* 400 Javelin Guided Missiles, Javelin Weapon Effects Simulator (JAVWES), containers, spare and repair parts, support equipment, personnel training and training equipment, publications and technical documentation, U.S. Government and contractor representative logistics and technical support services, and other related elements of logistics and program support.

(iv) *Military Department:* Army (UKB)

(v) *Prior Related Cases, if any:* FMS case UIW, 9 November 2007—$95M

(vi) *Sales Commission, Fee, etc., Paid, Offered, or Agreed to be Paid:* None

(vii) *Sensitivity of Technology Contained in the Defense Article or Defense Services Proposed to be Sold:* See Annex attached

(viii) *Date Report Delivered to Congress:* 15 Nov 12

* as defined in Section 47(6) of the Arms Export Control Act.

POLICY JUSTIFICATION

Oman—Javelin Missile

The Sultanate of Oman has requested a possible sale of 400 Javelin Guided Missiles, Javelin Weapon Effects Simulator (JAVWES), containers, spare and repair parts, support equipment, personnel training and training equipment, publications and technical documentation, U.S. Government and contractor representative logistics and technical support services, and other related elements of logistics and program support. The total estimated cost is $96 million.

This proposed sale will contribute to the foreign policy and national security of the United States by helping to improve the security of a friendly country that has been, and continues to be, an important force for political and economic progress in the Middle East.

The proposed sale of the JAVELIN Anti-Tank Weapon System will improve Oman's capability to meet current and future threats and provide greater security for its critical oil and natural gas infrastructure. Oman will use the enhanced capability to strengthen its homeland defense. Oman will have no difficulty absorbing these missiles into its armed forces.

The proposed sale of this equipment and support will not alter the basic military balance in the region.

The principal contractors will be Raytheon/Lockheed Martin Javelin Joint Venture in Orlando, Florida and Tucson, Arizona. There are no known offset agreements proposed in connection with this potential sale.

Implementation of this proposed sale will not require the assignment of any additional U.S. Government or contractor representatives to Oman.

There will be no adverse impact on U.S. defense readiness as a result of this proposed sale.

Transmittal No. 12–64

Notice of Proposed Issuance of Letter of Offer Pursuant to Section 36(b)(1) of the Arms Export Control Act

Annex

Item No. vii

(vii) *Sensitivity of Technology:*

1. The Javelin Weapon System is a medium-range, man portable, shoulder-launched, fire and forget, anti-tank system for infantry, scouts, and combat engineers. It may also be mounted on a variety of platforms to include vehicles and watercraft. The system weighs 49.5 pounds and has a maximum range in excess of 2,500 meters. The system is highly lethal against tanks and other systems with conventional and reactive armors. The system possesses a secondary capability against bunkers.

2. Javelin's key technical feature is the use of fire-and-forget technology which allows the gunner to fire and immediately relocate or take cover. Additional special features are the top attack and/or direct fire modes, an advanced tandem warhead and imaging infrared seeker, target lock-on before launch, and soft launch from enclosures or covered fighting positions. The Javelin missile also has a minimum smoke motor thus decreasing its detection on the battlefield. The Javelin Training System consists of the following training devices: the missile simulation round, the basic skills trainer and the field tactical trainer, JAVWES, and tripod.

3. The Javelin Weapon System is comprised of two major tactical components, which are a reusable Command Launch Unit (CLU) and a round contained in a disposable launch tube assembly. The CLU incorporates an integrated day-night sight that provides a target engagement capability in adverse weather and countermeasure environments. The CLU may also be used in a stand-alone mode for battlefield surveillance and target detection. The CLU's thermal sight is a second generation Forward-Looking Infrared (FLIR) sensor operating in the 8–10 micron wavelength and has a 240 X 2 scanning array with a Dewar-coolant unit. To facilitate initial loading and subsequent updating of software, all on-board missile software is uploaded via the CLU after mating and prior to launch.

4. The missile is autonomously guided to the target using an imaging infrared seeker and adaptive correlation tracking algorithms. This allows the gunner to take cover or reload and engage another target after firing a missile. The missile contains an infrared seeker with a 64 x 64 element staring Mercury-Cadmium-Telluride (HgCdTE) Focal Plane Array (FPA) operating in the 8–10 micron wavelength. The missile has an advanced tandem warhead and can be used in either the top attack or direct fire modes (for targets undercover). An onboard flight computer guides the missile to the selected target. The missile is designed as a ''wooden round'' thus requiring no maintenance.

5. The Javelin Missile System hardware and the documentation are unclassified. The missile software which resides in the CLU is considered sensitive. The sensitivity is primarily in the software programs which instruct the system how to operate in the presence of countermeasures.

6. If a technologically advanced adversary were to obtain knowledge of the specific hardware and software elements, the information could be used to develop countermeasures that might reduce weapon system effectiveness or be used in the development of a system with similar or advanced capabilities.

[FR Doc. 2012–28418 Filed 11–21–12; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Department of the Navy

Notice of Intent To Prepare an Environmental Impact Statement for the Disposal and Reuse of the Former Naval Air Station Joint Reserve Base Willow Grove, Horsham, PA, and Notice of Public Scoping Meetings

AGENCY: Department of the Navy, DoD.

ACTION: Notice.

SUMMARY: Pursuant to Section 102(2)(c) of the National Environmental Policy Act (NEPA) of 1969, as implemented by the Council on Environmental Quality regulations (40 CFR parts 1500–1508), the Department of the Navy (DoN) announces its intent to prepare an Environmental Impact Statement (EIS) to evaluate the potential environmental consequences of the disposal and reuse of the former Naval Air Station Joint Reserve Base (NAS JRB) Willow Grove, Horsham, Pennsylvania, per Public Law 101–510, the Defense Base Closure and Realignment Act of 1990, as amended in 2005 (BRAC Law). Potential impacts associated with reuse of NAS JRB Willow Grove, including the change in land use and traffic patterns, will be evaluated and will contribute to the alternatives considered.

DATES: The DoN will conduct public scoping meetings in Horsham Township

in Montgomery County, PA to receive comments on the environmental concerns that should be addressed in the EIS. Both public scoping open houses will be held at the Horsham Township Community Center located at 1025 Horsham Road, Horsham, PA. Schedule will be as follows:

1. Open House: Thursday, December 13, 2012, 4:00 p.m.–8:00 p.m.

2. Open House: Friday, December 14, 2012, 10:00 a.m.–2:00 p.m.

The previously announced public scoping meetings scheduled for October 29 and October 30, 2012 were cancelled due to Hurricane Sandy.

FOR FURTHER INFORMATION CONTACT: Director, BRAC Program Management Office Northeast, 4911 Broad Street, Building 679, Philadelphia, PA 19112–1303, telephone 215–897–4900, fax 215–897–4902, email: *david.drozd@navy.mil.*

SUPPLEMENTARY INFORMATION: The Base Closure and Realignment (BRAC) Commission was established by Public Law 101–510, the BRAC Law, to recommend military installations for realignment and closure. Recommendations of the 2005 BRAC Commission were included in a report presented to the President on September 8, 2005. The President approved and forwarded this report to Congress on September 16, 2005, which became effective as public law on November 9, 2005, and must be implemented in accordance with the requirements of the BRAC Law. In 2005, NAS JRB Willow Grove, PA was designated for closure under the authority of the Defense Base Closure and Realignment Act of 1990, Public Law 101–510, as amended (the Act). Pursuant to this designation, on January 8, 2010, land and facilities at this installation were declared excess to the DoN and made available to other DoD components and other Federal agencies. The DoN has evaluated all timely Federal requests and made a decision to close the former NAS JRB Willow Grove on September 15, 2011.

The proposed action for this EIS is to accommodate the BRAC 2005 law. The BRAC-directed action includes disposal and reuse of NAS JRB Willow Grove and its excess properties. Upon completion of the disposal, the property will be redeveloped in accordance with the Horsham Township Authority (HLRA) Redevelopment Plan.

The EIS will consider the alternatives that are reasonable to accomplish the proposed action. Alternatives to be considered include: (1) Disposal of the property by the DoN and reuse in accordance with the HLRA's Preferred Land Use Plan; (2) Disposal of the property by the DoN with a higher-density reuse scenario; (3) Disposal of the property by the DoN and reuse as an airport; and (4) No Action in which the DoN would retain the property in a caretaker status and no reuse or development would occur.

Alternative 1 would meet the requirements of the BRAC Law by allowing for the disposal and reuse of NAS JRB Willow Grove. Reuse would be conducted in accordance with the HLRA Plan. The Plan provides a mix of land uses based on existing conditions on the installation and in the community, guiding principles for development established by the HLRA, and public participation. It is anticipated that full build-out of the Plan would be implemented over a 20-year period. The Reuse Plan calls for the development of approximately 444 acres (52%) of the total base property. In addition, approximately 418 acres (48%) would be dedicated to a variety of active and passive land uses, including recreation, open space, and natural areas. The plan also incorporates elements based on smart-growth principles, including pedestrian-friendly transportation features (e.g., walkable neighborhoods, bike lanes, and compact development), open spaces, and a mix of land use types.

Alternative 2 would also meet the requirements of the BRAC Law by allowing for disposal and reuse of NAS JRB Willow Grove. This alternative features a higher density of residential and community mixed-use development. Similar to Alternative 1, this alternative includes a mix of land use types, preserves open space and natural areas, and incorporates elements based on smart-growth principles, including pedestrian-friendly transportation and compact development. It is anticipated that full build-out of the higher-density scenario would be implemented over a 20-year period. The higher density alternative calls for the development of approximately 576 acres (67%) of the total base property. In addition, approximately 280 acres (32%) of the base would be dedicated to a variety of active and passive land uses, including recreation, open space, and natural areas.

Alternative 3 would maintain and reuse the existing airfield for private aviation purposes. The plan reuses the existing airfield and its supporting infrastructure (i.e., taxiways, parking aprons and hangar facilities). After accounting for the area being reused for aviation purposes, the remaining land available for development would be approximately 380 acres. This would be developed in a mix of land use types and densities, and preserves open space and natural areas. New development would be airport related industry and businesses.

Alternative 4 is required by NEPA and is the No Action Alternative. Under this alternative, NAS JRB Willow Grove would be retained by the U.S. government in caretaker status. No reuse or redevelopment would occur at the facility.

The EIS will address potential direct, indirect, short-term, long-term, and cumulative impacts on the human and natural environments, including potential impacts on topography, geology and soils, water resources, biological resources, air quality, noise, infrastructure and utilities, traffic, cultural resources, land use, socioeconomics, environmental justice, and waste management. Known areas of concern associated with the BRAC action include impacts on socioeconomics due to loss of the military and civilian workforce, impacts on local traffic patterns resulting from reuse scenarios, and the clean-up of installation remediation sites.

The DoN is initiating the scoping process to identify community concerns and issues that should be addressed in the EIS. Agencies and the public are encouraged to provide written comments at scheduled public scoping meetings. Comments should clearly describe specific issues or topics that the EIS should address. Written comments must be postmarked or emailed by midnight December 31, 2012, and should be sent to: Director, BRAC Program Management Office Northeast, 4911 South Broad Street, Building 679, Philadelphia, PA 19112–1303, telephone 215–897–4900, fax 215–897–4902, email: *david.drozd@navy.mil*.

Requests for special assistance, sign language interpretation for the hearing impaired, language interpreters, or other auxiliary aids for scheduled public scoping meetings must be sent by mail or email by November 30, 2012, to Mr. Matt Butwin, Ecology and Environment, Inc., 348 Southport Circle, Suite 101, Virginia Beach, Virginia, 23452, telephone 757–456–5356, ext. 2811, email: *MButwin@ene.com*.

Dated: November 16, 2012.

C.K. Chiappetta,

Lieutenant Commander, Office of the Judge Advocate General, U.S. Navy, Federal Register Liaison Officer.

[FR Doc. 2012–28408 Filed 11–21–12; 8:45 am]

BILLING CODE 3810–FF–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Combined Notice of Filings #1

Take notice that the Commission received the following electric rate filings:

Docket Numbers: ER11–2547–008.
Applicants: New York Independent System Operator, Inc.
Description: NYISO compliance 15-minute variable scheduling at Linden VFT Proxy Generator Bus to be effective 11/28/2012.
Filed Date: 11/13/12.
Accession Number: 20121113–5413.
Comments Due: 5 p.m. ET 12/4/12.

Docket Numbers: ER12–2591–002.
Applicants: Monongahela Power Company.
Description: Compliance to Filing 21 to be effective 9/1/2012.
Filed Date: 11/14/12.
Accession Number: 20121114–5142.
Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–2932–002.
Applicants: NorthWestern Corporation.
Description: Revised Attachment K Compliance Filing—SD OATT to be effective 11/14/2012.
Filed Date: 11/14/12.
Accession Number: 20121114–5001.
Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER12–2506–001.
Applicants: Southern California Edison Company.
Description: Compliance Filing SGIA with TA-Acacia, LLC, TA-Acacia Project to be effective 8/24/2012.
Filed Date: 11/13/12.
Accession Number: 20121113–5292.
Comments Due: 5 p.m. ET 12/4/12.

Docket Numbers: ER13–113–001.
Applicants: Sunbury Energy, LLC.
Description: Amended Filing to be effective 11/12/2012.
Filed Date: 11/13/12.
Accession Number: 20121113–5328.
Comments Due: 5 p.m. ET 12/4/12.

Docket Numbers: ER13–327–001.
Applicants: Porter-Walker LLC.
Description: Amendment to FERC Electric Tariff, Volume No. 1 to be effective 11/13/2012.
Filed Date: 11/13/12.
Accession Number: 20121113–5254.
Comments Due: 5 p.m. ET 12/4/12.

Docket Numbers: ER13–377–000.
Applicants: PJM Interconnection, L.L.C.
Description: Original Service Agreement No. 3419; Queue No. X3–077 (WMPA) to be effective 10/24/2012.
Filed Date: 11/14/12.
Accession Number: 20121114–5145.
Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER13–378–000.
Applicants: Duquesne Light Company.
Description: Amendment to Connection and Site Agreement to be effective 1/13/2013.
Filed Date: 11/14/12.
Accession Number: 20121114–5147.
Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER13–379–000.
Applicants: PJM Interconnection, L.L.C.
Description: Cancellation of Rate Sch 41 Operating Protocols among PJM, NYISO, ConEd & PSE&G to be effective 5/1/2012.
Filed Date: 11/14/12.
Accession Number: 20121114–5149.
Comments Due: 5 p.m. ET 12/5/12.

The filings are accessible in the Commission's eLibrary system by clicking on the links or querying the docket number.

Any person desiring to intervene or protest in any of the above proceedings must file in accordance with Rules 211 and 214 of the Commission's Regulations (18 CFR 385.211 and 385.214) on or before 5:00 p.m. Eastern time on the specified comment date. Protests may be considered, but intervention is necessary to become a party to the proceeding.

eFiling is encouraged. More detailed information relating to filing requirements, interventions, protests, service, and qualifying facilities filings can be found at: *http://www.ferc.gov/docs-filing/efiling/filing-req.pdf.* For other information, call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Dated: November 15, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28404 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Combined Notice of Filings

Take notice that the Commission has received the following Natural Gas Pipeline Rate and Refund Report filings:

Filings Instituting Proceedings

Docket Numbers: RP13–278–000.
Applicants: Antero Resources Piceance LLC.
Description: Joint Petition for Temporary Waiver of Antero Resources Piceance LLC and Ursa Piceance LLC.
Filed Date: 11/14/12.
Accession Number: 20121114–5168.
Comments Due: 5 p.m. ET 11/26/12.

Docket Numbers: RP13–279–000.
Applicants: Texas Eastern Transmission, LP.
Description: Contracting Processes Nov2012 Filing to be effective 1/1/2013.
Filed Date: 11/15/12.
Accession Number: 20121115–5051.
Comments Due: 5 p.m. ET 11/27/12.

Docket Numbers: RP13–280–000.
Applicants: Algonquin Gas Transmission, LLC.
Description: Contracting Processes Nov2012 Filing to be effective 1/1/2013.
Filed Date: 11/15/12.
Accession Number: 20121115–5052.
Comments Due: 5 p.m. ET 11/27/12.

Docket Numbers: RP13–281–000.
Applicants: Big Sandy Pipeline, LLC.
Description: Contracting Processes Nov2012 Filing to be effective 1/1/2013.
Filed Date: 11/15/12.
Accession Number: 20121115–5053.
Comments Due: 5 p.m. ET 11/27/12.

Docket Numbers: RP13–282–000.
Applicants: Steckman Ridge, LP.
Description: Contracting Processes Nov2012 Filing to be effective 1/1/2013.
Filed Date: 11/15/12.
Accession Number: 20121115–5054.
Comments Due: 5 p.m. ET 11/27/12.

Any person desiring to intervene or protest in any of the above proceedings must file in accordance with Rules 211 and 214 of the Commission's Regulations (18 CFR 385.211 and 385.214) on or before 5:00 p.m. Eastern time on the specified comment date. Protests may be considered, but intervention is necessary to become a party to the proceeding.

Filings in Existing Proceedings

Docket Numbers: RP13–91–001.
Applicants: Questar Pipeline Company.
Description: Order 587–V Compliance Filing, Revised Section 26 to be effective 12/1/2012.
Filed Date: 11/14/12.
Accession Number: 20121114–5104.
Comments Due: 5 p.m. ET 11/26/12.

Any person desiring to protest in any the above proceedings must file in accordance with Rule 211 of the Commission's Regulations (18 CFR 385.211) on or before 5:00 p.m. Eastern time on the specified comment date.

The filings are accessible in the Commission's eLibrary system by clicking on the links or querying the docket number.

eFiling is encouraged. More detailed information relating to filing requirements, interventions, protests, and service can be found at:

http://www.ferc.gov/docs-filing/efiling/filing-req.pdf. For other information, call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Dated: November 15, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28401 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Combined Notice of Filings #2

Take notice that the Commission received the following electric corporate filings:

Docket Numbers: EC13–39–000.

Applicants: Public Service Company of New Mexico.

Description: Application of Public Service Company of New Mexico for Approval of Acquisition of Jurisdictional Facilities under Section 203 of the Federal Power Act.

Filed Date: 11/14/12.

Accession Number: 20121114–5187.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: EC13–40–000.

Applicants: Spearville 3, LLC.

Description: Application for Approval under Section 203 of the Federal Power Act and Requests for Expedited Consideration and Confidential Treatment of Spearville 3, LLC.

Filed Date: 11/14/12.

Accession Number: 20121114–5188.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: EC13–41–000.

Applicants: Florida Power Corporation.

Description: Application for Authorization Under Section 203 of the Federal Power Act of Florida Power Corporation.

Filed Date: 11/15/12.

Accession Number: 20121115–5143.

Comments Due: 5 p.m. ET 12/6/12.

Take notice that the Commission received the following electric rate filings:

Docket Numbers: ER11–4628–000.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–4628–001.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–4628–002.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–4628–003.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–4628–004.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–4628–005.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER11–4628–006.

Applicants: PJM Interconnection, L.L.C.

Description: Compliance Filing of PJM Interconnection, L.L.C.

Filed Date: 11/14/12.

Accession Number: 20121114–5153.

Comments Due: 5 p.m. ET 12/5/12.

Docket Numbers: ER12–2658–001.

Applicants: Pacific Gas and Electric Company.

Description: Tridam Project—Tulloch Powerhouse LGIA Compliance Filing to be effective 3/31/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5104.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–354–001.

Applicants: QC Power Strategies Fund LLC.

Description: QCP Initial Tariff to be effective 11/15/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5055.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–380–000.

Applicants: Sierra Pacific Power Company.

Description: Rate Schedule No. 27—Annual BPA–GTA Update 2012 to be effective 10/31/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5007.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–381–000.

Applicants: Southern California Edison Company.

Description: Letter Agreement SCE-Victorville 33kV Project to be effective 1/15/2013.

Filed Date: 11/15/12.

Accession Number: 20121115–5075.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–382–000.

Applicants: Southwest Power Pool, Inc.

Description: 2234R2 Osage Wind/PSO Facilities Construction Agreement to be effective 10/18/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5088.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–383–000.

Applicants: Alcoa Power Generating Inc.

Description: Tapoco Cancellation to be effective 11/15/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5096.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–384–000.

Applicants: Alcoa Power Generating Inc.

Description: Cancellation of TVA Interconnection Agreement Filed in ER11–4059 to be effective 11/15/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5097.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–385–000.

Applicants: Wabash Valley Power Association, Inc.

Description: Amendments to Formulary Rate Tariff—Rate Schedule EDR–7 to be effective 1/15/2013.

Filed Date: 11/15/12.

Accession Number: 20121115–5098.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–386–000.

Applicants: Southwest Power Pool, Inc.

Description: 2490 Steele Flats Wind Project, LLC GIA to be effective 10/30/2012.

Filed Date: 11/15/12.

Accession Number: 20121115–5114.

Comments Due: 5 p.m. ET 12/6/12.

Docket Numbers: ER13–387–000.

Applicants: Alcoa Power Generating Inc.

Description: Alcoa Power Generating Inc. submits Notice of Cancellation of Electric Rate Schedules FERC Nos. 17 and 19.

Filed Date: 11/15/12.

Accession Number: 20121115–5117.

Comments Due: 5 p.m. ET 12/6/12.

The filings are accessible in the Commission's eLibrary system by

clicking on the links or querying the docket number.

Any person desiring to intervene or protest in any of the above proceedings must file in accordance with Rules 211 and 214 of the Commission's Regulations (18 CFR 385.211 and 385.214) on or before 5:00 p.m. Eastern time on the specified comment date. Protests may be considered, but intervention is necessary to become a party to the proceeding.

eFiling is encouraged. More detailed information relating to filing requirements, interventions, protests, service, and qualifying facilities filings can be found at: *http://www.ferc.gov/docs-filing/efiling/filing-req.pdf.* For other information, call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Dated: November 15, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28405 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. EL13–20–000]

Marble River, LLC v. Noble Clinton Windpark I, LLC, Noble Ellenburg Windpark, LLC, Noble Chateaugay Windpark, LLC, New York Independent System Operator, Inc.; Notice of Complaint

Take notice that on November 15, 2012, pursuant to sections 306 and 309 of the Federal Power Act and Rule 206 of the Federal Energy Regulatory Commission's (Commission) Rules of Practice and Procedure, Marble River, LLC (Marble River or Complainant) filed a formal complaint against Noble Clinton Windpark I, LLC, Noble Ellenburg Windpark, LLC, Noble Chateaugay Windpark, LLC, (collectively, Noble or Respondent) and New York Independent System Operator, Inc. (NYISO or Respondent), alleging that Noble failed to pay Marble River for headroom created by common system upgrade facilities that benefit Noble and that were paid for by Marble River. The complaint also alleges that NYISO has failed to properly implement Attachment S of its Open Access Transmission Tariff, as more fully explained in the complaint.

The Complainant certifies that copies of the complaint were served on the contacts for each of the Respondents as listed on the Commission's list of Corporate Officials.

Any person desiring to intervene or to protest this filing must file in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211 and 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a notice of intervention or motion to intervene, as appropriate. The Respondent's answer and all interventions, or protests must be filed on or before the comment date. The Respondent's answer, motions to intervene, and protests must be served on the Complainants.

The Commission encourages electronic submission of protests and interventions in lieu of paper using the ''eFiling'' link at *http://www.ferc.gov.* Persons unable to file electronically should submit an original and 14 copies of the protest or intervention to the Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426.

This filing is accessible on-line at *http://www.ferc.gov,* using the ''eLibrary'' link and is available for review in the Commission's Public Reference Room in Washington, DC. There is an ''eSubscription'' link on the Web site that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email *FERCOnlineSupport@ferc.gov,* or call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Comment Date: 5:00 p.m. Eastern Time on December 5, 2012.

Dated: November 16, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28406 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. ID–7020–000]

Knueppel, Henry W.; Notice of Filing

Take notice that on November 15, 2012, Henry W. Knueppel submitted for filing, an application for authority to hold interlocking positions, pursuant to section 305(b) of the Federal Power Act, 16 U.S.C. 825d(b) (2008), Part 45 of Title 18 of the Code of Federal Regulations, 18 CFR part 45(c)(2012).

Any person desiring to intervene or to protest this filing must file in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211, 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a notice of intervention or motion to intervene, as appropriate. Such notices, motions, or protests must be filed on or before the comment date. On or before the comment date, it is not necessary to serve motions to intervene or protests on persons other than the Applicant.

The Commission encourages electronic submission of protests and interventions in lieu of paper using the ''eFiling'' link at *http://www.ferc.gov.* Persons unable to file electronically should submit an original and 14 copies of the protest or intervention to the Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426.

This filing is accessible on-line at *http://www.ferc.gov,* using the ''eLibrary'' link and is available for review in the Commission's Public Reference Room in Washington, DC. There is an ''eSubscription'' link on the Web site that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email *FERCOnlineSupport@ferc.gov,* or call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Comment Date: 5:00 p.m. Eastern Time on December 6, 2012.

Dated: November 16, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28402 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. ER01–3001–000]

New York Independent System Operator, Inc.; Notice Establishing Comment Date To Respond to Motion Requesting Extension of Time

On November 9, 2012, New York Independent System Operator, Inc. (NYISO) filed a motion requesting a 2-month extension of time (motion), until February 15, 2013, to submit its annual Installed Capacity Demand Curve Report. The report would otherwise be due December 20, 2012. NYISO

indicates that it needs more time for data gathering and analyses for this report, now that it has completed the analyses for the related mitigation retests. NYISO states that no Party will be harmed by the delay.

Notice is hereby given that NYISO has filed a motion requesting an extension of time to submit its annual report until February 15, 2013. Any Party wishing to respond to the motion may file an answer within 21 days from the date of the motion, or November 30, 2012.

Dated: November 16, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28400 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. EL13–21–000]

California Independent System, Operator Corporation; Notice of Petition for Declaratory Order

Take notice that on November 15, 2012, pursuant to section 207(a)(2) and 212 of the Federal Energy Regulatory Commission's (Commission) Rules of Practice and Procedure, California Independent System Operator Corporation filed a petition requesting that the Commission issue a declaratory order to enforce the exercise of its authority and rights under its tariff to obtain reliability services under a Reliability Must-Run (''RMR'') agreement with AES Huntington Beach LLC.

Any person desiring to intervene or to protest this filing must file in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211, 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a notice of intervention or motion to intervene, as appropriate. Such notices, motions, or protests must be filed on or before the comment date. On or before the comment date, it is not necessary to serve motions to intervene or protests on persons other than the Applicant.

The Commission encourages electronic submission of protests and interventions in lieu of paper using the ''eFiling'' link at *http://www.ferc.gov.* Persons unable to file electronically should submit an original and 14 copies of the protest or intervention to the Federal Energy Regulatory Commission, 888 First Street NE., Washington, DC 20426.

This filing is accessible on-line at *http://www.ferc.gov*, using the ''eLibrary'' link and is available for review in the Commission's Public Reference Room in Washington, DC. There is an ''eSubscription'' link on the Web site that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email *FERCOnlineSupport@ferc.gov*, or call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Comment Date: 5:00 p.m. Eastern Time on November 29, 2012.

Dated: November 16, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28407 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Notice of Commission Staff Attendance

The Federal Energy Regulatory Commission hereby gives notice that members of the Commission's staff may attend the following meetings related to the interregional transmission planning activities of the Southwest Power Pool (SPP):

SPP Seams FERC Order 1000 Task Force Meeting—November 16, 2012

The above-referenced meeting will be a teleconference.

The above-referenced meeting is open to the public.

Further information may be found at *www.spp.org.*

The discussions at the meeting described above may address matters at issue in the following proceedings:

Docket No. ER09–35–001, *Tallgrass Transmission, LLC*
Docket No. ER09–36–001, *Prairie Wind Transmission, LLC*
Docket No. ER09–548–001, *ITC Great Plains, LLC*
Docket No. ER09–659–002, *Southwest Power Pool, Inc.*
Docket No. ER11–4105–000, *Southwest Power Pool, Inc.*
Docket No. EL11–34–001, *Midwest Independent Transmission System Operator, Inc.*
Docket No. ER12–1401–000, *Southwest Power Pool, Inc.*
Docket No. ER12–1402–000, *Southwest Power Pool, Inc.*
Docket No. ER12–1415–000, *Southwest Power Pool, Inc.*
Docket No. ER12–1460–000, *Southwest Power Pool, Inc.*
Docket No. ER12–1586–000 *et al., Southwest Power Pool, Inc.*
Docket No. ER12–1610–000, *Southwest Power Pool, Inc.*
Docket No. ER12–1772–000, *Southwest Power Pool, Inc.*
Docket No. ER12–2366–000, *Southwest Power Pool, Inc.*
Docket No. EL12–2–000, *Southwest Power Pool, Inc.*
Docket No. EL12–60–000, *Southwest Power Pool, Inc., et al.*
Docket No. ER12–2387–000 *et al., Southwest Power Pool, Inc.*

For more information, contact Luciano Lima, Office of Energy Markets Regulation, Federal Energy Regulatory Commission at (202) 288–6738 or *Luciano.Lima@ferc.gov.*

Dated: November 16, 2012.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2012–28403 Filed 11–21–12; 8:45 am]

BILLING CODE 6717–01–P

ENVIRONMENTAL PROTECTION AGENCY

[ER–FRL–9006–2]

Environmental Impacts Statements; Notice of Availability

Responsible Agency: Office of Federal Activities, General Information (202) 564–7146 or *http://www.epa.gov/compliance/nepa/.*

Weekly Receipt of Environmental Impact Statements

Filed 11/12/2012 Through 11/16/2012 Pursuant to 40 CFR 1506.9.

SUMMARY: Section 309(a) of the Clean Air Act requires that EPA make public its comments on EISs issued by other Federal agencies. EPA's comment letters on EISs are available at: *http://www.epa.gov/compliance/nepa/eisdata.html.*

SUPPLEMENTARY INFORMATION: As of October 1, 2012, EPA will not accept paper copies or CDs of EISs for filing purposes; all submissions on or after October 1, 2012 must be made through e-NEPA.

While this system eliminates the need to submit paper or CD copies to EPA to meet filing requirements, electronic submission does not change requirements for distribution of EISs for public review and comment. To begin using e-NEPA, you must first register

with EPA's electronic reporting site—*https://cdx.epa.gov/epa_home.asp.*

EIS No. 20120366, Final EIS, NOAA, CA, Authorization for Incidental Take and Implementation of the Stanford University Habitat Conservation Plan, San Mateo and Santa Clara Counties, CA, Review Period Ends: 12/24/2012, Contact: Gary Stern 707–575–6060.

EIS No. 20120367, Draft EIS, BPA, WA, I–5 Corridor Reinforcement Project, Cowlitz and Clark Counties, WA, Comment Period Ends: 03/01/2013, Contact: Nancy Wittpenn 503–230–3297.

EIS No. 20120368, Draft EIS, BLM, CA, Stateline Solar Farm Project, San Bernardino County, CA, Comment Period Ends: 02/21/2013, Contact: Jeffery Childers 951–697–5308.

EIS No. 20120369, Draft EIS, NOAA, USFWS, CA, Authorization of Incidental Take and Implementation of the Mendocino Redwood Habitat Conservation Plan/Natural Community Conservation and Timber Management Plan, Mendocino County, CA, Comment Period Ends: 02/21/2013, Contact: Eric Shott 707–575–6089 The Department of Commerce's National Oceanic and Atmospheric Administration and the Department of the Interior's Fish and Wildlife Service are joint lead agencies for the above project.

EIS No. 20120370, Draft Supplement, NRC, SD, Dewey-Burdock Project, Supplement to the In-Situ Leach Uranium Milling Facilities, Custer and Fall River Counties, SD, Comment Period Ends: 01/07/2013, Contact: Haimanot Yilma 301–415–8029.

Dated: November 19, 2012.

Cliff Rader,

Director, NEPA Compliance Division, Office of Federal Activities.

[FR Doc. 2012–28483 Filed 11–21–12; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

[FRN–9754–2]

Meeting of the National Environmental Education Advisory Council

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice.

SUMMARY: The National Environmental Education Advisory Council will meet on December 13–14th, 2012 in Washington, DC. The focus of the meeting will be to convene the new members of the Council, form work groups and develop plans for the report to congress.

This is an open meeting and all interested persons are invited to attend. The Council will hear comments from the public between 4:30 p.m. and 5:00 p.m. on Thursday December 13th, 2012. Each individual or organization wishing to address the NEEAC meeting will be allowed a maximum of five minutes to present their point of view. Also, written comments should be submitted electronically to *araujo.javier@epa.gov.* Please contact the Designated Federal Officer (DFO) at the number listed below to schedule agenda time. Time will be allotted on a first come first serve basis, and the total period for comments may be extended if the number of requests for appearances requires it.

ADDRESSES: The NEEAC meeting will be held at Ariel Rios North, Room 3530 located at 1201 Constitution Avenue NW., Washington, DC 20004.

The Council's meeting minutes and summary notes will be available online after the meeting, at *http://www.epa.gov/enviroed/neeac.html* or can be obtained by written request to the DFO.

FOR FURTHER INFORMATION CONTACT: Javier Araujo, DFO for the National Environmental Education Advisory Council (NEEAC) at (202) 564–2642 or email at *araujo.javier@epa.gov.*

Information on Services for Those with Disabilities: To request accommodation of a disability, please request it 10 days prior to the meeting, to give EPA as much time as possible to process your request.

Please contact Javier Araujo at (202) 564–2642 or email at: *araujo.javier@epa.gov.*

Javier Araujo,

Designated Federal Officer, National Environmental Education Advisory Council.

[FR Doc. 2012–28474 Filed 11–21–12; 8:45 am]

BILLING CODE 6560–50–P

EXPORT-IMPORT BANK

[Public Notice 2012–0543]

Application for Final Commitment for a Long-Term Loan or Financial Guarantee in Excess of $100 Million: AP087512XX

AGENCY: Export-Import Bank of the United States .

ACTION: Notice.

SUMMARY: This Notice is to inform the public, in accordance with Section 3(c)(10) of the Charter of the Export-Import Bank of the United States (''Ex-Im Bank''), that Ex-Im Bank has received an application for final commitment for a long-term loan or financial guarantee in excess of $100 million (as calculated in accordance with Section 3(c)(10) of the Charter). Comments received within the comment period specified below will be presented to the Ex-Im Bank Board of Directors prior to final action on this Transaction.

Reference: AP087512XX.

Purpose and Use: Brief description of the purpose of the transaction:

To support the export of U.S. manufactured aircraft under operating lease from the United States to South Korea and China.

Brief non-proprietary description of the anticipated use of the items being exported:

To provide regional and domestic airline service from and within South Korea and China.

To the extent that Ex-Im Bank is reasonably aware, the item(s) being exported are not expected to produce exports or provide services in competition with the exportation of goods or provision of services by a United States industry.

Parties: Principal Supplier: The Boeing Company.

Obligor: Air Lease Corporation.

Guarantor(s): N/A.

Description of Items Being Exported: Boeing 737 aircraft.

Information on Decision: Information on the final decision for this transaction will be available in the ''Summary Minutes of Meetings of Board of Directors'' on *http://www.exim.gov/articles.cfm/board%20minute.*

Confidential Information: Please note that this notice does not include confidential or proprietary business information; information which, if disclosed, would violate the Trade Secrets Act; or information which would jeopardize jobs in the United States by supplying information that competitors could use to compete with companies in the United States.

DATES: Comments must be received on or before December 18, 2012 to be assured of consideration before final consideration of the transaction by the Board of Directors of Ex-Im Bank.

ADDRESSES: Comments may be submitted through Regulations.gov at *www.regulations.gov.* To submit a comment, enter EIB–2012–0044 under the heading ''Enter Keyword or ID'' and select Search. Follow the instructions provided at the Submit a Comment screen. Please include your name,

company name (if any) and EIB–2012–0044 on any attached document.

Sharon A. Whitt,

Records Clearance Officer.

[FR Doc. 2012–28413 Filed 11–21–12; 8:45 am]

BILLING CODE 6690–01–P

FEDERAL DEPOSIT INSURANCE CORPORATION

FDIC Systemic Resolution Advisory Committee; Notice of Meeting

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Notice of open meeting.

SUMMARY: In accordance with the Federal Advisory Committee Act, 5 U.S.C. App. 2, notice is hereby given of a meeting of the FDIC Systemic Resolution Advisory Committee (the ''SR Advisory Committee''), which will be held in Washington, DC. The SR Advisory Committee will provide advice and recommendations on a broad range of issues regarding the resolution of systemically important financial companies pursuant to Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 (July 21, 2010), 12 U.S.C. 5301 *et seq.* (the ''Dodd-Frank Act'').

DATES: Monday, December 10, 2012, from 8:45 a.m. to 3:00 p.m.

ADDRESSES: The meeting will be held in the FDIC Board Room on the sixth floor of the FDIC Building located at 550 17th Street NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Requests for further information concerning the meeting may be directed to Mr. Robert E. Feldman, Committee Management Officer of the FDIC, at (202) 898–7043.

SUPPLEMENTARY INFORMATION:

Agenda: The agenda will include a discussion of a range of issues related to the resolution of systemically important financial companies pursuant to Title II of the Dodd-Frank Act. The agenda may be subject to change. Any changes to the agenda will be announced at the beginning of the meeting.

Type of Meeting: The meeting will be open to the public, limited only by the space available, on a first-come, first-served basis. For security reasons, members of the public will be subject to security screening procedures and must present valid photo identification to enter the building. The FDIC will provide attendees with auxiliary aids (e.g., sign language interpretation) required for this meeting. Those attendees needing such assistance should call (703) 562–6067 (Voice or TTY) at least two days before the meeting to make necessary arrangements. Written statements may be filed with the SR Advisory Committee before or after the meeting. This SR Advisory Committee meeting will be Webcast live via the Internet at *http://www.vodium.com/MediapodLibrary/index.asp?library=pn100472_fdic_SRAC.* This service is free and available to anyone with the following systems requirements: *http://www.vodium.com/home/sysreq.html.* Adobe Flash Player is required to view these presentations. The latest version of Adobe Flash Player can be downloaded at: *http://www.adobe.com/shockwave/download/download.cgi?P1_Prod_Version=ShockwaveFlash*. Installation questions or troubleshooting help can be found at the same link. For optimal viewing, a high speed Internet connection is recommended. The SR Advisory Committee meeting videos are made available on-demand approximately two weeks after the event.

Dated: November 19, 2012.

Federal Deposit Insurance Corporation.

Robert Feldman,

Executive Secretary, Federal Deposit Insurance Corporation.

[FR Doc. 2012–28399 Filed 11–21–12; 8:45 am]

BILLING CODE 6714–01–P

FEDERAL MARITIME COMMISSION

Ocean Transportation Intermediary License Applicants

The Commission gives notice that the following applicants have filed an application for an Ocean Transportation Intermediary (OTI) license as a Non-Vessel-Operating Common Carrier (NVO) and/or Ocean Freight Forwarder (OFF) pursuant to section 19 of the Shipping Act of 1984 (46 U.S.C. 40101). Notice is also given of the filing of applications to amend an existing OTI license or the Qualifying Individual (QI) for a licensee.

Interested persons may contact the Office of Ocean Transportation Intermediaries, Federal Maritime Commission, Washington, DC 20573, by telephone at (202) 523–5843 or by email at *OTI@fmc.gov.*

Certified Packaging & Transport, Inc. (OFF), 10305 Guliford Road, Jessup, MD 20794, Officer: Mark Feinberg, President (QI), Application Type: New OFF License.

Concepts In Freight, Inc. (NVO & OFF), 10813 NW. 30th Street, Suite 115, Doral, FL 33172, Officers: Asma Aftimos, President (QI), Fadi Aftimos, Vice President, Application Type: QI Change.

DRV Cargo Express Inc. (NVO) 5563 NW 72nd Avenue, Miami, FL 33166, Officer: Dante R. Viggiano, President (QI), Application Type: New NVO License.

Dax Cargo Inc (OFF), 8514 NW 66th Street, Miami, FL 33166, Officers: Winston R. Lopez, Secretary (QI), Carlos E. Chalbaud, President, Application Type: New OFF License.

Forwarding Services International, Inc. dba Triangle Shipping Lines (NVO & OFF), 900 Center Park Drive, Suite F, Charlotte, NC 28217, Officers: Paul L. Carter, Vice President (QI), James D. McClaskey, President, Application Type: Name Change to Midrex Global Logistics, Inc. dba Triangle Shipping Lines.

Green World Export, Inc. (OFF), 17800 Castleton Street, Suite 255, City of Industry, CA 91748, Officer: Danyang Zhao, CEO (QI), Application Type: New OFF License.

Intell SCM LLC dba iContainers (NVO), 5150 Pacific Coast Highway, Suite 460, Long Beach, CA 90804, Officer: Andrew P. Scott, Manager (QI), Application Type: Remove Trade Name iContainers and Add Trade Names AWA Lines and Island Cargo Support.

Jolly Forwarding USA, Inc. dba Jollibox Cargo dba Pinoy Express Cargo dba Chips R'Us (NVO), 470 Cloverleaf Drive, Suites A&B, Baldwin Park, CA 91706, Officers: Urdelia C. Linayao, Secretary (QI), Maria Lourdes A. Timbol, President, Application Type: New NVO License.

Kaizen Logistics Corp (NVO & OFF), 1925 NW. 108th Avenue, Miami, FL 33172, Officers: Claudia Pabon, Vice President (QI), Juan P. Cadena, President, Application Type: New NVO & OFF License.

MIA Trans Corp. (NVO & OFF), 8174 SW. 118th Place, Miami, FL 33183, Officers: Donald H. Pertuz, President (QI), Marilena Pertuz, Secretary, Application Type: License Transfer to MIA Logistics Solutions, Inc.

Midnite Air Corp. dba Midnite Express dba MNX (OFF), 300 N. Oak Street, Los Angeles, CA 90302, Officers: Thomas A. Belmont, COO (QI), Christine Storey, Board Member, Application Type: QI Change.

O.K. Cargo Corp. (OFF), 1720 NW. 94th Avenue, Miami, FL 33172, Officers: Jorge L. Garcia, President (QI), Nora V. Garcia, Vice President, Application Type: New OFF License.

Oncarriage LLC (NVO & OFF), 214 Windgate Court, Peachtree City, GA

30269, Officer: Joshua Wolf, Member/Manager (QI), Application Type: New NVO & OFF License.

Pegasus Logistics Group, Inc. (NVO & OFF), 615 Freeport Pkwy, Suite 100, Coppell, TX 75019, Officer: Kenneth C. Beam, President (QI), Application Type: Add NVO Service.

Reliable Shipping Agency, LLC (NVO), 7710 Brooklyn Boulevard North, Suite 211, Brooklyn Park, MN 55443, Officers: Wells Wescott, Manager (QI), Christian K. Kolleh, Chief Executive Manager, Application Type: New NVO License.

Santa Fe Group Americas, Inc. (NVO & OFF), 1001 S. Dairy Ashford Street, Suite 100, Houston, TX 77077, Officers: Francesca A. Vollaro, Vice President (QI), Lars L. Iversen, President, Application Type: New NVO & OFF License.

SH Transport, Inc. (NVO), 1975 Charles Willard Street, Rancho Dominguez, CA 90220, Officer: Steven Park, President (QI), Application Type: New NVO License.

Transport Partner (USA), Inc. (NVO & OFF), 2006 Cherry Hill Lane, Charleston, SC 29405, Officers: Adam Adaway, Secretary (QI), Wim Spinhoven, President, Application Type: Add NVO Service.

Transports P. Fatton Inc. dba Fatton USA (NVO), 145 Hook Creek Blvd., Bldg. A5, Valley Stream, NY 11581, Officers: Renaud Mellier, Treasurer (QI), Henri Ducasse, CEO, Application Type: QI Change.

Dated: November 16, 2012.

By the Commission.

Karen V. Gregory,

Secretary.

[FR Doc. 2012–28475 Filed 11–21–12; 8:45 am]

BILLING CODE 6730–01–P

FEDERAL MARITIME COMMISSION

Ocean Transportation Intermediary License Revocations

The Commission gives notice that the following Ocean Transportation Intermediary license has been revoked pursuant to section 19 of the Shipping Act of 1984 (46 U.S.C. 40101) effective on the date shown.

License No.: 022069N.

Name: Unique Logistics International (ATL) LLC.

Address: 510 Plaza Drive, Suite 2290, Atlanta, GA 30349.

Date Revoked: October 15, 2012.

Reason: Failed to maintain a valid bond.

Vern W. Hill,

Director, Bureau of Certification and Licensing.

[FR Doc. 2012–28476 Filed 11–21–12; 8:45 am]

BILLING CODE 6730–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

[CMS–9961–N]

Recognition of Entities for the Accreditation of Qualified Health Plans

AGENCY: Department of Health and Human Services.

ACTION: Notice.

SUMMARY: This notice announces the recognition of the National Committee for Quality Assurance (NCQA) and URAC as recognized accrediting entities for the purposes of fulfilling the accreditation requirement as part of qualified health plan certification.

DATES: This notice is effective on November 20, 2012.

FOR FURTHER INFORMATION CONTACT: Rebecca Zimmermann, (301) 492–4396. Deborah Greene, (301) 492–4293.

SUPPLEMENTARY INFORMATION:

I. Background

Section 1311(c)(1)(D) of the Affordable Care Act specifies that to be certified as a qualified health plan (QHP) and operate in the Exchange, a health plan must be accredited by a recognized accrediting entity on a uniform timeline established by the applicable Exchange. On July 20, 2012, we published a final rule in the **Federal Register** (77 FR 42658) titled, ''Patient Protection and Affordable Care Act; Data Collection To Support Standards Related to Essential Health Benefits; Recognition of Entities for the Accreditation of Qualified Health Plans.'' In that rule, we finalized 45 CFR 156.275(c), which specified the requirements for accrediting entities to be recognized for the purposes of fulfilling the accreditation requirement as part of QHP certification. We also established that, effective upon completion of the conditions at § 156.275 in paragraphs (c)(2) through (c)(4), that the National Committee for Quality Assurance (NCQA) and URAC will be recognized as accrediting entities for the purposes of QHP certification and that the Department of Health and Human Services (HHS) will notify the public of this recognition in the **Federal Register**. As discussed in the preamble to the final rule published on July 20, 2012, the recognition of accrediting entities in phase one is effective until it is rescinded or this interim phase one process is replaced by the phase two process.

II. Provisions of the Final Notice

NCQA and URAC met the requirements and criteria described in the final rule to be recognized as an accrediting entity (77 FR 42662 through 42668). Therefore, this notice serves as public notification that NCQA and URAC are recognized by the Secretary of HHS [1] as accrediting entities for the purposes of QHP certification.

III. Collection of Information Requirements

This document does not impose information collection and recordkeeping requirements. Consequently, it need not be reviewed by the Office of Management and Budget under the authority of the Paperwork Reduction Act of 1995.

Dated: November 8, 2012.

Marilyn Tavenner,

Acting Administrator, Centers for Medicare & Medicaid Services.

[FR Doc. 2012–28440 Filed 11–20–12; 11:15 am]

BILLING CODE 4120–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Medicare & Medicaid Services

[CMS–1437–N]

Medicare Program; Town Hall Meeting on FY 2014 Applications for New Medical Services and Technology Add-On Payments

AGENCY: Centers for Medicare & Medicaid Services (CMS), HHS.

ACTION: Notice of meeting.

SUMMARY: This notice announces a Town Hall meeting in accordance with section 1886(d)(5)(K)(viii) of the Social Security Act (the Act) to discuss fiscal year (FY) 2014 applications for add-on payments for new medical services and technologies under the hospital inpatient prospective payment system (IPPS). Interested parties are invited to this meeting to present their comments, recommendations, and data regarding whether the FY 2014 new medical services and technologies applications meet the substantial clinical improvement criterion.

[1] Delegated to CCIIO, 76 FR 53903 through 53906 2011–08–30.

DATES: *Meeting Date:* The Town Hall Meeting announced in this notice will be held on Tuesday, February 5, 2013. The Town Hall Meeting will begin at 9:00 a.m. Eastern Standard Time (e.s.t.) and check-in will begin at 8:30 a.m. e.s.t. Only one check-in is required to enter the building.

Deadline for Registration for Participants (not Presenting) at the Town Hall Meeting and Submitting Requests for Special Accommodations: The deadline to register to attend the Town Hall Meeting and requests for special accommodations must be received no later than 5:00 p.m., e.s.t. on Monday, January 21, 2013.

Deadline for Registration of Presenters of the Town Hall Meeting: The deadline to register to present at the Town Hall Meeting must be received no later than 5:00 p.m., e.s.t. on Monday, January 14, 2013.

Deadline for Submission of Agenda Item(s) or Written Comments for the Town Hall Meeting: Written comments and agenda items for discussion at the Town Hall Meeting, including agenda items by presenters, must be received by Monday, January 14, 2013. In addition to materials submitted for discussion at the Town Hall Meeting, individuals may submit other written comments after the Town Hall Meeting, as specified in the **ADDRESSES** section of this notice, on whether the service or technology represents a substantial clinical improvement. These comments must be received by Tuesday, February 26, 2013, for consideration in the FY 2014 IPPS proposed rule.

ADDRESSES: *Meeting Location:* The Town Hall Meeting will be held in the main Auditorium in the central building of the Centers for Medicare and Medicaid Services located at 7500 Security Boulevard, Baltimore, MD 21244–1850.

In addition, we are providing two alternatives to attending the meeting in person—(1) there will be an open toll-free phone line to call into the Town Hall Meeting; or (2) participants may view and participate in the Town Hall Meeting via live stream technology and/or webinar. Information on these options are discussed in section II.B. of this notice.

Registration and Special Accommodations: Individuals wishing to participate in the meeting must register by following the on-line registration instructions located in section III. of this notice or by contacting staff listed in the **FOR FURTHER INFORMATION CONTACT** section of this notice. Individuals who need special accommodations should contact staff listed in the **FOR FURTHER INFORMATION CONTACT** section of this notice.

Submission of Agenda Item(s) or Written Comments for the Town Hall Meeting: Each presenter must submit an agenda item(s) regarding whether a FY 2014 application meets the substantial clinical improvement criterion. Agenda items, written comments, questions or other statements must not exceed three single-spaced typed pages and may be sent via email to *newtech@cms.hhs.gov.*

FOR FURTHER INFORMATION CONTACT: Michael Treitel, (410) 786–4552, *michael.treitel@cms.hhs.gov,* or Celeste Beauregard, (410) 786–8102, *celeste.beauregard@cms.hhs.gov*. Alternatively, you may forward your requests via email to *newtech@cms.hhs.gov*.

SUPPLEMENTARY INFORMATION:

I. Background on the Add-On Payments for New Medical Services and Technologies Under the IPPS

Sections 1886(d)(5)(K) and (L) of the Social Security Act (the Act) require the Secretary to establish a process of identifying and ensuring adequate payments to acute care hospitals for new medical services and technologies under Medicare. Effective for discharges beginning on or after October 1, 2001, section 1886(d)(5)(K)(i) of the Act requires the Secretary to establish (after notice and opportunity for public comment) a mechanism to recognize the costs of new services and technologies under the hospital inpatient prospective payment system (IPPS). In addition, section 1886(d)(5)(K)(vi) of the Act specifies that a medical service or technology will be considered ''new'' if it meets criteria established by the Secretary (after notice and opportunity for public comment). (See the FY 2002 IPPS proposed rule (66 FR 22693, May 4, 2001) and final rule (66 FR 46912, September 7, 2001) for a more detailed discussion.)

In the September 7, 2001 final rule (66 FR 46914), we noted that we evaluated a request for special payment for a new medical service or technology against the following criteria in order to determine if the new technology meets the substantial clinical improvement requirement:

- The device offers a treatment option for a patient population unresponsive to, or ineligible for, currently available treatments.
- The device offers the ability to diagnose a medical condition in a patient population where that medical condition is currently undetectable or offers the ability to diagnose a medical condition earlier in a patient population than allowed by currently available methods. There must also be evidence that use of the device to make a diagnosis affects the management of the patient.
- Use of the device significantly improves clinical outcomes for a patient population as compared to currently available treatments. Some examples of outcomes that are frequently evaluated in studies of medical devices are the following:

++ Reduced mortality rate with use of the device.

++ Reduced rate of device-related complications.

++ Decreased rate of subsequent diagnostic or therapeutic interventions (for example, due to reduced rate of recurrence of the disease process).

++ Decreased number of future hospitalizations or physician visits.

++ More rapid beneficial resolution of the disease process treatment because of the use of the device.

++ Decreased pain, bleeding or other quantifiable symptoms.

++ Reduced recovery time.

In addition, we indicated that the requester is required to submit evidence that the technology meets one or more of these criteria.

Section 503 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) amended section 1886(d)(5)(K)(viii) of the Act to revise the process for evaluating new medical services and technology applications by requiring the Secretary to do the following:

- Provide for public input regarding whether a new service or technology represents an advance in medical technology that substantially improves the diagnosis or treatment of Medicare beneficiaries before publication of a proposed rule.
- Make public and periodically update a list of all the services and technologies for which an application is pending.
- Accept comments, recommendations, and data from the public regarding whether the service or technology represents a substantial improvement.
- Provide for a meeting at which organizations representing hospitals, physicians, manufacturers and any other interested party may present comments, recommendations, and data to the clinical staff of CMS as to whether the service or technology represents a substantial improvement before publication of a proposed rule.

The opinions and alternatives provided during this meeting will assist us as we evaluate the new medical

services and technology applications for fiscal year (FY) 2014. In addition, they will help us to evaluate our policy on the IPPS new technology add-on payment process before the publication of the FY 2014 IPPS proposed rule.

II. Town Hall Meeting and Conference Calling/Live Streaming Information

A. Format of the Town Hall Meeting

As noted in section I. of this notice, we are required to provide for a meeting at which organizations representing hospitals, physicians, manufacturers and any other interested party may present comments, recommendations, and data to the clinical staff of CMS concerning whether the service or technology represents a substantial clinical improvement. This meeting will allow for a discussion of the substantial clinical improvement criteria on each of the FY 2014 new medical services and technology add-on payment applications. Information regarding the applications can be found on our Web site at *http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/AcuteInpatientPPS/newtech.html.*

The majority of the meeting will be reserved for presentations of comments, recommendations, and data from registered presenters. The time for each presenter's comments will be approximately 10 to 15 minutes and will be based on the number of registered presenters. Presenters will be scheduled to speak in the order in which they register and grouped by new technology applicant. Therefore, individuals who would like to present must register and submit their agenda item(s) via email to *newtech@cms.hhs.gov* by the date specified in the **DATES** section of this notice.

In addition, written comments will also be accepted and presented at the meeting if they are received via email to *newtech@cms.hhs.gov* by the date specified in the **DATES** section of this notice. Written comments may also be submitted after the meeting for our consideration. If the comments are to be considered before the publication of the proposed rule, the comments must be received via email to *newtech@cms.hhs.gov* by the date specified in the **DATES** section of this notice.

B. Conference Call, Live Streaming, and Webinar Information

For participants who cannot attend the Town Hall Meeting in person, an open toll-free phone line, (877) 267–1577, has been made available. The conference code is ''7702.''

Also, there will be an option to view and participate in the Town Hall Meeting via live streaming technology and/or a webinar. Information on the option to participate via live streaming technology and/or a webinar will be provided through an upcoming listserv notice and posted on the New Technology Web site at *http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/AcuteInpatientPPS/newtech.html.* Continue to check the Web site for updates.

Disclaimer: Because this is the first year that we are providing an option for live streaming technology and/or a webinar, we cannot guarantee the reliability of these technologies.

III. Registration Instructions

The Division of Acute Care in CMS is coordinating the meeting registration for the Town Hall Meeting on substantial clinical improvement. While there is no registration fee, individuals planning to attend the Town Hall Meeting in person must register to attend.

Registration may be completed on-line at the following web address: *http://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/AcuteInpatientPPS/newtech.html.* Select the link at the bottom of the page ''Register to Attend the New Technology Town Hall Meeting''. After completing the registration, on-line registrants should print the confirmation page(s) and bring it with them to the meeting(s).

If you are unable to register on-line, you may register by sending an email to *newtech@cms.hhs.gov.* Please include your name, address, telephone number, email address and fax number. If seating capacity has been reached, you will be notified that the meeting has reached capacity.

IV. Security, Building, and Parking Guidelines

Because these meetings will be located on Federal property, for security reasons, any persons wishing to attend these meetings must register by the date specified in the **DATES** section of this notice. Please allow sufficient time to go through the security checkpoints. It is suggested that you arrive at 7500 Security Boulevard no later than 8:30 a.m. e.s.t. if you are attending the Town Hall Meeting so that you will be able to arrive promptly for the meeting.

Security measures include the following:

- Presentation of government-issued photographic identification to the Federal Protective Service or Guard Service personnel.
- Interior and exterior inspection of vehicles (this includes engine and trunk inspection) at the entrance to the grounds. Parking permits and instructions will be issued after the vehicle inspection.
- Passing through a metal detector and inspection of items brought into the building. We note that all items brought to CMS, whether personal or for the purpose of demonstration or to support a demonstration, are subject to inspection. We cannot assume responsibility for coordinating the receipt, transfer, transport, storage, set-up, safety, or timely arrival of any personal belongings or items used for demonstration or to support a demonstration.

Note: *Individuals who are not registered in advance will not be permitted to enter the building and will be unable to attend the meeting in person. The public may not enter the building earlier than 45 minutes prior to the convening of the meeting(s).*

All visitors must be escorted in areas other than the lower and first floor levels in the Central Building. Seating capacity is limited to the first 250 registrants.

Authority: Section 503 of Public Law 108–173.

(Catalog of Federal Domestic Assistance Program No. 93.773, Medicare—Hospital Insurance; and Program No. 93.774, Medicare—Supplementary Medical Insurance Program)

Dated: November 14, 2012.

Marilyn Tavenner,

Acting Administrator, Centers for Medicare & Medicaid Services.

[FR Doc. 2012–28478 Filed 11–21–12; 8:45 am]

BILLING CODE 4120–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Administration for Children and Families

Proposed Information Collection Activity; Comment Request

Proposed Projects

Title: Form CB–496: Title IV–E Programs Quarterly Financial Report.

OMB No.: 0970–0205.

Description: This is a financial report submitted following the end of each fiscal quarter by each State or Tribe with an approved title IV–E plan administering any of three title IV–E entitlement grant programs—Foster Care, Adoption Assistance or Guardianship Assistance.

The purpose of this form is to enable each State or Tribe to meet its statutory and regulatory requirement to report program expenditures made in the

preceding fiscal quarter and to estimate program expenditures to be made in the upcoming fiscal quarter. This form also allows States and Tribes to report the actual and estimated average monthly number of children assisted in each of the three IV–E entitlement grant programs in the preceding and upcoming fiscal quarters, respectively.

The Administration for Children and Families provides Federal funding at the rate of 50 percent for nearly all allowable and legitimate administrative costs of these programs and at other funding rates for other specific categories of costs as detailed in Federal statute and regulations. The information collected in this report is used by this agency to calculate quarterly Federal grant awards and to enable oversight of the financial management of the programs.

Respondents: States (including Puerto Rico and the District of Columbia) and Tribes* with approved title IV–E plans. (*An estimated 10 Tribes will have approved title IV–E plans within the next 3-year period.)

ANNUAL BURDEN ESTIMATES

Instrument	Number of respondents	Number of responses per respondent	Average burden hours per response	Total burden hours
Form CB–496: Title IV–E Programs Quarterly Financial Report	62	4	20	4,960

Estimated Total Annual Burden Hours: 4,960.

In compliance with the requirements of Section 506(c)(2)(A) of the Paperwork Reduction Act of 1995, the Administration for Children and Families is soliciting public comment on the specific aspects of the information collection described above. Copies of the proposed collection of information can be obtained and comments may be forwarded by writing to the Administration for Children and Families, Office of Planning, Research and Evaluation, 370 L'Enfant Promenade SW., Washington, DC 20447, Attn: ACF Reports Clearance Officer. Email address: *infocollection@acf.hhs.gov*. All requests should be identified by the title of the information collection.

The Department specifically requests comments on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the proposed collection of information; (c) the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology. Consideration will be given to comments and suggestions submitted within 60 days of this publication.

Robert Sargis,

Reports Clearance Officer.

[FR Doc. 2012–28340 Filed 11–21–12; 8:45 am]

BILLING CODE 4184–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

[Docket No. FDA–2012–N–1090]

Provisions of the Food and Drug Administration Safety and Innovation Act Related to Medical Gases; Establishment of a Public Docket

AGENCY: Food and Drug Administration, HHS.

ACTION: Notice.

SUMMARY: The Food and Drug Administration (FDA) is establishing a public docket for information pertaining to FDA's implementation of the provisions of the Food and Drug Administration Safety and Innovation Act (FDASIA) related to medical gases. This action is intended to ensure that information submitted to FDA on the implementation of the medical gas provisions of FDASIA is available to all interested persons in a timely fashion.

DATES: Submit electronic or written comments by November 25, 2013.

ADDRESSES: Submit electronic comments to *http://www.regulations.gov*. Submit written comments to the Division of Dockets Management (HFA–305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852. All comments should be identified with the docket number found in brackets in the heading of this document.

FOR FURTHER INFORMATION CONTACT: Patrick Raulerson, Center for Drug Evaluation and Research, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 51, rm. 6368, Silver Spring, MD 20993–0002, 301–796–3522, *patrick.raulerson@fda.hhs.gov;* or Germaine Connolly, Center for Veterinary Medicine, Food and Drug Administration, 7500 Standish Pl., MPN2, Rockville, MD 20855, 240–276–8331, *germaine.connolly@fda.hhs.gov*.

SUPPLEMENTARY INFORMATION:

I. Background

On July 9, 2012, President Obama signed into law FDASIA (Pub. L. 112–144, 126 Stat. 993). Title XI, Subtitle B, section 1111 of FDASIA added new sections 575, 576, and 577 to the Federal Food, Drug, and Cosmetic Act (the FD&C Act) regarding medical gases. Among other things, these new sections define the terms ''designated medical gas'' and ''medical gas'' and establish the process for the certification of a medical gas as a designated medical gas. (See sections 575(1) and (2) of the FD&C Act.) The sections describe the process for filing a request for certification and describe the information that should be included in the request for certification. (See section 576(a) of the FD&C Act.) Under section 576(a)(3) of the FD&C Act, if a certification is granted for a designated medical gas, the designated medical gas will be deemed to have in effect an approved new human drug application under section 505 (21 U.S.C. 355) or an approved new animal drug application under section 512 (21 U.S.C. 360b) of the FD&C Act for certain specified indications and subject to all applicable postapproval requirements. Under section 576(a)(1) of the FD&C Act, requests for certification may be submitted to FDA beginning 180 days after the enactment of FDASIA, or January 5, 2013.

FDA is establishing a public docket for information pertaining to FDA's implementation of these new medical gas provisions. This action is intended to ensure that information submitted to FDA on the implementation of the medical gas provisions of FDASIA is available to all interested persons in a timely fashion. The Compressed Gas

Association and the Gases and Welding Distributors Association voluntarily submitted to the Agency its views on implementation of the medical gas provisions of FDASIA. FDA plans to place these comments in the public docket so they are readily available to all interested members of the public. FDA expects to place all additional submissions containing recommendations on how the Agency should implement the medical gas provisions of FDASIA in this docket, and directs the public to submit all comments related to these provisions to this docket. This docket will be open for comments for 1 year from the date of publication of this notice. In addition, as FDA implements the medical gas provisions of FDASIA, FDA plans to open other dockets. For example, we plan to issue a separate **Federal Register** notice in the future to provide the public with an opportunity to submit comments on section 1112 of FDASIA. Section 1112(a)(1) of FDASIA provides that not later than 18 months after the date of the enactment of FDASIA, the Secretary, after obtaining input from medical gas manufacturers and any other interested members of the public, must determine whether any changes to the Federal drug regulations are necessary for medical gases.

II. Comments

Interested persons may submit either written comments to the Division of Dockets Management (see **ADDRESSES**) or electronic comments to *http://www.regulations.gov.* It is only necessary to send one set of comments. Identify comments with the docket number found in brackets in the heading of this document. Received comments may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday, and will be posted to the docket at *http://www.regulations.gov.*

Dated: November 19, 2012.

Leslie Kux,

Assistant Commissioner for Policy.

[FR Doc. 2012–28431 Filed 11–21–12; 8:45 am]

BILLING CODE 4160–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

[Docket No. FDA–2012–D–1120]

Draft Guidance for Industry on Vaginal Microbicides: Development for the Prevention of Human Immunodeficiency Virus Infection; Availability

AGENCY: Food and Drug Administration, HHS.

ACTION: Notice.

SUMMARY: The Food and Drug Administration (FDA) is announcing the availability of a draft guidance for industry entitled ''Vaginal Microbicides: Development for the Prevention of HIV Infection.'' The purpose of this guidance is to assist sponsors in all phases of development of vaginal microbicides for the prevention of human immunodeficiency virus (HIV) infection. The guidance outlines the types of nonclinical studies and clinical trials recommended throughout the drug development process to support approval of vaginal microbicides.

DATES: Although you can comment on any guidance at any time (see 21 CFR 10.115(g)(5)), to ensure that the Agency considers your comment on this draft guidance before it begins work on the final version of the guidance, submit either electronic or written comments on the draft guidance by February 21, 2013.

ADDRESSES: Submit written requests for single copies of the draft guidance to the Division of Drug Information, Center for Drug Evaluation and Research, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 51, Rm. 2201, Silver Spring, MD 20993–0002. Send one self-addressed adhesive label to assist that office in processing your requests. See the **SUPPLEMENTARY INFORMATION** section for electronic access to the draft guidance document.

Submit electronic comments on the draft guidance to *http://www.regulations.gov.* Submit written comments to the Division of Dockets Management (HFA–305), Food and Drug Administration, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852.

FOR FURTHER INFORMATION CONTACT: Charu Mullick, Center for Drug Evaluation and Research, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 22, Rm. 6365, Silver Spring, MD 20993–0002, 301–796–1500.

SUPPLEMENTARY INFORMATION:

I. Background

FDA is announcing the availability of a draft guidance for industry entitled ''Vaginal Microbicides: Development for the Prevention of HIV Infection.'' This guidance addresses nonclinical development, early phases of clinical development, phase 3 trial considerations, and safety considerations in vaginal microbicide development, including safety considerations in adolescent and pregnant populations. The guidance also provides some information on approaches for developing combination microbicide products such as drug-drug combinations, drug-device combinations containing a microbicide, or combination products containing a microbicide that are intended for multiple indications. With the recent approval of oral emtricitabine/tenofovir for HIV pre-exposure prophylaxis (PrEP), the effect of oral PrEP on microbicide trial designs is an emerging topic. The guidance discusses this issue; however, it should be noted the pertinent sections may be revised as FDA takes into consideration evolving opinions in the prevention field as well as public comments on this topic.

This draft guidance is being issued consistent with FDA's good guidance practices regulation (21 CFR 10.115). The draft guidance, when finalized, will represent the Agency's current thinking on developing vaginal microbicides for preventing HIV transmission. It does not create or confer any rights for or on any person and does not operate to bind FDA or the public. An alternative approach may be used if such approach satisfies the requirements of the applicable statutes and regulations.

II. The Paperwork Reduction Act of 1995

This draft guidance refers to previously approved collections of information that are subject to review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). The collections of information in 21 CFR part 312 have been approved under OMB control number 0910–0014, and the collections of information referred to in the guidance for clinical trial sponsors entitled ''Establishment and Operation of Clinical Trial Data Monitoring Committees'' have been approved under OMB control number 0910–0581.

III. Comments

Interested persons may submit either written comments regarding the draft guidance to the Division of Dockets

Management (see **ADDRESSES**) or electronic comments to *http://www.regulations.gov.* It is only necessary to send one set of comments. Identify comments with the docket number found in brackets in the heading of this document. Received comments may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday, and will be posted to the docket at *http://www.regulations.gov.*

IV. Electronic Access

Persons with access to the Internet may obtain the document at either *http://www.fda.gov/Drugs/GuidanceComplianceRegulatoryInformation/Guidances/default.htm* or *http://www.regulations.gov.*

Dated: November 19, 2012.

Leslie Kux,

Assistant Commissioner for Policy.

[FR Doc. 2012–28430 Filed 11–21–12; 8:45 am]

BILLING CODE 4160–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

[Docket No. FDA–2011–D–0464]

Guidance for Industry and Food and Drug Administration Staff; The Content of Investigational Device Exemption and Premarket Approval Applications for Artificial Pancreas Device Systems; Availability

AGENCY: Food and Drug Administration, HHS.

ACTION: Notice.

SUMMARY: The Food and Drug Administration (FDA) is announcing the availability of the guidance entitled ''The Content of Investigational Device Exemption (IDE) and Premarket Approval (PMA) Applications for Artificial Pancreas Device Systems.'' FDA is issuing this guidance to inform industry and Agency staff of its recommendations for analytical and clinical performance studies to support premarket submissions for artificial pancreas systems.

DATES: Submit either electronic or written comments on this guidance at any time. General comments on Agency guidance documents are welcome at any time.

ADDRESSES: Submit written requests for single copies of the guidance document entitled ''The Content of Investigational Device Exemption (IDE) and Premarket Approval (PMA) Applications for Artificial Pancreas Device Systems'' to the Division of Small Manufacturers, International and Consumer Assistance, Center for Devices and Radiological Health, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 66, rm. 4613, Silver Spring, MD 20993–0002. Send one self-addressed adhesive label to assist that office in processing your request, or fax your request to 301–847–8149. See the **SUPPLEMENTARY INFORMATION** section for information on electronic access to the guidance.

Submit electronic comments on the guidance to *http://www.regulations.gov.* Submit written comments to the Division of Dockets Management (HFA–305), Food and Drug Administration, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852. Identify comments with the docket number found in brackets in the heading of this document.

FOR FURTHER INFORMATION CONTACT: Stayce Beck, Center for Devices and Radiological Health, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 66, Rm. 5609, Silver Spring, MD 20993, 301–796–6514.

SUPPLEMENTARY INFORMATION:

I. Background

Diabetes mellitus has reached epidemic proportions in the United States and, more recently, worldwide. The morbidity and mortality associated with diabetes is anticipated to account for a substantial proportion of health care expenditures. Although there are many devices available that help patients manage the disease, FDA recognizes the need for new and improved devices for treatment of diabetes. One of the more advanced diabetes management systems is an artificial pancreas device system. An artificial pancreas system is a type of autonomous system that adjusts insulin infusion based upon the continuous glucose monitor via a control algorithm. On June 22, 2011 (76 FR 36542), FDA announced the availability of the draft guidance document entitled ''Draft Guidance for Industry and Food and Drug Administration Staff: The Content of Investigational Device Exemption (IDE) and Premarket Approval Applications (PMA) for Low Glucose Suspend (LGS) Device Systems.'' On December 6, 2011 (76 FR 76166), FDA announced the availability of the draft guidance document entitled ''The Content of Investigational Device Exemption (IDE) and Premarket Approval (PMA) Applications for Artificial Pancreas Device Systems.'' Ninety-seven sets of comments were received in total for both guidance documents. In response to comments, FDA made clarifying edits in several sections. Based on the similarities between the two draft guidance documents and the comments received, these two documents have been combined into one guidance document, which provides industry and Agency staff with recommendations for developing premarket submissions for artificial pancreas device systems (APDS) and is the subject of this **Federal Register** document. The guidance outlines considerations for development of clinical studies, and recommends elements that should be included in IDE and PMA applications for artificial pancreas systems, including threshold suspend systems (also known as low glucose suspend systems), single hormonal control systems, and bihormonal control systems. This guidance focuses on critical elements of safety and effectiveness for approval of this device type, while keeping in mind the risks diabetic patients face everyday.

Artificial pancreas device systems are class III devices and require the submission of a PMA. All components of the APDS (insulin pump, continuous glucose monitoring system, blood glucose device, and control algorithm and signal processing functional component) are considered essential components of the system and will be regulated as class III devices when used as part of an APDS. As such, all information sufficient for approval of the components as part of the system should be provided in the PMA submission (e.g., manufacturing information, specifications, etc.).

II. Significance of Guidance

This guidance is being issued consistent with FDA's good guidance practices regulation (21 CFR 10.115). The guidance represents the Agency's current thinking on the content of IDE and PMA applications for artificial pancreas device systems. It does not create or confer any rights for or on any person and does not operate to bind FDA or the public. An alternative approach may be used if such approach satisfies the requirements of the applicable statute and regulations.

III. Electronic Access

Persons interested in obtaining a copy of the guidance may do so by using the Internet. A search capability for all CDRH guidance documents is available at *http://www.fda.gov/MedicalDevices/DeviceRegulationandGuidance/GuidanceDocuments/default.htm.* Guidance documents are also available at *http://www.regulations.gov.* To receive the document ''The Content of Investigational Device Exemption (IDE) and Premarket Approval (PMA)

Applications for Artificial Pancreas Device Systems,'' you may either send an email request to *dsmica@fda.hhs.gov* to receive an electronic copy of the document or send a fax request to 301–847–8149 to receive a hard copy. Please use the document number 1759 to identify the guidance you are requesting.

IV. Paperwork Reduction Act

This guidance refers to currently approved collections of information found in FDA regulations and guidance documents. These collection of information are subject to review by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). The collections of information in 21 CFR 54.4 are approved under OMB control number 0910–0396; the collections of information in 21 CFR 56.115 are approved under OMB control number 0910–0130; the collections of information in 21 CFR parts 801 and 809 are approved under OMB control number 0910–0485; the collections of information in 21 CFR part 812 are approved under OMB control number 0910–0078; and the collections of information in 21 CFR part 814 are approved under OMB control number 0910–0231; the collections of information in 21 CFR part 820 are approved under OMB control number 0910–0073.

V. Comments

Interested persons may submit either written comments regarding this document to the Division of Dockets Management (see **ADDRESSES**) or electronic comments to *http://www.regulations.gov.* It is only necessary to send one set of comments. Identify comments with the docket number found in brackets in the heading of this document. Received comments may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday, and will be posted to the docket at *http://www.regulations.gov.*

Dated: November 16, 2012.

Leslie Kux,

Assistant Commissioner for Policy.

[FR Doc. 2012–28339 Filed 11–21–12; 8:45 am]

BILLING CODE 4160–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Resources and Service Administration

Advisory Committee on Interdisciplinary, Community-Based Linkages; Notice of Meeting

In accordance with section 10(a)(2) of the Federal Advisory Committee Act (Pub. L. 92–463), notice is hereby given of the following meeting:

Name: Advisory Committee on Interdisciplinary, Community-Based Linkages (ACICBL).

Dates and Times: December 7, 2012, 1:00 p.m.–5:00 p.m. EST.

Place: Webinar and Conference Call Format.

SUPPLEMENTARY INFORMATION: *Status:* The meeting will be open to the public. The conference call access will be limited only by availability of telephone ports.

Purpose: The members of the ACICBL will begin the planning required to develop the legislatively mandated 13th Annual Report to the Secretary of Health and Human Services and Congress. The meeting objectives are to: (1) Focus on a relevant topic that will enhance the mission of the Title VII training programs; (2) develop an outline that will inform the development of the 13th Annual Report; (3) provide an update on training programs; and (4) provide an update on the 12th Annual Report.

Agenda: The ACICBL agenda includes an opportunity for each member to offer ideas for the upcoming report, along with identifying consultants in specific areas who could provide expert testimony. The staff writer provided by the Health Resources and Services Administration (HRSA), Bureau of Health Professions, will offer a strategy for outlining the upcoming report. The agenda will be available days prior to the meeting on the HRSA Web site (*http://www.hrsa.gov/advisorycommittees/bhpradvisory/acicbl/acicbl.html*). Agenda items are subject to change as priorities dictate.

Individuals who plan to participate on the webinar should register at least one day prior to the meeting, using the following webinar information: *https://hrsa.connectsolutions.com/r5x1ckkknl6.* The conference call-in number is 1–800–857–5750, using the participant passcode 6694174.

Requests to make oral comments or provide written comments to the ACICBL should be sent to Dr. Joan Weiss, Designated Federal Official, at least 3 days prior to the meeting using the address and phone number below. Individuals who plan to participate on the conference call or webinar should notify Dr. Weiss at least 3 days prior to the meeting, using the address and phone number below. Members of the public will have the opportunity to provide comments. Interested parties should refer to meeting subject as the HRSA Advisory Committee on Interdisciplinary, Community-Based Linkages.

FOR FURTHER INFORMATION CONTACT: Anyone requesting information regarding the ACICBL should contact Dr. Joan Weiss, Designated Federal Official within the Bureau of Health Professions, Health Resources and Services Administration, in one of three ways: (1) Send a request to the following address: Dr. Joan Weiss, Designated Federal Official, Bureau of Health Professions, Health Resources and Services Administration, Parklawn Building, Room 9C–05, 5600 Fishers Lane, Rockville, Maryland 20857; (2) call (301) 443–6950; or (3) email *jweiss@hrsa.gov*. The web address for information on the Advisory Committee is *http://www.hrsa.gov/advisorycommittees/bhpradvisory/acicbl/acicbl.html*.

Dated: November 16, 2012.

Bahar Niakan,

Director, Division of Policy and Information Coordination.

[FR Doc. 2012–28378 Filed 11–21–12; 8:45 am]

BILLING CODE 4165–15–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Resources and Services Administration

Advisory Commission on Childhood Vaccines; Notice of Meeting

In accordance with section 10(a)(2) of the Federal Advisory Committee Act (Pub. L. 92–463), notice is hereby given of the following meeting:

Name: Advisory Commission on Childhood Vaccines (ACCV).

Date and Time: December 6, 2012, 1:00 p.m. to 4:45 p.m. EDT.

Place: Parklawn Building (and via audio conference call), 5600 Fishers Lane, Conference Room 10–65, Rockville, MD 20857.

The ACCV will meet on Thursday, December 6, 2012, from 1:00 p.m. to 4:45 p.m. (EDT). The public can join the meeting via audio conference call by dialing 1–800–369–3104 on December 6 and providing the following information:

Leader's Name: Dr. Vito Caserta.

Password: ACCV.

Agenda: The agenda items for the December meeting will include, but are not limited to: updates from the Division of Vaccine Injury Compensation (DVIC); Department of Justice (DOJ); National Vaccine Program Office (NVPO); Immunization Safety Office (Centers for Disease Control and Prevention); National Institute of Allergy and Infectious Diseases (National Institutes of Health); and Center for Biologics, Evaluation and Research (Food and Drug Administration). A draft agenda and additional meeting materials will be posted on the ACCV Web site (*http://www.hrsa.gov/vaccinecompensation/accv.htm*) prior to the meeting. Agenda items are subject to change as priorities dictate.

Public Comment: Persons interested in attending the meeting in person or providing an oral presentation should submit a written request along with a copy of their presentation to: Annie Herzog, DVIC, Healthcare Systems Bureau (HSB), Health Resources and Services Administration (HRSA), Room 11C–26, 5600 Fishers Lane, Rockville, Maryland 20857 or email: *aherzog@hrsa.gov*. Requests should contain the name, address, telephone number, email address, and any business or professional affiliation of the person desiring to make an oral presentation. Groups having similar interests are requested to combine their comments and present them through a single representative. The allocation of time may be adjusted to accommodate the level of expressed interest. DVIC will notify each presenter by email, mail, or telephone of their assigned presentation time. Persons who do not file an advance request for a presentation, but desire to make an oral statement, may announce it at the time of the public comment period. Public participation and ability to comment will be limited to space and time as it permits.

For Further Information Contact: Anyone requiring information regarding the ACCV should contact Annie Herzog, DVIC, HSB, HRSA, Room 11C–26, 5600 Fishers Lane, Rockville, MD 20857; telephone (301) 443–6593; or email: *aherzog@hrsa.gov*.

Dated: November 16, 2012.

Bahar Niakan,

Director, Division of Policy and Information Coordination.

[FR Doc. 2012–28377 Filed 11–21–12; 8:45 am]

BILLING CODE 4165–15–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

Center for Scientific Review; Amended Notice of Meeting

Notice is hereby given of a change in the meeting of the Center for Scientific Review Special Emphasis Panel, December 3, 2012, 8:30 a.m. to December 4, 2012, 5:00 p.m., which was published in the **Federal Register** on November 1, 2012, 77 FR Pg. 66854–66855.

The meeting will be held November 27–28, 2012 at 8:30 a.m. and will end at 5:00 p.m. The meeting location remains the same. The meeting is closed to the public.

Dated: November 16, 2012

Melanie J. Gray,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28368 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Cancer Institute; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended (5 U.S.C. Appendix 2); notice is hereby given of the following meeting.

The meeting will be closed to the public in accordance with the provisions set forth in sections 552b(c)(4) and 552b(c)(6), Title 5 U.S.C., as amended. The purpose of this meeting is to evaluate requests for preclinical development resources for potential new therapeutics for the treatment of cancer. The outcome of the evaluation will provide information to internal NCI committees that will decide whether NCI should support requests and make available contract resources for development of the potential therapeutic to improve the treatment of various forms of cancer. The research proposals and the discussions could disclose confidential trade secrets or commercial property such as patentable material, and personal information concerning individuals associated with the proposed research projects, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

Name of Committee: National Cancer Institute Special Emphasis Panel; NCI Experimental Therapeutics Program (NExT).

Date: December 12, 2012.

Time: 8:30 a.m. to 4:30 p.m.

Agenda: To evaluate the NCI Experimental Therapeutics Program Portfolio.

Place: National Institutes of Health, Neuroscience Building, 6001 Executive Boulevard, Conference Room A1 & A2, Bethesda, MD 20852.

Contact Person: Barbara Mroczkowski, Ph.D., Executive Secretary, Discovery Experimental Therapeutics Program, National Cancer Institute, NIH, 31 Center Drive, Room 3A44, Bethesda, MD 20892, (301) 496–4291, *mroczkoskib@mail.nih.gov.*

Joseph Tomaszewski, Ph.D., Executive Secretary, Development Experimental Therapeutics Program, National Cancer Institute, NIH, 31 Center Drive, Room 3A44, Bethesda, MD 20892, (301) 496–6711, *tomaszej@mail.nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.392, Cancer Construction; 93.393, Cancer Cause and Prevention Research; 93.394, Cancer Detection and Diagnosis Research; 93.395, Cancer Treatment Research; 93.396, Cancer Biology Research; 93.397, Cancer Centers Support; 93.398, Cancer Research Manpower; 93.399, Cancer Control, National Institutes of Health, HHS)

Dated: November 16, 2012.

Melanie J. Gray,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28370 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Cancer Institute; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended (5 U.S.C. Appendix 2); notice is hereby given of the following meeting.

The meeting will be closed to the public in accordance with the provisions set forth in sections 552b(c)(4) and 552b(c)(6), Title 5 U.S.C., as amended. The purpose of this meeting is to evaluate requests for preclinical development resources for potential new therapeutics for the treatment of cancer. The outcome of the evaluation will provide information to internal NCI committees that will decide whether NCI should support requests and make available contract resources for development of the potential therapeutic to improve the treatment of various forms of cancer. The research proposals and the discussions could disclose confidential trade secrets or commercial property such as patentable material, and personal information concerning individuals associated with the proposed research projects, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

Name of Committee: National Cancer Institute Special Emphasis Panel NCI Experimental Therapeutics Program (NExT).

Date: December 12, 2012.

Time: 8:30 a.m. to 4:30 p.m.

Agenda: To evaluate the NCI Experimental Therapeutics Program Portfolio.

Place: National Institutes of Health, Neuroscience Building, 6001 Executive

Boulevard, Conference Room A1 & A2, Bethesda, MD 20852.

Contact Person: Barbara Mroczkowski, Ph.D., Executive Secretary, Discovery Experimental Therapeutics Program, National Cancer Institute, NIH, 31 Center Drive, Room 3A44, Bethesda, MD 20892, (301) 496–4291 *mroczkoskib@mail.nih.gov.*

Joseph Tomaszewski, Ph.D. Executive Secretary, Development Experimental Therapeutics Program, National Cancer Institute, NIH, 31 Center Drive, Room 3A44, Bethesda, MD 20892, (301) 496–6711, *tomaszej@mail.nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.392, Cancer Construction; 93.393, Cancer Cause and Prevention Research; 93.394, Cancer Detection and Diagnosis Research; 93.395, Cancer Treatment Research; 93.396, Cancer Biology Research; 93.397, Cancer Centers Support; 93.398, Cancer Research Manpower; 93.399, Cancer Control, National Institutes of Health, HHS)

Dated: November 16, 2012.

Melanie J. Gray,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28373 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Alcohol Abuse and Alcoholism; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended (5 U.S.C. App.), notice is hereby given of the following meeting.

The meeting will be closed to the public in accordance with the provisions set forth in sections 552b(c)(4) and 552b(c)(6), Title 5 U.S.C., as amended. The grant applications and the discussions could disclose confidential trade secrets or commercial property such as patentable material, and personal information concerning individuals associated with the grant applications, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

Name of Committee: National Institute on Alcohol Abuse and Alcoholism Initial Review Group Neuroscience Review Subcommittee.

Date: March 6, 2013.

Time: 8:00 a.m. to 5:00 p.m.

Agenda: To review and evaluate grant applications.

Place: NIAAA, 5635 Fishers Lane, Room T–508, Rockville, MD 20852.

Contact Person: Beata Buzas, Ph.D. Scientific Review Officer, National Institute on Alcohol Abuse and Alcoholism, National Institutes of Health, 5635 Fishers Lane, RM 2081, Rockville, MD 20852, 301–443–0800, *bbuzas@mail.nih.gov*.

(Catalogue of Federal Domestic Assistance Program Nos. 93.273, Alcohol Research Programs, National Institutes of Health, HHS)

Dated: November 16, 2012.

Carolyn A. Baum,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28374 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Alcohol Abuse and Alcoholism; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended (5 U.S.C. App.), notice is hereby given of the following meeting.

The meeting will be closed to the public in accordance with the provisions set forth in sections 552b(c)(4) and 552b(c)(6), Title 5 U.S.C., as amended. The grant applications and the discussions could disclose confidential trade secrets or commercial property such as patentable material, and personal information concerning individuals associated with the grant applications, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

Name of Committee: National Institute on Alcohol Abuse and Alcoholism Initial Review Group Biomedical Research Review Subcommittee.

Date: March 5, 2013.

Time: 8:00 a.m. to 5:00 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institutes of Health, 5635 Fishers Lane, T508, Rockville, MD 20852.

Contact Person: Philippe Marmillot, Ph.D., Scientific Review Officer National Institutes of Health, National Institute on Alcohol Abuse and Alcoholism, 5635 Fishers Lane, RM 2019, Bethesda, MD 20892, 301–443–2861, *marmillotp@mail.nih.gov*.

(Catalogue of Federal Domestic Assistance Program Nos. 93.273, Alcohol Research Programs, National Institutes of Health, HHS)

Dated: November 16, 2012 .

Carolyn A. Baum,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28371 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Cancer Institute; Amended Notice of Meeting

Notice is hereby given of a change in the meeting of the National Cancer Institute Special Emphasis Panel, October 30, 2012, 8:00 a.m. to October 30, 2012, 5:00 p.m., National Institutes of Health, 6120 Executive Blvd., Rockville, MD 20852 which was published in the **Federal Register** on September 12, 2012, 77 FR 56215.

This notice is being amended to change the location, date and time to 6116 Executive Boulevard, Room 707, Rockville, MD 20852, November 30, 2012, 9:00 a.m.–4:00 p.m. Additionally the meeting is being held as a teleconference. The meeting is closed to the public.

Melanie J. Gray,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28369 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Alcohol Abuse and Alcoholism; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended (5 U.S.C. App.), notice is hereby given of the following meeting.

The meeting will be closed to the public in accordance with the provisions set forth in sections 552b(c)(4) and 552b(c)(6), Title 5 U.S.C., as amended. The grant applications and the discussions could disclose confidential trade secrets or commercial property such as patentable material, and personal information concerning individuals associated with the grant applications, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

Name of Committee: National Institute on Alcohol Abuse and Alcoholism Initial Review Group Clinical, Treatment and Health Services Research Review Subcommittee.

Date: March 12, 2013.

Time: 8:00 a.m. to 5:00 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institutes of Health, 5635 Fishers Lane, Bethesda, MD 20892.

Contact Person: Katrina L Foster, Ph.D., Scientific Review Officer, National Institute

on Alcohol Abuse & Alcoholism, National Institutes of Health, 5635 Fishers Lane, RM. 2019, Rockville, MD 20852, 301–443–4032 , *katrina@mail.nih.gov*.

(Catalogue of Federal Domestic Assistance Program Nos. 93.273, Alcohol Research Programs, National Institutes of Health, HHS)

Dated: November 16, 2012.

Carolyn A. Baum,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2012–28367 Filed 11–21–12; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

[USCG–2012–0848]

Lifesaving and Fire-Fighting Equipment, Training and Drills Onboard Offshore Facilities and Mobile Offshore Drilling Units (MODUs) Operating on the U.S. Outer Continental Shelf (OCS)

AGENCY: Coast Guard, DHS.

ACTION: Notice of recommended interim voluntary guidance with request for comments.

SUMMARY: As part of its continuing response to the explosion, fire and sinking of the Mobile Offshore Drilling Unit (MODU) *DEEPWATER HORIZON,* in the Gulf of Mexico on April 20, 2010, with loss of life, the Coast Guard announces recommended interim voluntary guidance concerning lifesaving and fire-fighting equipment, training, and drills onboard manned offshore facilities and MODUs operating on the U.S. Outer Continental Shelf (OCS), and requests comments on that guidance. Comments received on the docket will be considered in our ongoing evaluation of the safety of offshore facilities.

DATES: The policy on recommended guidance described in this notice is effective November 23, 2012. Comments and related materials must reach the Docket Management Facility by February 21, 2013.

ADDRESSES: You may submit comments identified by docket number USCG–2012–0848 using any one of the following methods. To avoid duplication, please use only one of these four methods:

(1) *Federal eRulemaking Portal: http://www.regulations.gov*.

(2) *Fax:* 202–493–2251.

(3) *Mail:* Docket Management Facility (M–30), U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590–0001.

(4) *Hand Delivery:* Same as mail address above, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The telephone number is 202–366–9329.

To avoid duplication, please use only one of these four methods. See the ''Public Participation'' portion of the **SUPPLEMENTARY INFORMATION** section below for instructions on submitting comments.

Documents mentioned as being available in the docket are part of docket USCG–2012–0848 and are available for inspection or copying at the Docket Management Facility (M–30), U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. You may also find this docket on the Internet by going to *http://www.regulations.gov,* inserting USCG–2012–0848 in the ''Keyword'' box, and then clicking ''Search.''

FOR FURTHER INFORMATION CONTACT: If you have questions on this notice, call or email Mr. Randall Eberly, U.S. Coast Guard, Office of Design and Engineering Standards, Lifesaving and Fire Safety Division (CG–ENG–4), telephone (202) 372–1393, email *Randall.Eberly@uscg.mil*.

SUPPLEMENTARY INFORMATION:

I. Public Participation

You may submit comments and related material regarding whether this recommended interim voluntary guidance should be incorporated into future rulemaking documents concerning lifesaving and fire-fighting equipment, training and drills on board offshore facilities and MODUs operating on the U.S. Outer Continental Shelf. All comments received will be posted, without change, to *http://www.regulations.gov* and will include any personal information you have provided.

Submitting Comments

If you submit a comment, please include the docket number for this notice (USCG–2012–0848) and provide a reason for each suggestion or recommendation. You may submit your comments and material online or by fax, mail or hand delivery, but please use only one of these means. We recommend that you include your name and a mailing address, an email address, or a telephone number in the body of your document so that we can contact you if we have questions regarding your submission.

To submit your comment online, go to *http://www.regulations.gov* and insert ''USCG–2012–0848'' in the ''Search'' box. Click ''Search,'' find this notice in the list of Results, and then click on the corresponding ''Comment Now'' box. If you submit your comments by mail or hand delivery, submit them in an unbound format, no larger than 8½ by 11 inches, suitable for copying and electronic filing. If you submit comments by mail and would like to know that they reached the Facility, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period.

Viewing the Comments

To view comments, as well as documents mentioned in this notice as being available in the docket, go to *http://www.regulations.gov* and insert ''USCG–2012–0848'' in the ''Search'' box. Click ''Search'' and use the filters on the left side of the page to highlight ''Public Submissions'' or other document types. If you do not have access to the Internet, you may view the docket online by visiting the Docket Management Facility in Room W12–140 on the ground floor of the Department of Transportation West Building, 1200 New Jersey Avenue SE., Washington, DC 20590, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. We have an agreement with the Department of Transportation to use the Docket Management Facility.

Privacy Act

Anyone can search the electronic form of comments received into any of our dockets by the name of the individual submitting the comment (or signing the comment, if submitted on behalf of an association, business, labor union, etc.). You may review a Privacy Act system of records notice regarding our public dockets in the January 17, 2008, issue of the **Federal Register** (73 FR 3316).

II. Background and Interim Voluntary Guidance

The Report of Investigation into the Circumstances Surrounding the Explosion, Fire, Sinking and Loss of Eleven Crew Members Aboard the Mobile Offshore Drilling Unit *DEEPWATER HORIZON* in the Gulf of Mexico, April 20–22, 2010, and related Commandant's Final Action Memo, dated September 9, 2011, (hereinafter referred to as ''Report'') contain a number of recommendations for OCS safety improvements that are presently

being evaluated for further regulatory action. (These documents may be found in the docket for this action, as indicated under **ADDRESSES**). The Coast Guard believes that the five recommendations discussed below could yield significant safety improvements, and, pending issuance of further regulatory action, urges operators of MODUs and manned offshore facilities on the U.S. OCS to consider voluntary compliance with these items, to the extent appropriate and practicable.

(a) Fixed Deluge Systems for Drill Floor Protection (Safety Recommendation 2D)

The Report recommended that a fixed deluge system or multiple high capacity water monitors should be installed for the protection of the drill floor and adjacent areas, with consideration given to requiring automatic operation upon gas detection.

We are considering proposing requirements for installation of such systems, since it is believed that, in some circumstances, early employment of a deluge or monitor spray system during a drilling mishap could serve to prevent or delay ignition of an uncontrolled release of product and/or mitigate the effects of ignition.

As an interim measure, we recommend that operators of MODUs and manned offshore facilities should consider installation of fixed water spray systems for the protection of critical drill floor equipment, structural components and intervening fire barriers. A minimum water application rate of at least 0.50 gpm/ft^2 is recommended. If fixed high capacity water monitors are used as an alternative measure, use of at least two dual purpose fixed monitors, each with a minimum flow rate and pressure of 500 gpm at 100 psi should be considered. The monitors should be arranged for remote operation, or local manual operation from a protected location not likely to be cut off during a fire.

(b) Carrying Capacity of Lifeboats (Safety Recommendation 3C)

The Report recommended that the Commandant work to amend the International Maritime Organization (IMO) Life-Saving Appliance Code (LSA Code) and its associated testing recommendations to ensure the adequacy of lifesaving appliance standards. In particular, the minimum average occupant weight of 165 or 181.5 lbs presently used to determine the carrying capacity of lifeboats is not considered representative of the weight of average offshore workers on the U.S. OCS, and thus lifeboat embarkation and evacuation could be hampered in an emergency due to occupant size.

We believe the existing requirements in the LSA Code, and associated Coast Guard type approval standards, are adequate for most shipboard applications subject to IMO requirements. Nevertheless, they are minimums. The number of requests the Coast Guard has received from offshore operators for approval of lifeboats designed to accommodate offshore workers larger than the average population is consistent with the Report's conclusion that current lifeboat design and testing requirements are not adequate for the physical build of the average offshore worker today. The Coast Guard is therefore considering proposing requirements for higher average occupant weight and size standards specifically for lifeboats used on MODUs and offshore facilities.

We recommend that operators of MODUs and manned offshore facilities should consider specifying any new or replacement lifeboats on the basis of an occupant average weight of at least 95 kg (210 lbs) per person (versus the current standard of 82.5 kg (181.5 lbs)), with a minimum seat width of 530 mm (21 inches) (versus the current standard of 430 mm (17 inches)). A number of Coast Guard approved SOLAS lifeboats have already been approved to this standard by request of the customer(s), and are currently available for use on OCS facilities.

(c) Training in the Deployment of Davit-Launched Liferafts (Safety Recommendation 3D)

The Report recommended that the Commandant clarify 46 CFR 109.213(g)(5), which requires that onboard training in the use of davit-launched liferafts must take place at intervals of not more than 4 months, and that ''whenever practicable'', this must include the inflation and lowering of a liferaft. The regulations permit the inflation and lowering of a davit launched liferaft to be performed only ''whenever practicable'' because an operational raft would need to be taken out of service to perform the drill, and would remain out of service until inspected and repacked by an approved servicing facility ashore. It was anticipated that the requirement to deploy the rafts ''whenever practicable'' would encourage scheduling drills to coordinate with the required periodic servicing of the facility's liferafts, to avoid having them repeatedly sent for servicing. However, the current requirement to inflate and deploy a liferaft ''whenever practicable'' also potentially allows for indefinite deferral of this important training.

To promote hands-on familiarity with davit-launched liferaft operations, the Coast Guard is considering proposing requirements for drills to include the inflation and lowering of a davit-launched liferaft at specified intervals.

In the interim, we recommend that operators of MODUs and manned offshore facilities fitted with davit-launched liferafts should consider the carriage of a dedicated training liferaft (which need not be serviced at an authorized facility after it is used in drills) for the crew to practice the necessary steps for successful deployment, including inflation of the raft, connection to the launching appliance, lowering, and recovery of the liferaft.

Alternatively, when the liferafts onboard the MODU or facility become due for required periodic servicing, the crew should be permitted to deploy them during drills, prior to being sent to a shoreside approved facility for servicing and repacking.

(d) Carriage of Dedicated Rescue Boats (Safety Recommendation 3J)

The Report recommended that the Commandant work with IMO to amend the Code for the Construction and Equipment of Mobile Offshore Drilling Units (MODU Code) to prohibit the dual purpose acceptance of life boats as rescue boats on MODUs.

The Coast Guard believes totally enclosed lifeboats are not well suited for use as rescue boats on MODUs and offshore facilities, and is considering changing the regulations that permit this practice. When a dual purpose life/rescue boat is fully loaded and being used as a survival craft, it is not available for use as a rescue boat, and vice versa. Rescue boats are primarily intended to marshal liferafts, and for man overboard situations. In order to carry out this mission, they are fitted with special launching and retrieval appliances that allow their recovery onboard in harsh weather and sea conditions. Dual purpose lifeboats do not have similar launching and retrieval capability, and on MODUs and offshore facilities, lifeboats can be difficult or impossible to safely recover in anything but the most benign conditions due to the large air gap and the lack of a ship's side to potentially provide a lee.

Until new regulations are proposed, we recommend that operators of new MODUs and manned offshore facilities should provide a dedicated approved SOLAS rescue boat (USCG approval series 160.156 or equivalent) and dedicated approved launching

appliance instead of relying on a dual approved life/rescue boat to meet this requirement. Operators of existing MODUs or facilities that currently use a dual approved life/rescue boat to meet this requirement are urged to supplement their life saving capability with a dedicated approved SOLAS rescue boat and launching appliance.

For MODUs or facilities with a large air gap, operators should consider the improved launching and recovery capabilities of an approved fast rescue boat with a dedicated fast rescue boat launching appliance (which is equipped with motion damping and a constant tensioning winch).

(e) Quarterly Man Overboard Drills (Safety Recommendation 3M)

The Report recommended the Commandant amend 46 CFR 109.213 to require performance of a man overboard drill on at least a quarterly basis.

We agree that 46 CFR 109.213, as well as the relevant OCS Activities regulations in 33 CFR Subchapter N, should include a quarterly man overboard drill, and are considering proposing regulation changes for this purpose.

Until new requirements are proposed, the Coast Guard urges operators of all MODUs and manned offshore facilities on the U.S. OCS to consider performing a man overboard drill on at least a quarterly basis, including deployment of a rescue boat, where provided, to simulate the recovery of a person from the water.

III. Authority

This document is issued under the authority of 5 U.S.C. 552(a), 43 U.S.C. 1331, *et seq.,* and 33 CFR 1.05–1. The guidance contained in this notice is not a substitute for applicable legal requirements, nor is it itself a rule. It is not intended to nor does it impose legally binding requirements on any party. It represents the Coast Guard's current thinking on this topic and provides the public with an indication of future action being considered by the Coast Guard.

Dated: October 24, 2012.

J.G. Lantz,

Director of Commercial Regulations and Standards, U.S. Coast Guard.

[FR Doc. 2012–28487 Filed 11–21–12; 8:45 am]

BILLING CODE 9110–04–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

[Docket No. USCG–2012–0640]

Waterway Suitability Assessment for Expansion of Liquefied Gas Terminals; Houston and Texas City, TX

AGENCY: Coast Guard, DHS.

ACTION: Notice and request for comments.

SUMMARY: In accordance with Coast Guard regulations in 33 CFR 127.007, Oil Tanking North America has submitted a Letter of Intent and Waterway Suitability Assessment to the Coast Guard Captain of the Port, Sector Houston-Galveston regarding the company's proposed expansion of its Liquefied Hazardous Gas (LHG) facilities in Houston and Texas City, Texas, and increased LHG marine traffic in the associated waterway. The Coast Guard is notifying the public of this action to solicit public comments on the proposed increase in LHG marine traffic in Houston and Texas City, Texas.

DATES: Comments and related material must be received on or before December 24, 2012.

ADDRESSES: You may submit comments identified by docket number USCG–2012–0640 using any one of the following methods:

(1) *Federal eRulemaking Portal: http://www.regulations.gov*.

(2) *Fax:* 202–493–2251.

(3) *Mail or Delivery:* Docket Management Facility (M–30), U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590–0001. Deliveries accepted between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The telephone number is 202–366–9329.

To avoid duplication, please use only one of these three methods. See the ''Public Participation and Request for Comments'' portion of the **SUPPLEMENTARY INFORMATION** section below for instructions on submitting comments.

FOR FURTHER INFORMATION CONTACT: If you have questions on this notice, call or email LCDR Xochitl Castaneda, U.S. Coast Guard; telephone 713–671–5164, email *Xochitl.L.Castaneda@uscg.mil*. If you have questions on viewing or submitting material to the docket, call Renee V. Wright, Program Manager, Docket Operations, telephone 202–366–9826.

SUPPLEMENTARY INFORMATION:

Public Participation and Request for Comments

We encourage you to submit comments and related material in response to this notice. All comments received will be posted without change to *http://www.regulations.gov* and will include any personal information you have provided.

Submitting Comments

If you submit a comment, please include the docket number for this notice (USCG–2012–0640), and provide a reason for each suggestion or recommendation. You may submit your comments and material online at *http://www.regulations.gov*, or by fax, mail, or hand delivery, but please use only one of these means. If you submit a comment online, it will be considered received by the Coast Guard when you successfully transmit the comment. If you fax, hand deliver, or mail your comment, it will be considered as having been received by the Coast Guard when it is received at the Docket Management Facility. We recommend that you include your name and a mailing address, an email address, or a telephone number in the body of your document so that we can contact you if we have questions regarding your submission.

To submit your comment online, go to *http://www.regulations.gov,* type the docket number (USCG–2012–0640) in the ''SEARCH'' box and click ''SEARCH.'' Click on ''Submit a Comment'' on the line associated with this notice.

If you submit your comments by mail or hand delivery, submit them in an unbound format, no larger than 8½ by 11 inches, suitable for copying and electronic filing. If you submit comments by mail and would like to know that they reached the Facility, please enclose a stamped, self-addressed postcard or envelope. We will consider all comments and material received during the comment period.

Viewing Comments

To view comments, go to *http://www.regulations.gov,* type the docket number (USCG–2012–0640) in the ''SEARCH'' box and click ''SEARCH.'' Click on ''Open Docket Folder'' on the line associated with this rulemaking. You may also visit the Docket Management Facility in Room W12–140 on the ground floor of the Department of Transportation West Building, 1200 New Jersey Avenue SE., Washington, DC 20590, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

Privacy Act

Anyone can search the electronic form of comments received into any of our dockets by the name of the individual submitting the comment (or signing the comment, if submitted on behalf of an association, business, labor union, etc.). You may review a Privacy Act notice regarding our public dockets in the January 17, 2008, issue of the **Federal Register** (73 FR 3316).

Public Meeting

We do not now plan to hold a public meeting, but you may submit a request for one, using one of the methods specified under **ADDRESSES**. Please explain why you believe a public meeting would be beneficial. If we determine that one would aid this rulemaking, we will hold one at a time and place announced by a later notice in the **Federal Register**.

Basis and Purpose

Under 33 CFR 127.007(a), an owner or operator planning new construction to expand or modify marine terminal operations in an existing facility handling Liquefied Natural Gas (LNG) or Liquefied Hazardous Gas (LHG), where the construction, expansion, or modification would result in an increase in the size and/or frequency of LNG or LHG marine traffic on the waterway associated with the facility, must submit a Letter of Intent (LOI) to the COTP of the zone in which the facility is located. Under 33 CFR 127.007(e), an owner or operator planning such an expansion must also file or update a Waterway Suitability Assessment (WSA) that addresses the proposed increase in LNG or LHG marine traffic in the associated waterway. Oil Tanking North America submitted an LOI on May 12, 2011 and a WSA on April 24, 2012 regarding the company's proposed expansion of its LHG facilities in Houston and Texas City, Texas.

Under 33 CFR 127.009, after receiving an LOI, the COTP issues a Letter of Recommendation (LOR) as to the suitability of the waterway for LNG or LHG marine traffic to the appropriate jurisdictional authorities. The LOR is based on a series of factors outlined in 33 CFR 127.009 that relate to the physical nature of the affected waterway and issues of safety and security associated with LNG or LHG marine traffic on the affected waterway.

The purpose of this notice is to solicit public comments on the proposed increase in LHG marine traffic in Houston and Texas City, Texas. The Coast Guard believes that input from the public may be useful to the COTP with respect to development of the LOR. Additionally, the Coast Guard tasked the Area Maritime Security Committee, Houston-Galveston, Texas, with forming a subcommittee comprised of affected port users and stakeholders, including appropriate members of the Harbor Safety Committee. The goal of the subcommittee will be to gather information to help the COTP assess the suitability of the associated waterway for increased LHG marine traffic as it relates to navigational safety and security.

On January 24, 2011, the Coast Guard published Navigation and Vessel Inspection Circular (NVIC) 01–2011, ''Guidance Related to Waterfront Liquefied Natural Gas (LNG) Facilities.'' NVIC 01–2011 provides guidance for owners and operators seeking approval to build and operate LNG facilities. While NVIC 01–2011 is specific to LNG, it provides useful process information and guidance for owners and operators seeking approval to build and operate LHG facilities as well. The Coast Guard will refer to NVIC 01–2011 for process information and guidance in evaluating Oil Tanking North America's WSA. A copy of NVIC 01–2011 is available for viewing in the public docket for this notice and also on the Coast Guard's Web site at *http://www.uscg.mil/hq/cg5/nvic/2010s.asp.*

This notice is issued under the authority of 33 U.S.C. 1223–1225, Department of Homeland Security Delegation Number 0170.1(70), 33 CFR 127.009, and 33 CFR 103.205.

Dated: October 19, 2012.

J.H. Whitehead,

Captain, U.S. Coast Guard, Captain of the Port Houston-Galveston, Texas.

[FR Doc. 2012–28498 Filed 11–21–12; 8:45 am]

BILLING CODE 9110–04–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5603–N–83]

Notice of Submission of Proposed Information Collection to OMB; Public Housing Mortgage Program and Section 30

AGENCY: Office of the Chief Information Officer, HUD.

ACTION: Notice.

SUMMARY: The proposed information collection requirement described below has been submitted to the Office of Management and Budget (OMB) for review, as required by the Paperwork Reduction Act. The Department is soliciting public comments on the subject proposal.

Section 516 of the Quality Housing and Work Responsibility Act of 1998 (QHWRA) (Pub. L. 105–276, October 21, 1998) added Section 30, Public Housing Mortgages and Security Interest, to the United States Housing Act of 1937 (1937 Act) (42 U.S.C. 1437z–2). Section 30 authorizes the Secretary of the Department of Housing and Urban Development (HUD) to approve a Housing Authority's (HA) request to mortgage public housing real property or grant a security interest in other tangible forms of personal property if the proceeds of the loan resulting from the mortgage or security interest are used for low-income housing uses. Public Housing Agencies (PHAs) must provide information to HUD for approval to allow PHAs to grant a mortgage in public housing real estate or a security interest in some tangible form of personal property owned by the PHA for the purposes of securing loans or other financing for modernization or development of low-income housing. The title of the information collection has been changed to be more clearly descriptive of the range of transactions that would be reviewed under this collection for compliance with Section 30. There are several circumstances other than a mixed finance transaction that would potentially trigger this collection. For example, most recently Energy Performance Contract (EPC) transactions that provide for a security interest in energy improvements have been reviewed for approval under Section 30.

DATES: *Comments Due Date:* December 24, 2012.

ADDRESSES: Interested persons are invited to submit comments regarding this proposal. Comments should refer to the proposal by name and/or OMB approval Number (2577–0265) and should be sent to: HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503; fax: 202–395–5806. Email: *OIRA_Submission@omb.eop.gov* fax: 202–395–5806.

FOR FURTHER INFORMATION CONTACT: Colette Pollard., Reports Management Officer, QDAM, Department of Housing and Urban Development, 451 Seventh Street SW., Washington, DC 20410; email Colette Pollard at *Colette.Pollard@hud.gov.* or telephone (202) 402–3400. This is not a toll-free number. Copies of available documents submitted to OMB may be obtained from Ms. Pollard.

SUPPLEMENTARY INFORMATION: This notice informs the public that the

Department of Housing and Urban Development has submitted to OMB a request for approval of the Information collection described below. This notice is soliciting comments from members of the public and affecting agencies concerning the proposed collection of information to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Enhance the quality, utility, and clarity of the information to be collected; and (4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

This notice also lists the following information:

Title of Proposed: Public Housing Mortgage Program and Section 30.

OMB Approval Number: 2577–0265.

Form Numbers: None.

Description of the need for the information and proposed use: Section 516 of the Quality Housing and Work Responsibility Act of 1998 (QHWRA) (Pub. L. 105–276, October 21, 1998) added Section 30, Public Housing Mortgages and Security Interest, to the United States Housing Act of 1937 (1937 Act) (42 U.S.C. 1437z–2). Section 30 authorizes the Secretary of the Department of Housing and Urban Development (HUD) to approve a Housing Authority's (HA) request to mortgage public housing real property or grant a security interest in other tangible forms of personal property if the proceeds of the loan resulting from the mortgage or security interest are used for low-income housing uses. Public Housing Agencies (PHAs) must provide information to HUD for approval to allow PHAs to grant a mortgage in public housing real estate or a security interest in some tangible form of personal property owned by the PHA for the purposes of securing loans or other financing for modernization or development of low-income housing. The title of the information collection has been changed to be more clearly descriptive of the range of transactions that would be reviewed under this collection for compliance with Section 30. There are several circumstances other than a mixed finance transaction that would potentially trigger this collection. For example, most recently Energy Performance Contract (EPC) transactions that provide for a security interest in energy improvements have been reviewed for approval under Section 30.

	Number of respondents	Annual responses	×	Hours per response	Burden hours
Reporting Burden	30	3		41.777	3,760

Total estimated burden hours: 3,760.

Status: Revision of a currently approved collection.

Authority: Section 3507 of the Paperwork Reduction Act of 1995, 44 U.S.C. 35, as amended

Dated: November 16, 2012.

Colette Pollard,

Department Reports Management Officer, Office of the Chief Information Officer.

[FR Doc. 2012–28364 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5603–N–86]

Previous Participation Certification

AGENCY: Office of the Chief Information Officer, HUD.

ACTION: Notice.

SUMMARY: The proposed information collection requirement described below has been submitted to the Office of Management and Budget (OMB) for review, as required by the Paperwork Reduction Act. The Department is soliciting public comments on the subject proposal.

This information is necessary to ensure that responsible individuals and organizations participate in HUD's multifamily housing programs. The information will be used to evaluate participants' previous participation in government programs and ensure that the past record is acceptable prior to granting approval to participate in HUD's multifamily housing programs. The collection of this information is designed to be 100 percent automated and digital submission of all data and certifications is available via HUD's secure Internet systems. However HUD will provide for both electronic and paper submissions until it publishes revised regulations.

DATES: *Comments Due Date:* December 24, 2012.

ADDRESSES: Interested persons are invited to submit comments regarding this proposal. Comments should refer to the proposal by name and/or OMB approval Number (2502–0118) and should be sent to: HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503; fax: 202–395–5806. Email: *OIRA_Submission@omb.eop.gov* fax: 202–395–5806.

FOR FURTHER INFORMATION CONTACT: Colette Pollard., Reports Management Officer, QDAM, Department of Housing and Urban Development, 451 Seventh Street SW., Washington, DC 20410; email Colette Pollard at *Colette.Pollard@hud.gov.* or telephone (202) 402–3400. This is not a toll-free number. Copies of available documents submitted to OMB may be obtained from Ms. Pollard.

SUPPLEMENTARY INFORMATION: This notice informs the public that the Department of Housing and Urban Development has submitted to OMB a request for approval of the Information collection described below. This notice is soliciting comments from members of the public and affecting agencies concerning the proposed collection of information to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Enhance the quality, utility, and clarity of the information to be collected; and (4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

This notice also lists the following information:

Title of Proposed: Previous Participation Certification.

OMB Approval Number: 2502–0118.

Form Numbers: HUD–2530 .

Description of the need for the information and proposed use: This

information is necessary to ensure that responsible individuals and organizations participate in HUD's multifamily housing programs. The information will be used to evaluate participants' previous participation in government programs and ensure that the past record is acceptable prior to granting approval to participate in HUD's multifamily housing programs. The collection of this information is designed to be 100 percent automated and digital submission of all data and certifications is available via HUD's secure Internet systems. However HUD will provide for both electronic and paper submissions until it publishes revised regulations.

	Number of respondents	Annual responses	×	Hours per response	=	Burden hours
Reporting Burden	10,000	1		0.75		7,500

Total estimated burden hours: 7,500.

Status: Revision of a currently approved collection.

Authority: Section 3507 of the Paperwork Reduction Act of 1995, 44 U.S.C. 35, as amended.

Dated: November 16, 2012.

Colette Pollard,

Department Reports Management Officer, Office of the Chief Information Officer.

[FR Doc. 2012–28375 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5603–N–85]

Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark to Market)

AGENCY: Office of the Chief Information Officer, HUD.

ACTION: Notice.

SUMMARY: The proposed information collection requirement described below has been submitted to the Office of Management and Budget (OMB) for review, as required by the Paperwork Reduction Act. The Department is soliciting public comments on the subject proposal.

The Mark to Market Program is authorized under the Multifamily Assisted Housing Reform and Affordability Act of 1997 as extended by the Market to Market Extension Act of 2001. The information collection is required and will be used to determine the eligibility of FHA insured multifamily properties for participation in the Mark to Market program and the terms on which such participation should occur as well as to process eligible properties from acceptance into the program through closing of the mortgage restructure in accordance with program guidelines. The result of participation in the program is the refinancing and restructure of the property's FHA insured mortgage and, generally the reduction of Section 8 rent payments and establishment of adequately funded accounts to fund required repair and rehabilitation of the property. Agency form numbers, if applicable: Operating Procedures Guide (OPG) Forms: Accommodation Agreement—Debt Assgn—TPA Post Restr (Form/Apdx C), Accommodation Agreement—Debt Forgiveness—TPA Post Restr (Form/Apdx C), Agreement of Assignment of Debt to QNP (Form/ ApdxC), Allonge—Debt Assignment From QNP (Form/Apdx C), Allonge—Debt Assignment to QNP (Form/Apdx C), Assignment of Debt from QNP (Form/Apdx C), Assumption & Modification of Use Agmt (Assignment) (Form/Apdx C), Assumption and Modification of Use Agreement—Forgiveness (Form/Apdx C), OPG 11.1, OPG 3.1, OPG 3.2, OPG 3.3, OPG 3.4, OPG 4.10, OPG 4.11, OPG 4.12, OPG 4.2, OPG 4.3, OPG 4.4, OPG 4.7, OPG 4.8, OPG 5.4, OPG 5.5, OPG 7.11, OPG 7.12, OPG 7.13, OPG 7.14, OPG 7.21, OPG 7.22, OPG 7.23, OPG 7.25, OPG 7.4, OPG 7.8.

DATES: *Comments Due Date:* December 24, 2012.

ADDRESSES: Interested persons are invited to submit comments regarding this proposal. Comments should refer to the proposal by name and/or OMB approval Number (2502–0533) and should be sent to: HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503; fax: 202–395–5806. Email: *OIRA_Submission@omb.eop.gov* fax: 202–395–5806.

FOR FURTHER INFORMATION CONTACT: Colette Pollard., Reports Management Officer, QDAM, Department of Housing and Urban Development, 451 Seventh Street SW., Washington, DC 20410; email Colette Pollard at *Colette.Pollard@hud.gov.* or telephone (202) 402–3400. This is not a toll-free number. Copies of available documents submitted to OMB may be obtained from Ms. Pollard.

SUPPLEMENTARY INFORMATION: This notice informs the public that the Department of Housing and Urban Development has submitted to OMB a request for approval of the Information collection described below. This notice is soliciting comments from members of the public and affecting agencies concerning the proposed collection of information to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Enhance the quality, utility, and clarity of the information to be collected; and (4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

This notice also lists the following information:

Title of Proposed: Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark to Market).

OMB Approval Number: 2502–0533.

Form Numbers: HUD 9625, HUD 9624.

Description of the need for the information and proposed use: The Mark to Market Program is authorized under the Multifamily Assisted Housing Reform and Affordability Act of 1997 as extended by the Market to Market Extension Act of 2001. The information collection is required and will be used to determine the eligibility of FHA insured multifamily properties for participation in the Mark to Market program and the terms on which such participation should occur as well as to process eligible properties from acceptance into the program through closing of the mortgage restructure in accordance with program guidelines. The result of participation in the program is the refinancing and restructure of the property's FHA

insured mortgage and, generally the reduction of Section 8 rent payments and establishment of adequately funded accounts to fund required repair and rehabilitation of the property. Agency form numbers, if applicable: Operating Procedures Guide (OPG) Forms: Accommodation Agreement—Debt Assgn—TPA Post Restr (Form/Apdx C), Accommodation Agreement—Debt Forgiveness—TPA Post Restr (Form/Apdx C), Agreement of Assignment of Debt to QNP (Form/ApdxC), Allonge—Debt Assignment From QNP (Form/Apdx C), Allonge—Debt Assignment to QNP (Form/Apdx C), Assignment of Debt from QNP (Form/Apdx C), Assumption & Modification of Use Agmt (Assignment) (Form/Apdx C), Assumption and Modification of Use Agreement—Forgiveness (Form/Apdx C), OPG 11.1, OPG 3.1, OPG 3.2, OPG 3.3, OPG 3.4, OPG 4.10, OPG 4.11, OPG 4.12, OPG 4.2, OPG 4.3, OPG 4.4, OPG 4.7, OPG 4.8, OPG 5.4, OPG 5.5, OPG 7.11, OPG 7.12, OPG 7.13, OPG 7.14, OPG 7.21, OPG 7.22, OPG 7.23, OPG 7.25, OPG 7.4, OPG 7.8.

	Number of respondents	Annual responses	×	Hours per response	Burden hours
Reporting Burden	1,658	1		1.454	2,412

Total estimated burden hours: 2,412.

Status: Extension without change a currently approved collection.

Authority: Section 3507 of the Paperwork Reduction Act of 1995, 44 U.S.C. 35, as amended.

Dated: November 16, 2012.

Colette Pollard,

Department Reports Management Officer, Office of the Chief Information Officer.

[FR Doc. 2012–28372 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5603–N–84]

Application for the Transfer of Physical Assets

AGENCY: Office of the Chief Information Officer, HUD.

ACTION: Notice.

SUMMARY: The proposed information collection requirement described below has been submitted to the Office of Management and Budget (OMB) for review, as required by the Paperwork Reduction Act. The Department is soliciting public comments on the subject proposal.

This information will be used to ensure that HUD multifamily housing properties are not placed in physical, financial, or managerial jeopardy during a transfer of physical assets.

DATES: *Comments Due Date:* December 24, 2012.

ADDRESSES: Interested persons are invited to submit comments regarding this proposal. Comments should refer to the proposal by name and/or OMB approval Number (2502–0275) and should be sent to: HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503; fax: 202–395–5806. Email: *OIRA_Submission@omb.eop.gov* fax: 202–395–5806.

FOR FURTHER INFORMATION CONTACT: Colette Pollard, Reports Management Officer, QDAM, Department of Housing and Urban Development, 451 Seventh Street SW., Washington, DC 20410; email Colette Pollard at *Colette.Pollard@hud.gov*. or telephone (202) 402–3400. This is not a toll-free number. Copies of available documents submitted to OMB may be obtained from Ms. Pollard.

SUPPLEMENTARY INFORMATION: This notice informs the public that the Department of Housing and Urban Development has submitted to OMB a request for approval of the Information collection described below. This notice is soliciting comments from members of the public and affecting agencies concerning the proposed collection of information to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Enhance the quality, utility, and clarity of the information to be collected; and (4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

This notice also lists the following information:

Title of Proposed: Application for the Transfer of Physical Assets.

OMB Approval Number: 2502–0275.

Form Numbers: HUD–92266.

Description of the need for the information and proposed use: This information will be used to ensure that HUD multifamily housing properties are not placed in physical, financial, or managerial jeopardy during a transfer of physical assets.

	Number of respondents	Annual responses	×	Hours per response	Burden hours
Reporting Burden	14,445	1		1.691	24,437

Total estimated burden hours: 24,437.

Status: Extension without change a currently approved collection.

Authority: Section 3507 of the Paperwork Reduction Act of 1995, 44 U.S.C. 35, as amended.

Dated: *November 16, 2012.*

Colette Pollard,

Department Reports Management Officer, Office of the Chief Information Officer.

[FR Doc. 2012–28366 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5603–N–87]

Requirements for Lead-Based Paint Hazards in Federally Owned Residential Properties and Housing Receiving Federal Assistance

AGENCY: Office of the Chief Information Officer, HUD.

ACTION: Notice.

SUMMARY: The proposed information collection requirement described below has been submitted to the Office of Management and Budget (OMB) for review, as required by the Paperwork Reduction Act. The Department is soliciting public comments on the subject proposal.

Requirements for notification of leadbased paint hazard in federally-owned residential properties and housing receiving Federal assistance, as codified in 24 CFR part 35.

DATES: *Comments Due Date:* December 24, 2012.

ADDRESSES: Interested persons are invited to submit comments regarding this proposal. Comments should refer to the proposal by name and/or OMB approval Number (2539–0009) and should be sent to: HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503; fax: 202–395–5806. Email: *OIRA_Submission@omb.eop.gov* fax: 202–395–5806.

FOR FURTHER INFORMATION CONTACT: Colette Pollard, Reports Management Officer, QDAM, Department of Housing and Urban Development, 451 Seventh Street SW., Washington, DC 20410; email Colette Pollard at *Colette.Pollard@hud.gov.* or telephone (202) 402–3400. This is not a toll-free number. Copies of available documents submitted to OMB may be obtained from Ms. Pollard.

SUPPLEMENTARY INFORMATION: This notice informs the public that the Department of Housing and Urban Development has submitted to OMB a request for approval of the Information collection described below. This notice is soliciting comments from members of the public and affecting agencies concerning the proposed collection of information to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information; (3) Enhance the quality, utility, and clarity of the information to be collected; and (4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

This notice also lists the following information:

Title of Proposed: Requirements for Lead-Based Paint Hazards in Federally Owned Residential Properties and Housing Receiving Federal Assistance.

OMB Approval Number: 2539–0009.

Form Numbers: None.

Description of the need for the information and proposed use: Requirements for notification of leadbased paint hazard in federally-owned residential properties and housing receiving Federal assistance, as codified in 24 CFR 35.

	Number of respondents	Annual responses	×	Hours per response	Burden hours
Reporting Burden	63,637	23.164	×	0.1137	167,744

Total estimated burden hours: 167,744.

Status: Revision of a currently approved collection.

Authority: Section 3507 of the Paperwork Reduction Act of 1995, 44 U.S.C. 35, as amended.

Dated*:* November 16, 2012.

Colette Pollard,

Department Reports Management Officer, Office of the Chief Information Officer.

[FR Doc. 2012–28376 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5601–N–46]

Federal Property Suitable as Facilities To Assist the Homeless

AGENCY: Office of the Assistant Secretary for Community Planning and Development, HUD.

ACTION: Notice.

SUMMARY: This Notice identifies unutilized, underutilized, excess, and surplus Federal property reviewed by HUD for suitability for possible use to assist the homeless.

FOR FURTHER INFORMATION CONTACT: Juanita Perry, Department of Housing and Urban Development, 451 Seventh Street SW., Room 7262, Washington, DC 20410; telephone (202) 402–3970; TTY number for the hearing- and speech-impaired (202) 708–2565, (these telephone numbers are not toll-free), or call the toll-free Title V information line at 800–927–7588.

SUPPLEMENTARY INFORMATION: In accordance with the December 12, 1988 court order in *National Coalition for the Homeless* v. *Veterans Administration,* No. 88–2503–OG (D.D.C.), HUD publishes a Notice, on a weekly basis, identifying unutilized, underutilized, excess and surplus Federal buildings and real property that HUD has reviewed for suitability for use to assist the homeless. Today's Notice is for the purpose of announcing that no additional properties have been determined suitable or unsuitable this week.

Dated: November 15, 2012.

Ann Marie Oliva,

Deputy Assistant Secretary for Special Needs (Acting) .

[FR Doc. 2012–28194 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5674–N–01]

Notice of HUD-Held Multifamily and Healthcare Loan Sale

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Notice of sale of mortgage loans.

SUMMARY: This notice announces HUD's intention to sell certain unsubsidized multifamily and healthcare mortgage loans, without Federal Housing Administration (FHA) insurance, in a competitive, sealed bid sale (MHLS 2013–1). This notice also describes generally the bidding process for the sale and certain persons who are ineligible to bid.

DATES: The Bidder's Information Package (BIP) was made available to qualified bidders on or about November 14, 2012. Bids for the loans must be submitted on the bid date of December 12, 2012. HUD anticipates that awards will be made on or before December 13, 2012. Closings are expected to take place between December 18 and December 21, 2012.

ADDRESSES: To become a qualified bidder and receive the BIP, prospective bidders must complete, execute, and submit a Confidentiality Agreement and a Qualification Statement acceptable to HUD. Both documents will be available on the HUD Web site at *www.hud.gov/fhaloansales.* Please mail and fax executed documents to KEMA Advisors: KEMA Advisors, c/o The Debt Exchange, 133 Federal Street, 10th Floor, Boston, MA 02111, Attention: MLS 2013–1 Sale Coordinator, Fax: 1–978–967–8607.

FOR FURTHER INFORMATION CONTACT: John Lucey, Deputy Director, Asset Sales Office, Room 3136, U.S. Department of Housing and Urban Development, 451 7th Street SW., Washington, DC 20410–8000; telephone 202–708–2625, extension 3927. Hearing- or speech-impaired individuals may call 202–708–4594 (TTY). These are not toll-free numbers.

SUPPLEMENTARY INFORMATION: HUD announces its intention to sell in MHLS 2013–1 certain unsubsidized mortgage loans (Mortgage Loans) secured by multifamily and healthcare properties located throughout the United States. The Mortgage Loans are comprised of non-performing mortgage loans. A final listing of the Mortgage Loans will be included in the BIP. The Mortgage Loans will be sold without FHA insurance and with servicing released. HUD will offer qualified bidders an opportunity to bid competitively on the Mortgage Loans.

The Mortgage Loans may be stratified for bidding purposes into several mortgage loan pools. Each pool may contain Mortgage Loans that generally have similar performance, property type, geographic location, lien position and other characteristics. Qualified bidders may submit bids on one or more pools of Mortgage Loans or may bid on individual loans. A mortgagor who is a qualified bidder may submit an individual bid on its own Mortgage Loan. Interested Mortgagors should review the Qualification Statement to determine whether they may also be eligible to qualify to submit bids on one or more pools of Mortgage Loans or on individual loans in MHLS 2013–1.

The Bidding Process

The BIP will describe in detail the procedure for bidding in MHLS 2013–1. The BIP will also include a standardized non-negotiable loan sale agreement (Loan Sale Agreement).

As part of its bid, each bidder must submit a deposit equal to the greater of $100,000 or 10% of the bid price. In the event that the bidder's aggregate bid is less than $100,000, the minimum deposit shall be not less than fifty percent (50%) of the bidder's aggregate bid. HUD will evaluate the bids submitted and determine the successful bids in its sole and absolute discretion. If a bidder is successful, the bidder's deposit will be non-refundable and will be applied toward the purchase price. Deposits will be returned to unsuccessful bidders. Closings are expected to take place between December 18 and December 21, 2012.

These are the essential terms of sale. The Loan Sale Agreement, which will be included in the BIP, will contain additional terms and details. To ensure a competitive bidding process, the terms of the bidding process and the Loan Sale Agreement are not subject to negotiation.

Due Diligence Review

The BIP will describe the due diligence process for reviewing loan files in MHLS 2013–1. Qualified bidders will be able to access loan information remotely via a high-speed Internet connection. Further information on performing due diligence review of the Mortgage Loans will be provided in the BIP.

Mortgage Loan Sale Policy

HUD reserves the right to add Mortgage Loans to or delete Mortgage Loans from MHLS 2013–1 at any time prior to the Award Date. HUD also reserves the right to reject any and all bids, in whole or in part, without prejudice to HUD's right to include any Mortgage Loans in a later sale. Mortgage Loans will not be withdrawn after the Award Date except as is specifically provided in the Loan Sale Agreement.

This is a sale of unsubsidized mortgage loans, pursuant to Section 204(a) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act of 1997, 12 U.S.C. 1715z–11a(a).

Mortgage Loan Sale Procedure

HUD selected a competitive sale as the method to sell the Mortgage Loans. This method of sale optimizes HUD's return on the sale of these Mortgage Loans, affords the greatest opportunity for all qualified bidders to bid on the Mortgage Loans, and provides the quickest and most efficient vehicle for HUD to dispose of the Mortgage Loans.

Bidder Eligibility

In order to bid in the sale, a prospective bidder must complete, execute and submit both a Confidentiality Agreement and a Qualification Statement acceptable to HUD. The following individuals and entities are ineligible to bid on any of the Mortgage Loans included in MHLS 2013–1:

1. Any employee of HUD, a member of such employee's household, or an entity owned or controlled by any such employee or member of such an employee's household;

2. Any individual or entity that is debarred, suspended, or excluded from doing business with HUD pursuant to Title 24 of the Code of Federal Regulations, Part 24, and Title 2 of the Code of Federal Regulations, Part 24;

3. Any contractor, subcontractor and/or consultant or advisor (including any agent, employee, partner, director, principal or affiliate of any of the foregoing) who performed services for, or on behalf of, HUD in connection with MHLS 2013–1;

4. Any individual who was a principal, partner, director, agent or employee of any entity or individual described in subparagraph 3 above, at any time during which the entity or individual performed services for or on behalf of HUD in connection with MHLS 2013–1;

5. Any individual or entity that uses the services, directly or indirectly, of any person or entity ineligible under subparagraphs 1 through 4 above to assist in preparing any of its bids on the Mortgage Loans;

6. Any individual or entity which employs or uses the services of an employee of HUD (other than in such employee's official capacity) who is involved in MHLS 2013–1;

7. Any affiliate, principal or employee of any person or entity that, within the two-year period prior to November 1, 2012, serviced any of the Mortgage

Loans or performed other services for or on behalf of HUD;

8. Any contractor or subcontractor to HUD that otherwise had access to information concerning the Mortgage Loans on behalf of HUD or provided services to any person or entity which, within the two-year period prior to November 1, 2012, had access to information with respect to the Mortgage Loans on behalf of HUD;

9. Any employee, officer, director or any other person that provides or will provide services to the potential bidder with respect to such Mortgage Loans during any warranty period established for the Loan Sale, that serviced any of the Mortgage Loans or performed other services for or on behalf of HUD or within the two-year period prior to November 1, 2012, provided services to any person or entity which serviced, performed services or otherwise had access to information with respect to the Mortgage Loans for or on behalf of HUD;

10. Any mortgagor or operator that failed to submit to HUD on or before October 31, 2012, audited financial statements for fiscal years 2008 through 2011 (for such time as the project has been in operation or the prospective bidder served as operator, if less than three (3) years) for a project securing a Mortgage Loan;

11. Any individual or entity and any Related Party (as such term is defined in the Qualification Statement) of such individual or entity that is a mortgagor in any of HUD's multifamily and or healthcare housing programs and that is in default under such mortgage loan or is in violation of any regulatory or business agreements with HUD, unless such default or violation was cured on or before October 31, 2012;

Prospective bidders should carefully review the Qualification Statement to determine whether they are eligible to submit bids on the Mortgage Loans in MHLS 2013–1.

Freedom of Information Act Requests

HUD reserves the right, in its sole and absolute discretion, to disclose information regarding MHLS 2013–1, including, but not limited to, the identity of any successful bidder and its bid price or bid percentage for any pool of loans or individual loan, upon the closing of the sale of all the Mortgage Loans. Even if HUD elects not to publicly disclose any information relating to MHLS 2013–1, HUD will have the right to disclose any information that HUD is obligated to disclose pursuant to the Freedom of Information Act and all regulations promulgated there under.

Scope of Notice

This notice applies to MHLS 2013–1 and does not establish HUD's policy for the sale of other mortgage loans.

Dated: November 16, 2012.

Laura M. Marin,

Acting General Deputy Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 2012–28502 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR–5597–N–02]

Request for Information on Adopting Smoke-Free Policies in Public Housing Agencies (PHAs) and Multifamily Housing: Reopening of Public Comment Period

AGENCY: Office of the General Counsel, HUD.

ACTION: Request for Information, Reopening of public comments period.

SUMMARY: On October 4, 2012, HUD published a request for information in the **Federal Register** inviting public comment on how HUD can best continue to support the implementation of smoke-free policies for both public housing and multifamily housing. HUD was seeking information from the general public and stakeholders, including resident councils, advocacy groups, and housing providers directly impacted by or involved with the implementation of smoke-free policies and methods for supporting residents and housing providers in transitioning to smoke-free housing. The comment period for HUD's request for information closed November 5, 2012. In response to recent requests for additional time to submit public comments, HUD is announcing through this notice that it is reopening the public comment period for an additional 60-day period.

DATES: *Comment Due Date:* Comments on the October 4, 2012, request for information are requested on or before January 22, 2013.

ADDRESSES: Interested persons are invited to submit comments responsive to this request for information to the Office of General Counsel, Regulations Division, Department of Housing and Urban Development, 451 7th Street, SW., Room 10276, Washington, DC 20410–0001. Communications must refer to the above docket number and title and should contain the information specified in the ''Request for Comments'' of this notice.

Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at *http://www.regulations.gov.* HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the *http://www.regulations.gov* Web site can be viewed by interested members of the public. Commenters should follow instructions provided on that site to submit comments electronically.

Submission of Hard Copy Comments. Comments may be submitted by mail or hand delivery. To ensure that the information is fully considered by all of the reviewers, each commenter submitting hard copy comments, by mail or hand delivery, should submit comments or requests to the address above, addressed to the attention of the Regulations Division. Due to security measures at all federal agencies, submission of comments or requests by mail often result in delayed delivery. To ensure timely receipt of comments, HUD recommends that any comments submitted by mail be submitted at least 2 weeks in advance of the public comment deadline. All hard copy comments received by mail or hand delivery are a part of the public record and will be posted to *http://www.regulations.gov* without change.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Comments. All comments submitted to HUD regarding this notice will be available, without charge, for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the documents must be scheduled by calling the Regulations Division at 202–708–3055 (this is not a toll-free number). Copies of all comments submitted will also be available for inspection and downloading at *http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: Shauna Sorrells, Director, Public Housing Programs, Office of Public and Indian Housing, Department of Housing and Urban Development, 451 7th Street, SW., Room 4232, Washington, DC, 20410–4000, telephone number 202–402–2769 (this is not a toll-free number) or Catherine Brennan, Director, Office of

Housing Assistance and Grant Administration, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW., Room 6134, Washington, DC, 20410–4000, telephone number 202–708–3000 (this is not a toll-free number). Persons with hearing- or speech-impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800–877–8339.

SUPPLEMENTARY INFORMATION: On October 4, 2012 (77 FR 60712), HUD published a notice in the **Federal Register** requesting information from the general public, PHAs, owners and management agents, public housing residents, multifamily housing residents and other stakeholders to help inform HUD on how it might best support housing providers and residents in implementing smoke-free policies for both public housing and multifamily housing. In the October 4, 2012 notice, HUD provided a list of topics for which HUD is seeking information and established a comment due date of November 5, 2012. In response to recent requests for additional time to submit public comments, HUD is announcing through this notice that it is reopening the public comment period for an additional 60-day period. Interested persons should refer to the October 4, 2012 notice for the list of topics to which HUD is seeking information.

Dated: November 19, 2012.

Aaron Santa Anna,

Assistant General Counsel, Regulations Division, Office of General Counsel.

[FR Doc. 2012–28519 Filed 11–21–12; 8:45 am]

BILLING CODE 4210–67–P

DEPARTMENT OF THE INTERIOR

United States Geological Survey

[GX13EN05ESB0500]

Reopening of Nomination Period for Members of the Advisory Committee on Climate Change and Natural Resource Science

AGENCY: U.S. Geological Survey, Interior.

ACTION: Notice.

SUMMARY: The U.S. Department of the Interior published a notice announcing the establishment of the Advisory Committee on Climate Change and Natural Resource Science (Committee), and inviting nominations for membership on the Committee. The closing date for nominations was November 19, 2012. This **Federal Register** Notice reopens the nomination and comment period for 30 days. If you have already submitted information to be considered for appointment to the Committee you do not have to resubmit it.

DATES: Written nominations must be received by December 24, 2012.

ADDRESSES: Send nominations to: Robin O'Malley, Policy and Partnership Coordinator, National Climate Change and Wildlife Science Center, U.S. Geological Survey, 12201 Sunrise Valley Drive, Mail Stop 400, Reston, VA 20192, *romalley@usgs.gov.*

FOR FURTHER INFORMATION CONTACT: Robin O'Malley, Policy and Partnership Coordinator, National Climate Change and Wildlife Science Center, U.S. Geological Survey, 12201 Sunrise Valley Drive, Mail Stop 400, Reston, VA 20192, *romalley@usgs.gov.*

SUPPLEMENTARY INFORMATION: On October 4, 2012, the U.S. Department of the Interior (DOI) published a notice announcing the establishment of the Advisory Committee on Climate Change and Natural Resource Science (Committee), and inviting nominations for membership on the committee. The Committee will provide advice on matters and actions relating to the establishment and operations of the U.S. Geological Survey National Climate Change and Wildlife Science Center and the DOI Climate Science Centers. In doing so, the Committee will obtain input from Federal, state, tribal, local government, nongovernmental organizations, private sector entities, and academic institutions.

The Department has determined that additional time is required to enable members to be nominated for the committee.

We are seeking nominations for individuals to be considered as Committee members. Nominations should include a resume that describes the nominee's qualifications in enough detail to enable us to make an informed decision regarding meeting the membership requirements of the Committee and to contact a potential member.

Members of the Committee will be composed of approximately 25 members from both the Federal Government, and the following interests: (1) State and local governments, including state membership entities; (2) Non-governmental organizations, including those whose primary mission is professional and scientific and those whose primary mission is conservation and related scientific and advocacy activities; (3) American Indian tribes and other Native American entities; (4) Academia; (5) Individual landowners; and (6) Business interests.

In addition, the Committee may include scientific experts, and will include rotating representation from one or more of the institutions that host the DOI Climate Science Centers.

The Committee will meet approximately 2–4 times annually, and at such times as designated by the DFO. The Secretary of the Interior will appoint members to the Committee. Members appointed as special Government employees are required to file on an annual basis a confidential financial disclosure report.

No individual who is currently registered as a Federal lobbyist is eligible to serve as a member of the Committee.

Dated: November 16, 2012.

Marcia McNutt,

Director, USGS.

[FR Doc. 2012–28414 Filed 11–21–12; 8:45 am]

BILLING CODE 4311–MP–P

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

[LLCAD09000, L51010000.LVRWB09B2380.FX0000] Notice of Availability of a Draft Environmental Impact Statement/Environmental

Impact Report for the Proposed Stateline Solar Farm, San Bernardino County, CA and Draft California Desert Conservation Area Land Use Plan Amendments

AGENCY: Bureau of Land Management, Interior.

ACTION: Notice of availability.

SUMMARY: In accordance with the National Environmental Policy Act of 1969, as amended, and the Federal Land Policy and Management Act of 1976, as amended (FLPMA), the Bureau of Land Management (BLM) has prepared a Draft California Desert Conservation Area (CDCA) Plan Amendment and a Draft Environmental Impact Statement/Environmental Impact Report (EIS/EIR) for the Stateline Solar Farm Project (Stateline) and by this notice is announcing the opening of the comment period.

DATES: To ensure that comments will be considered, the BLM must receive written comments on the Draft Plan Amendment and Draft EIS/EIR within 90 days following the date the Environmental Protection Agency publishes its Notice of Availability in the **Federal Register**. The BLM will announce future meetings or hearings and any other public involvement

activities at least 15 days in advance through public notices, media releases, and/or mailings.

ADDRESSES: You may submit comments related to the Stateline Draft Plan Amendment and Draft EIS/EIR by any of the following methods:

- *Web site: http://www.blm.gov/ca/st/en/fo/cdd.html.*
- *Email: statelinesolar@blm.gov.*
- *Fax:* 951–697–5299.
- *Mail:* ATTN: Jeffery Childers, Project Manager, BLM California Desert District Office, 22835 Calle San Juan de Los Lagos, Moreno Valley, CA 92553–9046

Copies of the Stateline Draft Plan Amendment and Draft EIS/EIR are available for public inspection at BLM California Desert District Office at the above address; or on the Internet at *http://www.blm.gov/ca/st/en/fo/cdd.html.*

FOR FURTHER INFORMATION CONTACT: Jeffery Childers, Project Manager; telephone 951–697–5308; address BLM California Desert District Office, 22835 Calle San Juan de Los Lagos, Moreno Valley, CA 92553–9046; email *jchilders@blm.gov*. Persons who use a telecommunications device for the deaf (TDD) may call the Federal Information Relay Service (FIRS) at 1–800–877–8339 to contact the above individual during normal business hours. The FIRS is available 24 hours a day, 7 days a week, to leave a message or question with the above individual. You will receive a reply during normal business hours.

SUPPLEMENTARY INFORMATION: First Solar Development, Inc. (First Solar) has requested a right-of-way (ROW) authorization to construct, operate, maintain and decommission the 300-megawatt (MW) Stateline Project from the BLM and a separate well permit from the County of San Bernardino. The BLM is responding to the ROW application as required by FLPMA. The proposed project located on BLM-administered lands would include access roads, a photovoltaic arrays, an electrical substation, a meteorological station, a monitoring and maintenance facility, water wells, and a 2.3-mile generation tie-line on up to 2,143 acres. The project location is in San Bernardino County approximately 2 miles south of the Nevada-California border and 0.5 miles west of Interstate 15.

The BLM's purpose and need for the Stateline EIS/EIR is to respond to First Solar's application for a ROW grant to construct, operate, maintain, and decommission a photovoltaic solar energy facility on public lands in compliance with FLPMA, BLM ROW regulations, and other applicable Federal laws. The BLM will decide whether to grant, grant with modification, or deny a ROW to First Solar. In connection with its consideration of the Stateline ROW application, the BLM is proposing to amend the CDCA Plan by designating the project area as either suitable or unsuitable for solar energy development. The CDCA Plan (1980, as amended), recognized the potential compatibility of solar energy generation facilities with other uses on public lands; however, it requires that all sites proposed for power generation or transmission not already identified in the plan be considered through the plan amendment process. While connected, the decision to amend the CDCA plan is separate from the decision to approve the ROW application. As part of its consideration of project impacts, the BLM may also amend the CDCA Plan to address cumulative impacts of this and other developments in the Ivanpah Valley watershed. Specifically, the BLM will consider whether to expand the boundaries of the Ivanpah Desert Wildlife Management Area (DWMA).

The Draft Plan Amendment and Draft EIS/EIR analyze four project development alternatives, including the proposed action, which is analyzed as Alternative 1: 300 MWs of development on 2,143 acres. The other alternatives include—Alternative 2: 300 MWs of development on 2,385 acres; Alternative 3: 300 MWs of development on 2,151 acres; and Alternative 4: 232 MWs of development on 1,766 acres. In addition to project-related impacts, all project development alternatives analyze potential expansion of the current boundaries of the Ivanpah DWMA. The management prescriptions for the Ivanpah DWMA are defined in Appendix A, Section A.2, of the Northern and Eastern Mojave Desert Management Plan Amendment to the California Desert Conservation Area Plan (July 2002). If the DWMA is expanded, these management prescriptions will be applied to the expansion.

The Draft Plan Amendment and Draft EIS/EIR also analyze three No Project alternatives—Alternative 5: No Action; Alternative 6: No Project and amendment of the CDCA Plan to find the Project area unsuitable for solar development; and Alternative 7: No Project and amendment of the CDCA Plan to find the Project area suitable for solar development.

The Draft Plan Amendment and EIS/EIR evaluate the potential impacts of the proposed Stateline on air quality and greenhouse gas emissions, biological resources, cultural resources, special status species, geology and soils, hazards and hazardous materials, hydrology and water quality, land use, noise, recreation, traffic, visual resources, lands with wilderness characteristics, cumulative effects and areas with high potential for renewable energy development.

A Notice of Intent to Prepare a Draft Plan Amendment and EIS/EIR for the Stateline Project was published in the **Federal Register** on August 4, 2011 (76 FR 47235). The BLM held one joint public scoping meeting with San Bernardino County at the Primm Valley Golf Course on August 31, 2011. The formal scoping period ended on September 6, 2011.

Please note that public comments will be available for public review at the above address during regular business hours (8 a.m. to 4 p.m.), Monday through Friday, except holidays.

Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment—including your personal identifying information—may be made publicly available at any time. While you can ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

Authority: 40 CFR 1506.6, 40 CFR 1506.10, 43 CFR 1610.2.

Thomas Pogacnik,

Deputy State Director, Natural Resources.

[FR Doc. 2012–28392 Filed 11–21–12; 8:45 am]

BILLING CODE 4310–40–P

DEPARTMENT OF THE INTERIOR

National Park Service

[NPS–NER–BOHA–11636; 1727 SZS]

Notice of Meeting for Boston Harbor Islands National Recreation Area Advisory Council

AGENCY: National Park Service, Interior.

ACTION: Notice of meeting.

SUMMARY: Under section 10(a)(2) of the Federal Advisory Committee Act (5 U.S.C. App.) the National Park Service (NPS) is hereby giving notice that the Boston Harbor Islands National Recreation Area Advisory Council will hold a meeting. This meeting is open to the public. Topics to be discussed include a report from the Council's environmental interest group, a summer review of park operations, activation of the nominating committee, and public

comment. Preregistration is not required for public attendance and comment. Those wishing to submit written comments may contact the Designated Federal Official for the Boston Harbor Islands Advisory Council, Bruce Jacobson, Superintendent, by mail at 408 Atlantic Avenue, Suite 228, Boston, MA 02110, or by email at *Bruce_Jacobson@nps.gov*. Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment—including your personal identifying information—may be made publicly available at any time. While you can ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

DATES: The Boston Harbor Islands Advisory Council will meet from 4:00 p.m. to 6:00 p.m. on December 5, 2012, (EASTERN).

Location: The meeting will be held at Mariner's House, 11 North Square, Boston, MA 02113.

FOR FURTHER INFORMATION CONTACT: Bruce Jacobson, Superintendent, Boston Harbor Islands National Recreation Area, at (617) 223–8669 or *Bruce_Jacobson@nps.gov*.

SUPPLEMENTARY INFORMATION: The Advisory Council was appointed by the Director of National Park Service pursuant to Public Law 104–333. The 28 members represent business, educational/cultural, community and environmental entities; municipalities surrounding Boston Harbor; Boston Harbor advocates; and Native American interests. The purpose of the Council is to advise and make recommendations to the Boston Harbor Islands Partnership with respect to the development and implementation of a management plan and the operations of the Boston Harbor Islands National Recreation Area.

Dated: November 16, 2012.

Bruce Jacobson,

Superintendent, Boston Harbor Islands NRA.

[FR Doc. 2012–28397 Filed 11–21–12; 8:45 am]

BILLING CODE 4310–WV–P

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

Notice of Proposed Information Collection for 1029–0098

AGENCY: Office of Surface Mining Reclamation and Enforcement, Interior.

ACTION: Notice and request for comments.

SUMMARY: In compliance with the Paperwork Reduction Act of 1995, the Office of Surface Mining Reclamation and Enforcement (OSM) is announcing that the information collection request for the Petition process for designation of Federal lands as unsuitable for all or certain types of surface coal mining operations and for termination of previous designations, has been submitted to the Office of Management and Budget (OMB) for review and approval. The information collection request describes the nature of the information collection and its expected burden and cost. This information collection activity was previously approved by OMB and assigned clearance number 1029–0098.

DATES: Comments must be submitted on or before December 24, 2012, to be assured of consideration.

ADDRESSES: Comments may be submitted to the Office of Information and Regulatory Affairs, Office of Management and Budget, Department of the Interior Desk Officer, via email at *OIRA submission@omb.eop.gov,* or by facsimile to (202) 395–5806. Also, please send a copy of your comments to John Trelease, Office of Surface Mining Reclamation and Enforcement, 1951 Constitution Ave NW., Room 203—SIB, Washington, DC 20240, or electronically to *jtrelease@osmre.gov*. Please reference 1029–0098 in your correspondence.

FOR FURTHER INFORMATION CONTACT: To receive a copy of the information collection request contact John Trelease at (202) 208–2783, or electronically at *jtrelease@osmre.gov.* You may also review this information collection request on the Internet by going to *http://www.reginfo.gov* (Information Collection Review, Currently Under Review, Agency is Department of the Interior, DOI–OSMRE).

SUPPLEMENTARY INFORMATION: OMB regulations at 5 CFR part 1320, which implement provisions of the Paperwork Reduction Act of 1995 (Pub. L. 104–13), require that interested members of the public and affected agencies have an opportunity to comment on information collection and recordkeeping activities [see 5 CFR 1320.8(d)]. OSM has submitted a request to OMB to renew its approval for the collection of information found at 30 CFR part 769—Petition process for designation of Federal lands as unsuitable for all or certain types of surface coal mining operations and for termination of previous designations. OSM is requesting a 3-year term of approval for this collection. This collection is required to obtain or retain a benefit.

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 OMB control number. The OMB control number for this collection of information is 1029–0098.

As required under 5 CFR 1320.8(d), a **Federal Register** notice soliciting comments on this collection of information was published on August 17, 2012 (77 FR 49827). No comments were received. This notice provides the public with an additional 30 days in which to comment on the following information collection activity:

Title: 30 CFR Part 769—Petition process for designation of Federal lands as unsuitable for all or certain types of surface coal mining operations and for termination of previous designations.

OMB Control Number: 1029–0098.

Summary: This part establishes the minimum procedures and standards for designating Federal lands unsuitable for certain types of surface mining operations and for terminating designations pursuant to a petition. The information requested will aid the regulatory authority in the decision making process to approve or disapprove a request.

Bureau Form Number: None.

Frequency of Collection: Once.

Description of Respondents: People who may be adversely affected by surface mining on Federal lands.

Total Annual Responses: 1.

Total Annual Burden Hours: 1,000.

Send comments on the need for the collection of information for the performance of the functions of the agency; the accuracy of the agency's burden estimates; ways to enhance the quality, utility and clarity of the information collection; and ways to minimize the information collection burden on respondents, such as use of automated means of collection of the information, to the offices listed in the **ADDRESSES** section. Please refer to the appropriate OMB control number in all correspondence.

Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment-including your personal identifying information-may be made publicly available at any time. While you can ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

Dated: November 14, 2012.

Andrew F. DeVito,

Chief, Division of Regulatory Support.

[FR Doc. 2012–28410 Filed 11–21–12; 8:45 am]

BILLING CODE 4310–05–M

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

Notice of Proposed Information Collection for 1029–0119

AGENCY: Office of Surface Mining Reclamation and Enforcement, Interior.

ACTION: Notice and request for comments.

SUMMARY: In compliance with the Paperwork Reduction Act of 1995, the Office of Surface Mining Reclamation and Enforcement (OSM) is announcing that the information collection request for contractor eligibility, and the Abandoned Mine Land Contractor Information Form, has been forwarded to the Office of Management and Budget (OMB) for review and approval. The information collection request describes the nature of the information collection and the expected burden and cost. This information collection activity was previously approved by OMB and assigned clearance number 1029–0119.

DATES: Comments must be submitted on or before December 24, 2012, to be assured of consideration.

ADDRESSES: Comments may be submitted to the Office of Information and Regulatory Affairs, Office of Management and Budget, Department of the Interior Desk Officer, via email at *OIRA_submission@omb.eop.gov,* or by facsimile to (202) 395–5806. Also, please send a copy of your comments to John Trelease, Office of Surface Mining Reclamation and Enforcement, 1951 Constitution Ave NW., Room 203—SIB, Washington, DC 20240, or electronically to *jtrelease@osmre.gov.* Please reference 1029–0119 in your correspondence.

FOR FURTHER INFORMATION CONTACT: To receive a copy of the information collection request contact John Trelease at (202) 208–2783, or electronically at *jtrelease@osmre.gov.* You may also review this information collection request on the Internet by going *http://www.reginfo.gov* (Information Collection Review, Currently Under Review, Agency is Department of the Interior, DOI–OSMRE).

SUPPLEMENTARY INFORMATION: The Office of Management and Budget (OMB) regulations at 5 CFR part 1320, which implement provisions of the Paperwork Reduction Act of 1995 (Pub. L. 104–13), require that interested members of the public and affected agencies have an opportunity to comment on information collection and recordkeeping activities [see 5 CFR 1320.8(d)]. OSM has submitted a request to OMB to renew its approval for the collection of information for 30 CFR 874.16, and the AML Contractor Information Form which is found in the Applicant/Violator System (AVS) handbook. OSM is requesting a 3-year term of approval for this collection. This collection is required to obtain or retain a benefit.

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 OMB control number. The OMB control number for this collection of information is 1029–0119.

As required by 5 CFR 1320.8(d), a **Federal Register** notice soliciting comments on this collection of information was published on August 17, 2012 (77 FR 49827). No comments were received. This notice provides the public with an additional 30 days in which to comment on the following information collection activity:

Title: 30 CFR 874.16—Contractor Eligibility and the Abandoned Mine Land Contractor Information Form.

OMB Control Number: 1029–0119.

Summary: 30 CFR 874.16 requires that every successful bidder for an AML contract must be eligible under 30 CFR 773.15(b)(1) at the time of contract award to receive a permit or conditional permit to conduct surface coal mining operations. Further, the regulation requires the eligibility to be confirmed by OSM's automated Applicant/Violator System (AVS) and the contractor must be eligible under the regulations implementing Section 510(c) of the Surface Mining Act to receive permits to conduct mining operations. This form provides a tool for OSM and the States/Indian tribes to help them prevent persons with outstanding violations from conducting further mining or AML reclamation activities in the State.

Bureau Form Title: AML Contractor Information Form (No form number).

Frequency of Collection: Once per contract.

Description of Respondents: AML contract applicants and State and Tribal regulatory authorities.

Total Annual Responses: 279 bidders and 46 State/Tribal responses.

Total Annual Burden Hours: 169.

Send comments on the need for the collection of information for the performance of the functions of the agency; the accuracy of the agency's burden estimates; ways to enhance the quality, utility and clarity of the information collection; and ways to minimize the information collection burden on respondents, such as use of automated means of collection of the information, to the offices listed in the **ADDRESSES** section. Please refer to the appropriate OMB control number in all correspondence.

Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment—including your personal identifying information—may be made publicly available at any time. While you can ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

Dated: November 14, 2012.

Andrew F. DeVito,

Chief, Division of Regulatory Support.

[FR Doc. 2012–28411 Filed 11–21–12; 8:45 am]

BILLING CODE 4310–05–M

INTERNATIONAL TRADE COMMISSION

[Investigation No. 731–TA–1205 (Preliminary)]

Silica Bricks and Shapes From China; Institution of an Antidumping Duty Investigation and Scheduling of a Preliminary Phase Investigation

AGENCY: United States International Trade Commission.

ACTION: Notice.

SUMMARY: The Commission hereby gives notice of the institution of an investigation and commencement of a preliminary phase antidumping investigation No. 731–TA–1205 (Preliminary) under section 733(a) of the Tariff Act of 1930 (19 U.S.C.1673b(a)) (the Act) to determine whether there is a reasonable indication that an industry in the United States is materially injured or threatened with material injury, or the establishment of an industry in the United States is materially retarded, by reason of imports from China of silica bricks and shapes, provided for in subheading 6902.20.10 of the Harmonized Tariff Schedule of the United States, that are alleged to be sold in the United States at less than fair value. Unless the Department of Commerce extends the time for initiation pursuant to section 732(c)(1)(B) of the Act (19 U.S.C.1673a(c)(1)(B)), the Commission must reach a preliminary determination in antidumping investigations in 45 days, or in this case by December 31,

2012. The Commission's views are due at Commerce within five business days thereafter, or by January 8, 2013.

For further information concerning the conduct of this investigation and rules of general application, consult the Commission's Rules of Practice and Procedure, part 201, subparts A through E (19 CFR part 201), and part 207, subparts A and B (19 CFR part 207).

DATES: *Effective Date:* November 15, 2012.

FOR FURTHER INFORMATION CONTACT: Mary Messer (202–205–3193), Office of Investigations, U.S. International Trade Commission, 500 E Street SW., Washington, DC 20436. Hearing-impaired persons can obtain information on this matter by contacting the Commission's TDD terminal on 202–205–1810. Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Office of the Secretary at 202–205–2000. General information concerning the Commission may also be obtained by accessing its internet server (*http://www.usitc.gov*). The public record for this investigation may be viewed on the Commission's electronic docket (EDIS) at *http://edis.usitc.gov.*

SUPPLEMENTARY INFORMATION:

Background. This investigation is being instituted in response to a petition filed on November 15, 2012, by Utah Refractories Corp., Lehi, UT.

Participation in the investigation and public service list. Persons (other than petitioners) wishing to participate in the investigation as parties must file an entry of appearance with the Secretary to the Commission, as provided in sections 201.11 and 207.10 of the Commission's rules, not later than seven days after publication of this notice in the **Federal Register**. Industrial users and (if the merchandise under investigation is sold at the retail level) representative consumer organizations have the right to appear as parties in Commission antidumping investigations. The Secretary will prepare a public service list containing the names and addresses of all persons, or their representatives, who are parties to this investigation upon the expiration of the period for filing entries of appearance.

Limited disclosure of business proprietary information (BPI) under an administrative protective order (APO) and BPI service list. Pursuant to section 207.7(a) of the Commission's rules, the Secretary will make BPI gathered in this investigation available to authorized applicants representing interested parties (as defined in 19 U.S.C. 677(9)) who are parties to the investigation under the APO issued in the investigation, provided that the application is made not later than seven days after the publication of this notice in the **Federal Register**. A separate service list will be maintained by the Secretary for those parties authorized to receive BPI under the APO.

Conference. The Commission's Director of Investigations has scheduled a conference in connection with this investigation for 9:30 a.m. on December 6, 2012, at the U.S. International Trade Commission Building, 500 E Street SW., Washington, DC. Requests to appear at the conference should be filed with the Office of the Secretary (*William.bishop@usitc.gov* and *Sharon.bellamy@usitc.gov*) on or before December 4, 2012. Parties in support of the imposition of antidumping duties in this investigation and parties in opposition to the imposition of such duties will each be collectively allocated one hour within which to make an oral presentation at the conference. A nonparty who has testimony that may aid the Commission's deliberations may request permission to present a short statement at the conference.

Written submissions. As provided in sections 201.8 and 207.15 of the Commission's rules, any person may submit to the Commission on or before December 11, 2012, a written brief containing information and arguments pertinent to the subject matter of the investigation. Parties may file written testimony in connection with their presentation at the conference no later than three days before the conference. If briefs or written testimony contain BPI, they must conform with the requirements of sections 201.6, 207.3, and 207.7 of the Commission's rules. Please consult the Commission's rules, as amended, 76 FR 61937 (Oct. 6, 2011) and the Commission's Handbook on Filing Procedures, 76 FR 62092 (Oct. 6, 2011), available on the Commission's Web site at *http://edis.usitc.gov*.

In accordance with sections 201.16(c) and 207.3 of the rules, each document filed by a party to the investigation must be served on all other parties to the investigation (as identified by either the public or BPI service list), and a certificate of service must be timely filed. The Secretary will not accept a document for filing without a certificate of service.

Authority: This investigation is being conducted under authority of title VII of the Tariff Act of 1930; this notice is published pursuant to section 207.12 of the Commission's rules.

Issued: November 19, 2012.

By order of the Commission.

Lisa R. Barton,

Acting Secretary to the Commission.

[FR Doc. 2012–28419 Filed 11–21–12; 8:45 am]

BILLING CODE 7020–02–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Importer Of Controlled Substances; Notice Of Registration; Cerilliant Corporation

By Notice dated August 17, 2012, and published in the **Federal Register** on August 20, 2012, 77 FR 50162, Cerilliant Corporation, 811 Paloma Drive, Suite A, Round Rock, Texas 78665–2402, made application by renewal; to the Drug Enforcement Administration (DEA) to be registered as an importer of the following basic classes of controlled substances:

Drug	Schedule
Cathinone (1235)	I
Methcathinone (1237)	I
4-Methyl-N-methylcathinone (1248).	I
N-Ethylamphetamine (1475)	I
N,N-Dimethylamphetamine (1480)	I
Fenethylline (1503)	I
Gamma Hydroxybutyric Acid (2010).	I
JWH–018 (7118)	I
JWH–073 (7173)	I
JWH–200 (7200)	I
Alpha-ethyltryptamine (7249)	I
Ibogaine (7260)	I
CP–47497 (7297)	I
CP–47497 C8 Homologue (7298)	I
Lysergic acid diethylamide (7315)	I
2C-T-7(2,5-Dimethoxy-4-(n)-propylthiophenethylamine) (7348).	I
Marihuana (7360)	I
Tetrahydrocannabinols (7370)	I
Mescaline (7381)	I
3,4,5-Trimethoxyamphetamine (7390).	I
4-Bromo-2,5-dimethoxyamphetamine (7391).	I
4-Bromo-2,5-dimethoxyphenethylamine (7392).	I
4-Methyl-2,5-dimethoxyamphetamine (7395).	I
2,5-Dimethoxyamphetamine (7396).	I
3,4-Methylenedioxyamphetamine (7400).	I
3,4-Methylenedioxy-N-ethylamphetamine (7404).	I
3,4-Methylenedioxymethamphetamine (7405).	I
4-Methoxyamphetamine (7411)	I
5-Methoxy-N-N-dimethyltryptamine (7431).	I

Drug	Schedule
Alpha-methyltryptamine (7432)	I
Diethyltryptamine (7434)	I
Dimethyltryptamine (7435)	I
Psilocybin (7437)	I
Psilocyn (7438)	I
5-Methoxy-N,N-diisopropyltryptamine (7439).	I
N-Benzylpiperazine (7493)	I
MDPV 3,4-Methylenedioxypyrovalerone (7535).	I
Methylone 3,4-Methylenedioxy-N-methylcathinone (7540).	I
Desomorphine (9055)	I
Etorphine (except HCl)(9056)	I
Heroin (9200)	I
Morphine-N-oxide (9307)	I
Normorphine (9313)	I
Pholcodine (9314)	I
Dextromoramide (9613)	I
Dipipanone (9622)	I
Racemoramide (9645)	I
Trimeperidine (9646)	I
1-Methyl-4-phenyl-4-propionoxypiperidine (9661).	I
Tilidine (9750)	I
Amphetamine (1100)	II
Methamphetamine (1105)	II
Methylphenidate (1724)	II
Amobarbital (2125)	II
Pentobarbital (2270)	II
Secobarbital (2315)	II
Phencyclidine (7471)	II
Phenylacetone (8501)	II
Cocaine (9041)	II
Codeine (9050)	II
Dihydrocodeine (9120)	II
Oxycodone (9143)	II
Hydromorphone (9150)	II
Benzoylecgonine (9180)	II
Ethylmorphine (9190)	II
Meperidine (9230)	II
Methadone (9250)	II
Dextropropoxyphene, bulk (non-dosage forms) (9273).	II
Morphine (9300)	II
Oripavine (9330)	II
Thebaine (9333)	II
Levo-alphacetylmethadol (9648)	II
Oxymorphone (9652)	II
Poppy Straw Concentrate (9670)	II
Alfentanil (9737)	II
Sufentanil (9740)	II
Fentanyl (9801)	II

The company plans to import small quantities of the listed controlled substances for the manufacture of analytical reference standards.

No comments or objections have been received. DEA has considered the factors in 21 U.S.C. 823(a) and 952(a) and determined that the registration of Cerilliant Corporation to import the basic classes of controlled substances is consistent with the public interest and with United States obligations under international treaties, conventions, or protocols in effect on May 1, 1971. DEA has investigated Cerilliant Corporation to ensure that the company's registration is consistent with the public interest. The investigation has included inspection and testing of the company's physical security systems, verification of the company's compliance with state and local laws, and a review of the company's background and history.

Therefore, pursuant to 21 U.S.C. 952(a) and 958(a), and in accordance with 21 CFR 1301.34, the above named company is granted registration as an importer of the basic classes of controlled substances listed.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28482 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Importer of Controlled Substances; Notice of Registration; Lipomed, Inc.

By Notice dated July 30, 2012, and published in the **Federal Register** on August 20, 2012, 77 FR 50162, Lipomed, Inc., One Broadway, Cambridge, Massachusetts 02142, made application by letter to the Drug Enforcement Administration (DEA) to be registered as an importer of the following basic classes of controlled substances:

Drug	Schedule
Bufotenine (7433)	I
Diethyltryptamine (7434)	I
1-Piperidinocyclohexane-carbonitrile (8603).	II

The company plans to import analytical reference standards for distribution to its customers for research and analytical purposes.

No comments or objections have been received. DEA has considered the factors in 21 U.S.C. 823(a) and 952(a) and determined that the registration of Lipomed, Inc., to import the basic classes of controlled substances is consistent with the public interest and with United States obligations under international treaties, conventions, or protocols in effect on May 1, 1971. DEA has investigated Lipomed, Inc., to ensure that the company's registration is consistent with the public interest. The investigation has included inspection and testing of the company's physical security systems, verification of the company's compliance with state and local laws, and a review of the company's background and history.

Therefore, pursuant to 21 U.S.C. 952(a) and 958(a), and in accordance with 21 CFR 1301.34, the above named company is granted registration as an importer of the basic classes of controlled substances listed.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28484 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Importer of Controlled Substances; Notice of Registration; Mylan Technologies, Inc.

By Notice dated March 8, 2012, and published in the **Federal Register** on March 20, 2012, 77 FR 16262, Mylan Technologies, Inc., 110 Lake Street, Saint Albans, Vermont 05478, made application by renewal to the Drug Enforcement Administration (DEA) to be registered as an importer of the following basic classes of controlled substances:

Drug	Schedule
Methylphenidate (1724)	II
Fentanyl (9801)	II

The company plans to import the listed controlled substances in finished dosage form (FDF) from foreign sources for analytical testing and clinical trials in which the foreign FDF will be compared to the company's own domestically-manufactured FDF. This analysis is required to allow the company to export domestically-manufactured FDF to foreign markets.

No comments or objections have been received. DEA has considered the factors in 21 U.S.C. 823(a) and 952(a), and determined that the registration of Mylan Pharmaceuticals, Inc. to import the basic classes of controlled substances is consistent with the public interest, and with United States obligations under international treaties, conventions, or protocols in effect on May 1, 1971. DEA has investigated Mylan Pharmaceuticals, Inc. to ensure that the company's registration is consistent with the public interest. The investigation has included inspection and testing of the company's physical security systems, verification of the company's compliance with state and local laws, and a review of the company's background and history.

Therefore, pursuant to 21 U.S.C. 952(a) and 958(a), and in accordance with 21 CFR 1301.34, the above named

company is granted registration as an importer of the basic classes of controlled substances listed.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28485 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Manufacturer of Controlled Substances; Notice of Application; Cayman Chemical Company

Pursuant to § 1301.33(a), Title 21 of the Code of Federal Regulations (CFR), this is notice that on September 25, 2012, Cayman Chemical Company, 1180 East Ellsworth Road, Ann Arbor, Michigan 48108, made application to the Drug Enforcement Administration (DEA) to be registered as a bulk manufacturer of the following basic classes of controlled substances:

Drug	Schedule
JWH–250 (6250)	I
SR–18 also known as RCS–8 (7008).	I
JWH–019 (7019)	I
JWH–081 (7081)	I
SR–19 also known as RCS–4 (7104).	I
JWH–122 (7122)	I
AM–2201 (7201)	I
JWH–203 (7203)	I
2C–T–2 (7385)	I
JWH–398 (7398)	I
Psilocybin (7437)	I
Psilocyn (7438)	I
2C–D (7508)	I
2C–E (7509)	I
2C–H (7517)	I
2C–I (7518)	I
2C–C (7519)	I
2C–N (7521)	I
2C–P (7524)	I
2C–T–4 (7532)	I
AM–694 (7694)	I
Phenylacetone (8501)	I

The company plans to manufacture the listed controlled substances for distribution to their research and forensics customers conducting drug testing and analysis.

Any other such applicant, and any person who is presently registered with DEA to manufacture such substances, may file comments or objections to the issuance of the proposed registration pursuant to 21 CFR 1301.33(a).

Any such written comments or objections should be addressed, in quintuplicate, to the Drug Enforcement Administration, Office of Diversion Control, Federal Register Representative (ODL), 8701 Morrissette Drive, Springfield, Virginia 22152; and must be filed no later than January 22, 2013.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28486 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Manufacturer of Controlled Substances; Notice of Application; Alltech Associates, Inc.

Pursuant to § 1301.33(a), Title 21 of the Code of Federal Regulations (CFR), this is notice that on September 14, 2012, Alltech Associates Inc., 2051 Waukegan Road, Deerfield, Illinois 60015, made application to the Drug Enforcement Administration (DEA) to be registered as a bulk manufacturer of the following basic classes of controlled substances:

Drug	Schedule
2C-T-2 (2-(4-Ethylthio-2,5-dimethoxyphenyl)ethanamine) (7385).	I
2C-1 (2-(4-Iodo-2,5-dimethoxyphenyl) Ethanamine) (7518).	I
2C-C (2-(4-Chloro-2,5-dimethoxyphenyl) ethanamine (7519).	I

The company plans to manufacture high purity drug standards used for analytical applications only in clinical, toxicological, and forensic laboratories.

Any other such applicant, and any person who is presently registered with DEA to manufacture such substances, may file comments or objections to the issuance of the proposed registration pursuant to 21 CFR 1301.33(a).

Any such comments or objections should be addressed, in quintuplicate, to the Drug Enforcement Administration, Office of Diversion Control, Federal Register Representative (ODL), 8701 Morrissette Drive, Springfield, Virginia 22152; and must be filed no later than January 22, 2013.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28493 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Manufacturer of Controlled Substances; Notice of Registration; Boehringer Ingelheim Chemicals, Inc.

By Notice dated July 17, 2012, and published in the **Federal Register** on July 26, 2012, 77 FR 43863, Boehringer Ingelheim Chemicals, Inc., 2820 N. Normandy Drive, Petersburg, Virginia 23805–9372, made application by renewal to the Drug Enforcement Administration (DEA) to be registered as a bulk manufacturer of the following basic classes of controlled substances:

Drug	Schedule
Amphetamine (1100)	II
Lisdexamfetamine (1205)	II
Methylphenidate (1724)	II
Methadone (9250)	II
Methadone Intermediate (9254)	II
Tapentadol (9780)	II

The company plans to manufacture the listed controlled substances in bulk for sale to its customers for formulation into finished pharmaceuticals. In reference to Methadone Intermediate (9254) the company plans to produce Methadone HCL active pharmaceutical ingredients (APIs) for sale to its customers.

No comments or objections have been received. DEA has considered the factors in 21 U.S.C. 823(a) and determined that the registration of Boehringer Ingelheim Chemicals, Inc., to manufacture the listed basic classes of controlled substances is consistent with the public interest at this time. DEA has investigated Boehringer Ingelheim Chemicals, Inc., to ensure that the company's registration is consistent with the public interest. The investigation has included inspection and testing of the company's physical security systems; verification of the company's compliance with state and local laws; and a review of the company's background and history.

Therefore, pursuant to 21 U.S.C. 823(a), and in accordance with 21 CFR 1301.33, the above named company is granted registration as a bulk manufacturer of the basic classes of controlled substances listed.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28496 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Manufacturer of Controlled Substances; Notice of Registration; Cayman Chemical Company

By Notice dated July 30, 2012, and published in the **Federal Register** on August 7, 2012, 77 FR 47115, Cayman Chemical Company, 1180 East Ellsworth Road, Ann Arbor, Michigan 48108, made application by renewal to the Drug Enforcement Administration (DEA) to be registered as a bulk manufacturer of the following basic classes of controlled substances:

Drug	Schedule
Cathinone (1235)	I
Methcathinone (1237)	I
4-Methyl-N-methylcathinone (1248).	I
N-Ethylamphetamine (1475)	I
N,N-Dimethylamphetamine (1480)	I
Aminorex (1585)	I
4-Methylaminorex (cis isomer) (1590).	I
Gamma Hydroxybutyric Acid (2010).	I
1-Pentyl-3-(1-naphthoyl) indole (7118).	I
1-Butyl-3-(1-naphthoyl) indole (7173).	I
1-[2-(4-Morpholinyl)ethyl]-3-(1-naphthoyl) indole (7200).	I
Alpha-ethyltryptamine (7249)	I
5-(1,1-Dimethylheptyl)-2-[(1R,3S)-3-hydroxycyclohexyl]-phenol (7297).	I
5-(1,1-Dimethyloctyl)-2-[(1R,3S)-3-hydroxycyclohexyl]-phenol (7298).	I
Lysergic acid diethylamide (7315)	I
2,5-Dimethoxy-4-(n)-propylthiophenethylamine (7348).	I
Marihuana (7360)	I
Tetrahydrocannabinols (7370)	I
Mescaline (7381)	I
3,4,5-Trimethoxyamphetamine (7390).	I
4-Bromo-2,5-dimethoxyamphetamine (7391).	I
4-Bromo-2,5-dimethoxyphenethylamine (7392).	I
4-Methyl-2,5-dimethoxyamphetamine (7395).	I
2,5-Dimethoxyamphetamine (7396).	I
2,5-Dimethoxy-4-ethylamphetamine (7399).	I
3,4-Methylenedioxyamphetamine (7400).	I
5-Methoxy-3,4-methylenedioxyamphetamine (7401).	I
N-Hydroxy-3,4-methylenedioxyamphetamine (7402).	I
3,4-Methylenedioxy-N-ethylamphetamine (7404).	I
3,4-Methylenedioxymethamphetamine (7405).	I
4-Methoxyamphetamine (7411)	I
5-Methoxy-N-N-dimethyltryptamine (7431).	I
Alpha-methyltryptamine (7432)	I
Bufotenine (7433)	I
Diethyltryptamine (7434)	I
Dimethyltryptamine (7435)	I
Psilocybin (7437)	I
Psilocyn (7438)	I
5-Methoxy-N-N-diisopropyltryptamine (7439).	I
N-Benzylpiperazine (7493)	I
3,4-Methylenedioxypyrovalerone (7535).	I
3,4-Methylenedioxy-N-methylcathinone (7540).	I
Amphetamine (1100)	II
Methamphetamine (1105)	II
Lisdexamfetamine (1205)	II

The company plans to manufacture small quantities of marihuana derivatives for research purposes. In reference to drug code 7360 (Marihuana), the company plans to bulk manufacture cannabidiol. In reference to drug code 7370 (Tetrahydrocannabinols), the company will manufacture a synthetic THC. No other activity for this drug code is authorized for this registration.

The company plans to manufacture the remaining listed controlled substances to supply these materials to the research and forensics community for drug testing and analysis.

No comments or objections have been received. DEA has considered the factors in 21 U.S.C. 823(a) and determined that the registration of Cayman Chemical Company to manufacture the listed basic classes of controlled substances is consistent with the public interest at this time. DEA has investigated Cayman Chemical Company to ensure that the company's registration is consistent with the public interest. The investigation has included inspection and testing of the company's physical security systems, verification of the company's compliance with state and local laws, and a review of the company's background and history.

Therefore, pursuant to 21 U.S.C. 823(a), and in accordance with 21 CFR 1301.33, the above named company is granted registration as a bulk manufacturer of the basic classes of controlled substances listed.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28500 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

Manufacturer of Controlled Substances; Notice of Registration; Cambrex Charles City, Inc.

By Notice dated July 17, 2012 and published in the **Federal Register** on July 26, 2012, 77 FR 43863, Cambrex Charles City, Inc., 1205 11th Street, Charles City, Iowa 50616, made application by renewal to the Drug Enforcement Administration (DEA) to be registered as a bulk manufacturer of the following basic classes of controlled substances:

Drug	Schedule
Gamma Hydroxybutyric Acid (2010).	I
Amphetamine (1100)	II
Lisdexamfetamine (1205)	II
Methylphenidate (1724)	II
4-Anilino-N-phenethyl-4-piperidine (ANPP) (8333).	II
Phenylacetone (8501)	II
Cocaine (9041)	II
Codeine (9050)	II
Oxycodone (9143)	II
Hydromorphone (9150)	II
Hydrocodone (9193)	II
Methadone (9250)	II
Dextropropoxyphene, bulk (non-dosage forms) (9273).	II
Morphine (9300)	II
Oripavine (9330)	II
Thebaine (9333)	II
Opium, raw (9600)	II
Opium extracts (9610)	II
Opium fluid extract (9620)	II
Opium tincture (9630)	II
Opium, powdered (9639)	II
Opium, granulated (9640)	II
Oxymorphone (9652)	II
Noroxymorphone (9668)	II
Poppy Straw Concentrate (9670)	II
Alfentanil (9737)	II
Remifentanil (9739)	II
Sufentanil (9740)	II
Fentanyl (9801)	II

The company plans to manufacture the listed controlled substances in bulk for sale to its customers, for dosage form development, for clinical trials, and for use in stability qualification studies.

No comments or objections have been received. DEA has considered the factors in 21 U.S.C. 823(a), and

determined that the registration of Cambrex Charles City, Inc., to manufacture the listed basic classes of controlled substances is consistent with the public interest at this time. DEA has investigated Cambrex Charles City, Inc., to ensure that the company's registration is consistent with the public interest. The investigation has included inspection and testing of the company's physical security systems, verification of the company's compliance with state and local laws, and a review of the company's background and history.

Therefore, pursuant to 21 U.S.C. 823(a), and in accordance with 21 CFR 1301.33, the above named company is granted registration as a bulk manufacturer of the basic classes of controlled substances listed.

Dated: November 14, 2012.

Joseph T. Rannazzisi,

Deputy Assistant Administrator, Office of Diversion Control, Drug Enforcement Administration.

[FR Doc. 2012–28499 Filed 11–21–12; 8:45 am]

BILLING CODE 4410–09–P

LEGAL SERVICES CORPORATION

Sunshine Act Meetings; Notice

DATE AND TIME: The Legal Services Corporation's Board of Directors will meet telephonically on November 29, 2012. The meeting will commence at 5:00 p.m., Eastern Standard Time, and will continue until the conclusion of the Board's agenda.

LOCATION: F. William McCalpin Conference Center, Legal Services Corporation Headquarters, 3333 K Street NW., Washington DC 20007.

PUBLIC OBSERVATION: Members of the public who are unable to attend in person but wish to listen to the public proceedings may do so by following the telephone call-in directions provided below but are asked to keep their telephones muted to eliminate background noises. To avoid disrupting the meeting, please refrain from placing the call on hold if doing so will trigger recorded music or other sound. From time to time, the presiding Chair may solicit comments from the public.

CALL-IN DIRECTIONS FOR OPEN SESSIONS:

- Call toll-free number: 1–866–451–4981;
- When prompted, enter the following numeric pass code: 5907707348;
- When connected to the call, please immediately ''MUTE'' your telephone.

STATUS OF MEETING: Open.

MATTERS TO BE CONSIDERED:

1. Approval of Agenda.
2. Approval of minutes of the Board's meeting of October 1–2, 2012.
3. Consider and act on the Board of Directors' transmittal to accompany the Inspector General's Semiannual Report to Congress for the period of April 1, 2012 through September 30, 2012.
4. Report on legal services needs and activities relating to Hurricane Sandy.
5. Public comment.
6. Consider and act on other business.
7. Consider and act on motion to adjourn the meeting.

* * * * *

CONTACT PERSON FOR INFORMATION: Katherine Ward, Executive Assistant to the Vice President & General Counsel, at (202) 295–1500. Questions may be sent by electronic mail to *FR_NOTICE_QUESTIONS@lsc.gov.*

NON-CONFIDENTIAL MEETING MATERIALS: Non-confidential meeting materials will be made available in electronic format at least 24 hours in advance of the meeting on the LSC Web site, at *http://www.lsc.gov/board-directors/meetings/board-meeting-notices/non-confidential-materials-be-considered-open-session.*

ACCESSIBILITY: LSC complies with the American's with Disabilities Act and Section 504 of the 1973 Rehabilitation Act. Upon request, meeting notices and materials will be made available in alternative formats to accommodate individuals with disabilities. Individuals who need other accommodations due to disability in order to attend the meeting in person or telephonically should contact Katherine Ward, at (202) 295–1500 or *FR_NOTICE_QUESTIONS@lsc.gov*, at least 2 business days in advance of the meeting. If a request is made without advance notice, LSC will make every effort to accommodate the request but cannot guarantee that all requests can be fulfilled.

Dated: November 20, 2012.

Victor M. Fortuno,

Vice President and General Counsel.

[FR Doc. 2012–28599 Filed 11–20–12; 4:15 pm]

BILLING CODE 7050–01–P

NUCLEAR REGULATORY COMMISSION

[Docket No. NRC–2012–0149]

Agency Information Collection Activities: Submission for the Office of Management and Budget (OMB) Review; Comment Request

AGENCY: Nuclear Regulatory Commission.

ACTION: Notice of the OMB review of information collection and solicitation of public comment.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) has recently submitted to OMB for review the following proposal for the collection of information under the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The NRC hereby informs potential respondents that an agency may not conduct or sponsor, and that a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The NRC published a **Federal Register** notice with a 60-day comment period on this information collection on August 1, 2012 (77 FR 45697).

1. *Type of submission, new, revision, or extension:* Extension.

2. *The title of the information collection:* Part 60 of Title 10 of the *Code of Federal Regulations* (10 CFR), ''Disposal of High-Level Radioactive Wastes in Geologic Repositories.''

3. *Current OMB approval number:* 3150–0127.

4. *The form number if applicable:* N/A.

5. *How often the collection is required:* The information need only be submitted one time.

6. *Who will be required or asked to report:* State or Indian tribes, or their representatives, requesting consultation with the NRC staff regarding review of a potential high-level radioactive waste geologic repository site, or wishing to participate in a license application review for a potential geologic repository (other than a potential geologic repository site at Yucca Mountain, Nevada, which is regulated under 10 CFR part 63).

7. *An estimate of the number of annual responses:* 1; however, none are expected in the next 3 years.

8. *The estimated number of annual respondents:* 1; however, none are expected in the next 3 years.

9. *An estimate of the total number of hours needed annually to complete the requirement or request:* 1 hour; however, none are expected in the next 3 years.

10. *Abstract:* Part 60 requires States and Indian tribes to submit certain information to the NRC if they request consultation with the NRC staff concerning the review of a potential repository site, or wish to participate in a license application review for a potential repository (other than the Yucca Mountain, Nevada site, which is regulated under 10 CFR part 63). Representatives of States or Indian tribes must submit a statement of their

authority to act in such a representative capacity. The information submitted by the States and Indian tribes is used by the Director of the Office of Nuclear Material Safety and Safeguards as a basis for decisions about the commitment of NRC staff resources to the consultation and participation efforts. The NRC anticipates conducting a public rulemaking to revise portions of 10 CFR part 60 in the near future (i.e., within the next 5 years). If, as part of this rulemaking, revisions are made affecting the information collection requirements, the NRC will follow OMB requirements for obtaining approval for any revised information collection requirements. [Note: All of the information collection requirements pertaining to Yucca Mountain were included in 10 CFR part 63, and were approved by OMB under control number 3150–0199. The Yucca Mountain site is regulated under 10 CFR part 63 (66 FR 55792, November 2, 2001).]

The public may examine and have copied for a fee publicly available documents, including the final supporting statement, at the NRC's Public Document Room, Room O–1F21, One White Flint North, 11555 Rockville Pike, Rockville, Maryland 20852. The OMB clearance requests are available at the NRC's Web site: *http://www.nrc.gov/public-involve/doc-comment/omb/.* The document will be available on the NRC's home page site for 60 days after the signature date of this notice.

Comments and questions should be directed to the OMB reviewer listed below by December 24, 2012. Comments received after this date will be considered if it is practical to do so, but assurance of consideration cannot be given to comments received after this date.

Chad Whiteman, Desk Officer, Office of Information and Regulatory Affairs (3150–0127), NEOB–10202, Office of Management and Budget, Washington, DC 20503.

Comments can also be emailed to *Chad_S_Whiteman@omb.eop.gov* or submitted by telephone at 202–395–4718.

The NRC Clearance Officer is Tremaine Donnell, 301–415–6258.

For the Nuclear Regulatory Commission.

Dated at Rockville, Maryland, this 16th day of November, 2012.

Tremaine Donnell,

NRC Clearance Officer, Office of Information Services.

[FR Doc. 2012–28442 Filed 11–21–12; 8:45 am]

BILLING CODE 7590–01–P

NUCLEAR REGULATORY COMMISSION

[Docket No. NRC–2012–0148]

Agency Information Collection Activities: Submission for the Office of Management and Budget (OMB) Review; Comment Request

AGENCY: Nuclear Regulatory Commission.

ACTION: Notice of the OMB review of information collection and solicitation of public comment.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) has recently submitted to OMB for review the following proposal for the collection of information under the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The NRC hereby informs potential respondents that an agency may not conduct or sponsor, and that a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The NRC published a **Federal Register** Notice with a 60-day comment period on this information collection on September 5, 2012 (77 FR 54616).

1. *Type of submission, new, revision, or extension:* Extension.

2. *The title of the information collection:* 10 CFR Part 150, ''Exemptions and Continued Regulatory Authority in Agreement States and in Offshore Waters Under Section 274.''

3. *Current OMB approval number:* 3150–0032.

4. *The form number if applicable:* N/A.

5. *How often the collection is required:* 10 CFR 150.16(b), 10 CFR 150.17(c), and 10 CFR 150.19(c) require the submission of reports following specified events, such as the theft or unlawful diversion of licensed radioactive material. The source material inventory reports required under 10 CFR 150.17(b) must be submitted annually by certain licensees.

6. *Who will be required or asked to report:* Agreement State licensees authorized to possess source or special nuclear material at certain types of facilities, or at any one time and location in greater than specified amounts. In addition, persons engaging in activities in non-Agreement States, in areas of exclusive Federal jurisdiction within Agreement States, or in offshore waters.

7. *An estimate of the number of annual responses:* 8.

8. *The estimated number of annual respondents:* 8.

9. *An estimate of the total number of hours needed annually to complete the requirement or request:* 190.

10. *Abstract:* Part 150 of Title 10 of the *Code of Federal Regulations* (10 CFR), provides certain exemptions from NRC regulations for persons in Agreement States. The regulations in 10 CFR part 150 also defines activities in Agreement States and in offshore waters over which the NRC regulatory authority continues, including certain information collection requirements. The information is needed to permit the NRC to make reports to other governments and the International Atomic Energy Agency in accordance with international agreements. The information is also used to carry out the NRC's safeguards and inspection programs.

The public may examine and have copied for a fee, publicly available documents, including the final supporting statement, at the NRC's Public Document Room, Room O–1F21, One White Flint North, 11555 Rockville Pike, Rockville, Maryland 20852. The OMB clearance requests are available at the NRC's Web site: *http://www.nrc.gov/public-involve/doc-comment/omb/.* The document will be available on the NRC's home page site for 60 days after the signature date of this notice.

Comments and questions should be directed to the OMB reviewer listed below by December 24, 2012. Comments received after this date will be considered if it is practical to do so, but assurance of consideration cannot be given to comments received after this date.

Chad Whiteman, Desk Officer, Office of Information and Regulatory Affairs (3150–0032), NEOB–10202, Office of Management and Budget, Washington, DC 20503.

Comments can also be emailed to *Chad_S_Whiteman@omb.eop.gov.* or submitted by telephone at 202–395–4718.

The NRC Clearance Officer is Tremaine Donnell, 301–415–6258.

Dated at Rockville, Maryland, this 16th day of November, 2012.

For the Nuclear Regulatory Commission.

Tremaine Donnell,

NRC Clearance Officer, Office of Information Services.

[FR Doc. 2012–28443 Filed 11–21–12; 8:45 am]

BILLING CODE 7590–01–P

NUCLEAR REGULATORY COMMISSION

[Docket No. NRC–2012–0263]

Agency Information Collection Activities: Proposed Collection; Comment Request

AGENCY: Nuclear Regulatory Commission.

ACTION: Notice of pending NRC action to submit an information collection request to the Office of Management and Budget (OMB) and solicitation of public comment.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) invites public comment about our intention to request the OMB's approval for renewal of an existing information collection that is summarized below. We are required to publish this notice in the **Federal Register** under the provisions of the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35).

Information pertaining to the requirement to be submitted:

1. *The title of the information collection:* NRC Form 664, General Licensee Registration.

2. *Current OMB approval number:* 3150–0198.

3. *How often the collection is required:* Annually.

4. *Who is required or asked to report:* General Licensees of the NRC who possess certain generally licensed devices subject to annual registration authorized pursuant to § 31.5 of the *Code of Federal Regulations* (10 CFR).

5. *The number of annual respondents:* 633.

6. *The number of hours needed annually to complete the requirement or request:* 211 hours.

7. *Abstract:* NRC Form 664 is used by NRC general licensees to make reports regarding certain generally licensed devices subject to annual registration. The registration program allows NRC to better track general licensees, so that they can be contacted or inspected as necessary, and to make sure that generally licensed devices can be identified even if lost or damaged. Also, the registration program ensures that general licensees are aware of and understand the requirements for the possession, use and disposal of devices containing byproduct material. Greater awareness helps to ensure that general licensees will comply with the regulatory requirements for proper handling and disposal of generally licensed devices and would reduce the potential for incidents that could result in unnecessary radiation exposure to the public and contamination of property.

Submit, by January 22, 2013, comments that address the following questions:

1. Is the proposed collection of information necessary for the NRC to properly perform its functions? Does the information have practical utility?

2. Is the burden estimate accurate?

3. Is there a way to enhance the quality, utility, and clarity of the information to be collected?

4. How can the burden of the information collection be minimized, including the use of automated collection techniques or other forms of information technology?

The public may examine and have copied for a fee publicly available document, including the draft supporting statement, at the NRC's Public Document Room, Room O–1F21, One White Flint North, 11555 Rockville Pike, Rockville, Maryland 20852. The OMB clearance requests are available at the NRC's Web site: *http://www.nrc.gov/public-involve/doc-comment/omb/.*

The document will be available on the NRC's home page site for 60 days after the signature date of this notice. Comments submitted in writing or in electronic form will be made available for public inspection. Because your comments will not be edited to remove any identifying or contact information, the NRC cautions you against including any information in your submission that you do not want to be publicly disclosed. Comments submitted should reference Docket No. NRC–2012–0263. You may submit your comments by any of the following methods: Electronic comments: Go to *http://www.regulations.gov* and search for Docket No. NRC–2012–0263. Mail comments to the NRC Clearance Officer, Tremaine Donnell (T–5 F53), U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001.

Questions about the information collection requirements may be directed to the NRC Clearance Officer, Tremaine Donnell (T–5 F53), U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001, by telephone at 301–415–6258, or by email to *INFOCOLLECTS.Resource@NRC.GOV.*

Dated at Rockville, Maryland, this 16th day of November, 2012.

For the Nuclear Regulatory Commission.

Tremaine Donnell,

NRC Clearance Officer, Office of Information Services.

[FR Doc. 2012–28444 Filed 11–21–12; 8:45 am]

BILLING CODE 7590–01–P

NUCLEAR REGULATORY COMMISSION

[NRC–2012–0276]

Appointments to Performance Review Boards for Senior Executive Service

AGENCY: Nuclear Regulatory Commission.

ACTION: Appointment to Performance Review Boards for Senior Executive Service.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) has announced the following appointments to the NRC's Performance Review Boards (PRB) responsible for making recommendations to the appointing and awarding authorities on performance appraisal ratings and performance awards for Senior Executives and Senior Level employees:

R.W. Borchardt, Executive Director for Operations.
Margaret M. Doane, General Counsel.
Darren B. Ash, Deputy Executive Director for Corporate Management, Office of the Executive Director for Operations.
Cynthia A. Carpenter, Director, Office of Administration.
James E. Dyer, Chief Financial Officer.
Michael R. Johnson, Deputy Executive Director for Reactor and Preparedness Programs, Office of the Executive Director for Operations.
Victor M. McCree, Regional Administrator, Region II.
Mark A. Satorius, Director, Office of Federal and State Materials and Environmental Management Programs.
Glenn M. Tracy, Director, Office of New Reactors.
Annette L. Vietti-Cook, Secretary of the Commission, Office of the Secretary.
Michael F. Weber, Deputy Executive Director for Materials, Waste, Research, State, Tribal, and Compliance Programs, Office of the Executive Director for Operations.
James T. Wiggins, Director, Office of Nuclear Security and Incident Response.

The following individuals will serve as members of the NRC's PRB Panel that was established to review appraisals and make recommendations to the appointing and awarding authorities for NRC's PRB members:

Eric J. Leeds, Director, Office of Nuclear Reactor Regulation.
Marvin L. Itzkowitz, Associate General Counsel for Hearings, Enforcement, and Administration, Office of the General Counsel.
Catherine Haney, Director, Office of Nuclear Material Safety and Safeguards.

All appointments are made pursuant to Section 4314 of Chapter 43 of Title 5 of the United States Code.

DATES: *Effective Date:* November 23, 2012.

FOR FURTHER INFORMATION CONTACT: Secretary, Executive Resources Board, U.S. Nuclear Regulatory Commission, Washington, DC 20555, (301) 492–2076.

Dated at Bethesda, Maryland, this 23rd day of October 2012.

For the U.S. Nuclear Regulatory Commission.

Miriam L. Cohen,

Secretary, Executive Resources Board.

[FR Doc. 2012–28426 Filed 11–21–12; 8:45 am]

BILLING CODE 7590–01–P

NUCLEAR REGULATORY COMMISSION

[Docket No. 70–3098–MLA; ASLBP No. 07–856–02–MLA–BD01]

Shaw Areva MOX Services (Mixed Oxide Fuel Fabrication Facility); Notice of Atomic Safety and Licensing Board Reconstitution

Pursuant to 10 CFR 2.313(c) and 2.321(b), the Atomic Safety and Licensing Board (Board) in the above-captioned *Mixed Oxide Fuel Fabrication Facility* license application proceeding is hereby reconstituted by appointing Administrative Judge Paul B. Abramson to serve on the Board in place of Administrative Judge Lawrence G. McDade.

All correspondence, documents, and other materials shall continue to be filed in accordance with 10 CFR 2.302 and any relevant filing directives issued by the Board.

Issued at Rockville, Maryland this 16th day of November 2012.

E. Roy Hawkens,

Chief Administrative Judge, Atomic Safety and Licensing Board Panel.

[FR Doc. 2012–28441 Filed 11–21–12; 8:45 am]

BILLING CODE 7590–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC–30266; 812–14074]

Wells Fargo Bank, N.A., et al.; Notice of Application and Temporary Order

November 16, 2012.

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

ACTION: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 (''Act'').

SUMMARY OF APPLICATION: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against Wells Fargo Bank, N.A. (''Wells Fargo Bank'') on September 20, 2012, by the United States District Court for the District of Columbia, until the Commission takes final action on an application for a permanent order. Applicants have requested a permanent order.

APPLICANTS: Wells Fargo Bank, First International Advisors, LLC (''First International''), Metropolitan West Capital Management, LLC (''Metropolitan West''), Golden Capital Management, LLC (''Golden Capital''), Alternative Strategies Brokerage Services, Inc. (''Alternative Strategies Brokerage''), Alternative Strategies Group, Inc. (''Alternative Strategies''), Wells Fargo Funds Management, LLC (''WF Funds Management''), Wells Capital Management Incorporated (''Wells Capital Management''), Peregrine Capital Management, Inc. (''Peregrine''), Galliard Capital Management, Inc. (''Galliard''), and Wells Fargo Funds Distributor, LLC (''WF Funds Distributor'') (each an ''Applicant'' and collectively, the ''Applicants'').[1]

FILING DATE: The application was filed on August 31, 2012, and amended on September 21, 2012.

HEARING OR NOTIFICATION OF HEARING: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on December 11, 2012, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

ADDRESSES: Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090. Applicants: Wells Fargo Bank, 101 North Phillips Avenue, Sioux Falls, SD 57104; First International, 30 Fenchurch Street, London, England, UK EC3M 3BD; Metropolitan West, 610 Newport Center Drive, Suite 1000, Newport Beach, CA 92660; Golden Capital, 5 Resource Square, Suite 400, 10715 David Taylor Drive, Charlotte, NC 28262; Alternative Strategies Brokerage, 401 South Tryon Street, Charlotte, NC 28202; Alternative Strategies, 401 South Tryon Street, TH 3, Charlotte, NC 28202; WF Funds Management and WF Funds Distributor, 525 Market Street, 12th Floor, San Francisco, CA 94105; Wells Capital Management, 525 Market Street, 10th Floor, San Francisco, CA 94105; Peregrine, 800 LaSalle Avenue, Suite 1850, Minneapolis, MN 55402; and Galliard, 800 LaSalle Avenue, Suite 1100, Minneapolis, MN 55402.

FOR FURTHER INFORMATION CONTACT: Steven I. Amchan, Senior Counsel, at (202) 551–6826 or Daniele Marchesani, Branch Chief, at (202) 551–6821 (Division of Investment Management, Office of Investment Company Regulation).

SUPPLEMENTARY INFORMATION: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's Web site by searching for the file number, or an applicant using the Company name box, at *http://www.sec.gov/search/search.htm* or by calling (202) 551–8090.

Applicants' Representations

1. Wells Fargo Bank is a national banking association wholly-owned, directly and indirectly, by Wells Fargo & Company (''Wells Fargo''). Through its direct and indirect subsidiaries, Wells Fargo, a registered financial holding company and bank holding company under the Bank Holding Company Act of 1956, as amended, offers banking, brokerage, advisory and other financial services to institutional and individual customers worldwide. Wells Fargo also is the ultimate parent of the other Applicants, who, as direct or indirect, majority-owned or wholly-owned, subsidiaries of the same ultimate parent, are, or may be considered to be, under common control with Wells Fargo Bank.

2. Effective December 1, 2011, and August 24, 2012, respectively, two separately identifiable departments within Wells Fargo Bank, Abbot Downing Investment Advisors and Wells Capital Management Singapore, each became registered as an investment adviser under the Investment Advisers Act of 1940 (''Advisers Act'') and each serves as an investment adviser to one or more Funds (as defined below). First International, Metropolitan West, Golden Capital, Alternative Strategies, WF Funds Management, Wells Capital

[1] Applicants request that any relief granted pursuant to the application also apply to any existing company of which Wells Fargo Bank is or may become an affiliated person within the meaning of section 2(a)(3) of the Act (together with the Applicants, the ''Covered Persons'').

Management, Peregrine, and Galliard are registered as investment advisers under the Advisers Act and serve as investment advisers or sub-advisers to various Funds. Alternative Strategies Brokerage and WF Funds Distributor are registered as broker-dealers under the Securities Exchange Act of 1934, and each serves as principal underwriter to various Funds. ''Fund'' means any registered investment company, including a registered unit investment trust (''UIT'') or registered face amount certificate company, as well as a business development company (''BDC'') or employees' securities company (''ESC''). ''Fund Servicing Activities'' means acting as an adviser, sub-adviser or depositor to Funds, or principal underwriter for any registered open-end investment company, UIT, registered face amount company or ESC.

3. On July 12, 2012, the U.S. Department of Justice filed a complaint (''Complaint'') against Wells Fargo Bank in the United States District Court for the District of Columbia (''District Court'') in a civil action.[2] The Complaint alleged that Wells Fargo Bank engaged in a pattern or practice of discrimination on the basis of race and national origin in violation of the Equal Credit Opportunity Act (''ECOA'') and the Fair Housing Act (''FHA''). More specifically, the Complaint alleged that Wells Fargo Bank's policies caused African-American and Hispanic borrowers to be placed into subprime loans at higher rates than similarly-situated white borrowers and to pay higher costs, fees and interest rates than similarly-situated white borrowers. Applicants state that Wells Fargo Bank has not been advised by the Department of Justice that any employee of Wells Fargo discriminated intentionally on the basis of race or national origin. On July 12, 2012, Wells Fargo Bank executed a Consent Order, in which it denied the allegations of the Complaint other than those facts deemed necessary to the jurisdiction of the District Court. Pursuant to that Consent Order, on September 20, 2012, the District Court entered a judgment that, among other things, enjoins Wells Fargo Bank from violating the anti-discrimination provisions of the ECOA and the FHA in connection with originating residential mortgages (the ''Injunction''), and requires Wells Fargo Bank to pay $125 million in compensation to borrowers who may have suffered as a result of the alleged ECOA and FHA violations, contribute at least $50 million to a homebuyer assistance program, and implement other measures that are designed to ensure Wells Fargo Bank's future adherence to fair lending practices.

Applicants' Legal Analysis

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from acting as a bank, or from engaging in or continuing any conduct or practice in connection with such activity, from acting, among other things, as an investment adviser or depositor of any registered investment company, or a principal underwriter for any registered open-end investment company, UIT or registered face-amount certificate company. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(2) to a company any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines ''affiliated person'' to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that Wells Fargo Bank is, or may be considered to be, under common control with and therefore an affiliated person of each of the other Applicants. Applicants state that the entry of the Injunction may result in Applicants being subject to the disqualification provisions of section 9(a) of the Act because Wells Fargo Bank is enjoined from engaging in or continuing certain conduct and/or practices in connection with its banking activity.[3]

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) if it is established that these provisions, as applied to Applicants, are unduly or disproportionately severe or that the Applicants' conduct has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking temporary and permanent orders exempting the Applicants and the other Covered Persons from the disqualification provisions of section 9(a) of the Act. On September 21, 2012, Applicants received a temporary conditional order from the Commission exempting them from section 9(a) of the Act with respect to the Injunction from September 20, 2012 until the Commission takes final action on an application for a permanent order or, if earlier, November 16, 2012.

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state that the conduct giving rise to the Injunction did not involve any of the Applicants acting in their capacity as investment adviser, sub-adviser, or principal underwriter for Funds. Applicants also state that the alleged conduct giving rise to the Injunction did not involve any Fund or the assets of any Fund for which they provided Fund Servicing Activities. Applicants further state that to the best of their reasonable knowledge: (i) None of the Applicants' (other than certain of Wells Fargo Bank's) current or former directors, officers or employees had any knowledge of, or had any involvement in, the conduct alleged in the Complaint to have constituted the alleged violations that provided a basis for the Injunction; (ii) the personnel who were involved in the violations alleged in the Complaint have had no involvement in, and will not have any future involvement in, providing advisory, sub-advisory, depository or underwriting services to Funds; and (iii) because the personnel of the Applicants involved in Fund Servicing Activities did not have any involvement in the alleged misconduct, shareholders of Funds that received investment advisory, depository and principal underwriting services from the Applicants were not affected any differently than if those Funds had received services from any other non-affiliated investment adviser, depositor or principal underwriter.

5. Applicants further represent that the inability of Applicants to continue providing Fund Servicing Activities would result in potentially severe financial hardships for both the Funds and their shareholders. Applicants state that they will distribute written materials, including an offer to meet in person to discuss the materials, to the board of directors of each Fund, including the directors who are not ''interested persons,'' as defined in section 2(a)(19) of the Act, of such Fund, and their independent legal counsel as defined in rule 0–1(a)(6) under the Act, if any, regarding the Injunction, any impact on the Funds, and the application. The Applicants will provide the Funds with all

[2] *United States* v. *Wells Fargo Bank, N.A.,* No. 1:12–cv–01150 (D.D.C., July 12, 2012).

[3] Applicants believe that the conduct and/or practices covered by the Injunction could be deemed to be in connection with Wells Fargo Bank's banking activity.

information concerning the Injunction and the application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

6. Applicants also assert that, if the Applicants were barred from engaging in Fund Servicing Activities, the effect on their businesses and employees would be severe. The Applicants state that they have committed substantial capital and resources to establishing expertise in advising and sub-advising Funds and in support of their principal underwriting business.

7. Applicants state that several Applicants and certain of their affiliates have previously received orders under section 9(c), as described in greater detail in the application.

Applicants' Condition

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following condition:

Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application, or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order

The Commission has considered the matter and finds that Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

It is hereby ordered, pursuant to section 9(c) of the Act, that the Applicants and the other Covered Persons are granted a temporary exemption from the provisions of section 9(a), effective forthwith, solely with respect to the Injunction, subject to the condition in the application, until the date the Commission takes final action on their application for a permanent order.

By the Commission.

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–28385 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68243; File No. SR–NYSE–2012–62]

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending NYSE Rule 123C To Add New Supplementary Material .40 To Clarify That All Times Specified in Rule 123C Are Adjusted When the Scheduled Close of Trading Is Before 4:00 p.m.

November 15, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the ''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 6, 2012, New York Stock Exchange LLC (the ''Exchange'' or ''NYSE'') filed with the Securities and Exchange Commission (the ''Commission'') the proposed rule change as described in Item I below, which Item has been prepared by the Exchange. The Exchange filed the proposal as a ''non-controversial'' proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act[3] and Rule 19b–4(f)(6) thereunder.[4] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend NYSE Rule 123C to add new Supplementary Material .40 to clarify that all times specified in Rule 123C are adjusted when the scheduled close of trading is before 4:00 p.m. The text of the proposed rule change is available on the Exchange's Web site at *www.nyse.com,* at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Rule 123C to add new Supplementary Material .40 to clarify that all times specified in Rule 123C are adjusted when the scheduled close of trading is before 4:00 p.m.[5]

Pursuant to Rule 51, except as may be otherwise determined by the Board of Directors as to particular days, the Exchange shall be open for the transaction of business on every business day for a 9:30 a.m. to 4:00 p.m. trading session. Each year, the Exchange announces which trading days shall have an early scheduled close. For example, for the years 2012, 2013, and 2014, the Exchange has announced an early scheduled close of 1:00 p.m. for the day after Thanksgiving, on December 24, and on July 3.[6]

Rule 123C specifies a number of times that are keyed off of the 4:00 p.m. closing time. For example, Rule 123C(1)(b) defines an Informational Imbalance Publication that is disseminated between 3:00 p.m. and 3:45 p.m.; Rule 123C(2) discusses order entry for MOC, LOC, and CO Orders before and after 3:45 p.m. However, these sections of the rule do not specify what happens in the case of an early scheduled close. Some subsections of Rule 123C specify what time is applicable when there is an early scheduled close. For example, Rule 123C(6)(a)(v) specifies that on any day that the scheduled close of trading on the Exchange is earlier than 4:00 p.m., the dissemination of Order Imbalance Information prior to the closing transaction will commence approximately 15 minutes before the scheduled close of trading.

The Exchange notes that even if not specified, all times in Rule 123C are adjusted when there is an early scheduled close. Accordingly, the Exchange proposes to add new Supplementary Material .40 to Rule 123C to clarify that if not otherwise specified, when the scheduled close of trading is before 4:00 p.m., the times specified in the Rule shall be adjusted based on the early scheduled closing

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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

[4] 17 CFR 240.19b–4(f)(6).

[5] The Exchange notes that parallel changes are proposed to be made to the rules of NYSE MKT LLC. *See* SR–NYSEMKT–2012–63.

[6] *See http://usequities.nyx.com/markets/holidays-and-hours/nyse.*

time and references to 4:00 p.m. shall mean the early scheduled close, 3:00 p.m. shall mean one hour before the early scheduled close, 3:45 p.m. shall mean 15 minutes before the early scheduled close, 3:55 p.m. shall mean five minutes before the early scheduled close, and 3:58 p.m. shall mean two minutes before the early scheduled close.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b)[7] of the Securities Exchange Act of 1934 (the ''Act''), in general, and furthers the objectives of Section 6(b)(5),[8] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and it is not designed to permit unfair discrimination among customers, brokers, or dealers. In particular, the Exchange believes that adding new Supplementary Material .40 to clarify that all times specified in Rule 123C are adjusted in the case of an early scheduled close removes impediments to and perfects the mechanism of a free and open market and national market system because it provides transparency in Exchange rules of how times are adjusted in Rule 123C in the case of an early scheduled close.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act[9] and Rule 19b–4(f)(6) thereunder.[10]

The Exchange asked the Commission to waive the 30-day operative delay period for non-controversial proposed rule changes to allow the proposed rule change to be operative upon filing.[11]

The Commission believes it is consistent with the public interest to waive the 30-day operative delay. Waiver of the operative delay will allow for the implementation of the amended rules prior to the next early scheduled close, November 23, 2012, which is the day after Thanksgiving, thereby providing additional clarity in the rules and reduce any potential confusion regarding how the times specified in Rule 123C are handled when there is an early scheduled close. The Commission, therefore, grants such waiver and designates the proposal operative upon filing.[12]

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number SR–NYSE–2012–62 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSE–2012–62. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSE–2012–62 and should be submitted on or before December 14, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[13]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–28352 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

[7] 15 U.S.C. 78f(b).

[8] 15 U.S.C. 78f(b)(5).

[9] 15 U.S.C. 78s(b)(3)(A).

[10] 17 CFR 240.19b–4(f)(6).

[11] As required under Rule 19b–4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

[12] For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[13] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68244; File No. SR–NYSEMKT–2012–63]

Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending NYSE MKT Rule 123C—Equities To Add New Supplementary Material .40 To Clarify That All Times Specified in Rule 123C—Equities Are Adjusted When the Scheduled Close of Trading Is Before 4:00 p.m.

November 15, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the ''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 6, 2012, NYSE MKT LLC (the ''Exchange'' or ''NYSE MKT'') filed with the Securities and Exchange Commission (the ''Commission'') the proposed rule change as described in Item I below, which Item has been prepared by the Exchange. The Exchange filed the proposal as a ''non-controversial'' proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act[3] and Rule 19b–4(f)(6) thereunder.[4] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend NYSE MKT Rule 123C—Equities to add new Supplementary Material .40 to clarify that all times specified in Rule 123C—Equities are adjusted when the scheduled close of trading is before 4:00 p.m. The text of the proposed rule change is available on the Exchange's Web site at *www.nyse.com,* at the principal office of the Exchange, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend NYSE MKT Rule 123C—Equities (''Rule 123C'') to add new Supplementary Material .40 to clarify that all times specified in Rule 123C are adjusted when the scheduled close of trading is before 4:00 p.m.[5]

Pursuant to Rule 51, except as may be otherwise determined by the Board of Directors as to particular days, the Exchange shall be open for the transaction of business on every business day for a 9:30 a.m. to 4:00 p.m. trading session. Each year, the Exchange announces which trading days shall have an early scheduled close. For example, for the years 2012, 2013, and 2014, the Exchange has announced an early scheduled close of 1:00 p.m. for the day after Thanksgiving, on December 24, and on July 3.[6]

Rule 123C specifies a number of times that are keyed off of the 4:00 p.m. closing time. For example, Rule 123C(1)(b) defines an Informational Imbalance Publication that is disseminated between 3:00 p.m. and 3:45 p.m.; Rule 123C(2) discusses order entry for MOC, LOC, and CO Orders before and after 3:45 p.m. However, these sections of the rule do not specify what happens in the case of an early scheduled close. Some subsections of Rule 123C specify what time is applicable when there is an early scheduled close. For example, Rule 123C(6)(a)(v) specifies that on any day that the scheduled close of trading on the Exchange is earlier than 4:00 p.m., the dissemination of Order Imbalance Information prior to the closing transaction will commence approximately 15 minutes before the scheduled close of trading.

The Exchange notes that even if not specified, all times in Rule 123C are adjusted when there is an early scheduled close. Accordingly, the Exchange proposes to add new Supplementary Material .40 to Rule 123C to clarify that if not otherwise specified, when the scheduled close of trading is before 4:00 p.m., the times specified in the Rule shall be adjusted based on the early scheduled closing time and references to 4:00 p.m. shall mean the early scheduled close, 3:00 p.m. shall mean one hour before the early scheduled close, 3:45 p.m. shall mean 15 minutes before the early scheduled close, 3:55 p.m. shall mean five minutes before the early scheduled close, and 3:58 p.m. shall mean two minutes before the early scheduled close.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b)[7] of the Securities Exchange Act of 1934 (the ''Act''), in general, and furthers the objectives of Section 6(b)(5),[8] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, and it is not designed to permit unfair discrimination among customers, brokers, or dealers. In particular, the Exchange believes that adding new Supplementary Material .40 to clarify that all times specified in Rule 123C are adjusted in the case of an early scheduled close removes impediments to and perfects the mechanism of a free and open market and national market system because it provides transparency in Exchange rules of how times are adjusted in Rule 123C in the case of an early scheduled close.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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

[4] 17 CFR 240.19b–4(f)(6).

[5] The Exchange notes that parallel changes are proposed to be made to the rules of New York Stock Exchange LLC. *See* SR–NYSE–2012–62.

[6] *See http://usequities.nyx.com/markets/holidays-and-hours/nyse.*

[7] 15 U.S.C. 78f(b).

[8] 15 U.S.C. 78f(b)(5).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act[9] and Rule 19b–4(f)(6) thereunder.[10]

The Exchange asked the Commission to waive the 30-day operative delay period for non-controversial proposed rule changes to allow the proposed rule change to be operative upon filing.[11]

The Commission believes it is consistent with the public interest to waive the 30-day operative delay. Waiver of the operative delay will allow for the implementation of the amended rules prior to the next early scheduled close, November 23, 2012, which is the day after Thanksgiving, thereby providing additional clarity in the rules and reduce any potential confusion regarding how the times specified in Rule 123C are handled when there is an early scheduled close. The Commission, therefore, grants such waiver and designates the proposal operative upon filing.[12]

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

[9] 15 U.S.C. 78s(b)(3)(A).

[10] 17 CFR 240.19b–4(f)(6).

[11] As required under Rule 19b–4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change along with a brief description and the text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

[12] For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number SR–NYSEMKT–2012–63 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSEMKT–2012–63. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEMKT–2012–63 and should be submitted on or before December 14, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[13]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–28353 Filed 11–21–12; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68254; File No. SR–NASDAQ–2012–130]

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Offer the Equity Trade Journal for Clearing Firms Service and Assess a Related Fee

November 16, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 15, 2012, The NASDAQ Stock Market LLC (''Nasdaq'' or the ''Exchange''), filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

Nasdaq proposes to establish the Equity Trade Journal for Clearing [sic] service, and assess a related fee. Nasdaq is proposing to implement the proposed service on November 15, 2012 and implement the proposed fee on January 2, 2013. The text of the proposed rule change is available at *http://nasdaq.cchwallstreet.com*, at Nasdaq's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The

[13] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Nasdaq is proposing to offer The Equity Trade Journal for Clearing Firms (''ETJ Clearing'') service, a new service offered to clearing member firms that provides daily and ad hoc reports of correspondent trading activity associated with the subscribing member firm's clearing number.[3] Specifically, the ETJ Clearing service provides a subscribing member firm a report of all trade activity done on Nasdaq, FINRA ORF, and FINRA/NASDAQ TRF on a given day, segregated by correspondent MPID.[4] Daily reports are provided for trading activity occurring the prior trading day and ad hoc reports cover trading activity that occurred for a selected full day's trading. ETJ Clearing reports are stored and accessible for thirty days on NasdaqTrader.com's FTP site, and can also be downloaded and stored by the subscribing member firm so that it has a historical repository of trade information for compliance and other purposes.

The ETJ Clearing service can only be accessed via NasdaqTrader.com. Nasdaq plans on offering the service at no cost beginning November 15, 2012, and to assess a monthly tiered fee, beginning January 2, 2013. The proposed ETJ Clearing service fee is divided into five tiers based on the total number of correspondent MPIDs subscribed for coverage by the service. The first tier provides daily reports for up to ten correspondent MPIDs for a monthly fee of $750, the second tier provides daily reports for eleven to twenty correspondent MPIDs for a monthly fee of $1,000, the third tier provides daily reports for twenty-one to thirty correspondent MPIDs for a monthly fee of $1,250, the fourth tier provides daily reports for thirty-one to forty correspondent MPIDs for a monthly fee of $1,500, and the fifth tier provides daily reports for forty-one or more correspondent MPIDs for a monthly fee of $1,750. As noted, the tiers are based on the total number of correspondent MPID [sic] subscribed, so for example, if a member clearing firm subscribes thirty correspondent MPIDs to the service it would be assessed a monthly fee of $1,250 per month. A member clearing firm that subscribes thirty-one correspondent MPIDs to the service, however, would be assessed a monthly fee of $1,500.

The ETJ Clearing service is similar to the equity trade journal report provided under the NasdaqTrader.com Trading and Compliance Data Package service (''Data Package'').[5] The Data Package service provides member firms access to multiple types of historical reports concerning a member firm's trading, including an equity trade journal report, for a fee of $175 per month (monthly maximum of 25 reports) or $225 per month (monthly maximum of 100 reports).[6] Subscribers may receive any mix of the different reports provided by the Data Package. The equity trade journal report of the Data Package provides trade details for all of a market participant's trades executed on Nasdaq or reported to the FINRA/NASDAQ TRF or FINRA ORF for the date requested. The data provided by the ETJ Clearing service is similar to that of the Data Package report, but requires further segregation and arrangement of the data so that it is useful for clearing member firms. Specifically, the ETJ Clearing service includes clearing numbers, and filters the data provided by clearing number to deliver only details of trades reported using the clearing firm's dedicated clearing number. In addition, ETJ Clearing will provide potentially a higher volume of reports in relation to the data provided in the Data Package equity trade journal report because using the regular Data Package, data is only produced for one MPID per user log in. In the ETJ Clearing subscription, the clearing member firm can elect to produce several reports based on its correspondent MPIDs.

The Exchange notes that it has a low number of clearing member firms with more than forty correspondent MPIDs registered with the Exchange at this time. Should this change, Nasdaq may file a rule change to modify the fees assessed under the tiers. The proposed fee will be applied to offset the costs associated with establishing the service, responding to customer requests, configuring Nasdaq's systems, programming to user specifications, and administering the service, among other things. To the extent that costs are covered by the proposed fee, the proposed fee may also provide Nasdaq with a profit.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,[7] in general, and Section 6(b)(4) of the Act,[8] in particular, because it provides for the equitable allocation of reasonable dues, fees and other charges among members and issuers and other persons using any facility or system that Nasdaq operates or controls, and it does not unfairly discriminate between customers, issuers, brokers or dealers.[9] The Exchange believes that the proposed fee does not discriminate unfairly because only member firms that voluntarily elect to subscribe to this service will be charged the fee. The Exchange also believes that the proposed fee is equitably allocated as it decreases on a per report basis with each successive tier, representing the lower incremental cost associated with providing additional reports.[10] The Exchange adopted a tiered fee structure to reduce the expense that would be incurred by the Exchange if it were to bill on a per report basis, which ultimately would be borne by subscribers. The proposed fee is assessed uniformly among subscribing member firms based on the number of MPIDs subscribed and the tier under which they fall.

Nasdaq determined that the proposed fee is reasonable based on member firm interest in the functionality provided by the ETJ Clearing service, costs associated with developing and supporting the service, and the value that ETJ Clearing service provides to subscribing member firms. Moreover, ETJ Clearing provides data similar to that as the equity trade journal report of the Data Package, and Nasdaq has set the proposed fee similarly on a per-report basis. The information provided by ETJ Clearing service relates to the trade activity done on Nasdaq, FINRA ORF, and FINRA/NASDAQ TRF by a correspondent of the subscribing clearing member firm on a given day,

[3] Clearing member firms have unique clearing numbers that their correspondents use to identify the clearing firm associated with each trade.

[4] Member firms have at least one MPID, also known as a market participant identifier, and often multiple MPIDs. MPIDs are special identifiers used by NASDAQ to identify member firms' transaction and quoting activity. Trades assigned to an MPID may be associated with one or more clearing member firms.

[5] *See* Rule 7021.

[6] *Id.*

[7] 15 U.S.C. 78f.

[8] 15 U.S.C. 78f(b)(4).

[9] The Commission notes that this last requirement is set forth in Section 6(b)(5), 15 U.S.C. 78f(b)(5).

[10] For example, assuming 20 trading days in a month, a clearing member firm that subscribes 5 correspondent MPIDs to the proposed service (the mid-point of the first tier) would pay $750 per month, or $7.50 per report ($750 divided by 100 reports). If the member were to subscribe 15 MPIDs to the proposed service (the mid-point of the second tier), it would pay $1,000 per month, or $3.33 per report ($1,000 divided by 300 reports). The per-report price declines similarly when comparing both the fewest MPIDs of each tier, as well as the top number of MPIDs of each tier.

segregated by correspondent MPID. A clearing member firm may elect to develop its own system to capture the information provided by the proposed service. As such, the Exchange believes that if a clearing member firm determines that the fee is not cost-efficient for its needs, it may decline to subscribe to ETJ Clearing service and access such information from other sources.

The Exchange also believes the proposed rule change is consistent with Section 6(b)(5) of the Act,[11] which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest. The Exchange believes the proposed rule change is consistent with these requirements because the proposed service provides subscribing clearing members firms with a useful compliance tool with which they may access information concerning the trading activity of their correspondent firms. As such, the Exchange believes that the proposed service will further goals of the Act by providing subscribing clearing members firms with greater transparency with respect to clearing activity and facilitating compliance with member firm books and records obligations.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)[12] of the Act and subparagraph (f)(6) of Rule 19b–4 thereunder.[13]

A proposed rule change filed under Rule 19b–4(f)(6)[14] normally does not become operative prior to 30 days after the date of the filing. However, Rule 19b–4(f)(6)(iii)[15] permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that Nasdaq may offer the ETJ for Clearing service beginning on November 15, 2012. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest as it will provide clearing member firms with the option to obtain greater transparency with respect to their correspondent's trading activity.[16] In addition, the Commission notes that the service is being offered at no charge beginning on November 15, 2012, that the service is optional, and that a service fee will not be assessed until January 2, 2013. Therefore, the Commission hereby waives the 30-day operative delay and designates the proposed rule change to be operative upon filing with the Commission.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number SR–NASDAQ–2012–130 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NASDAQ–2012–130. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NASDAQ–2012–130, and should be submitted on or before December 14, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[17]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–28390 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

[11] 15 U.S.C. 78f(b)(5).

[12] 15 U.S.C. 78s(b)(3)(A).

[13] 17 CFR 240.19b–4(f)(6)(iii). In addition, Rule 19b–4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of the filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

[14] 17 CFR 240.19b–4(f)(6).

[15] 17 CFR 240.19b–4(f)(6)(iii).

[16] For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

[17] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68252; File No. SR–CBOE–2012–112]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Correct Rule Numbering Errors

November 16, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the ''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 14, 2012, the Chicago Board Options Exchange, Incorporated (the ''Exchange'' or ''CBOE'') filed with the Securities and Exchange Commission (the ''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a ''non-controversial'' proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act[3] and Rule 19b–4(f)(6) thereunder.[4] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to correct a numbering error in CBOE Rule 12.3 that was unintentionally created. No substantive changes are proposed in this filing. The text of the proposed rule change is available on the Exchange's Web site (*http://www.cboe.org/legal*), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

In SR–CBOE–2012–043, an error was inadvertently made to the numbering of Rule 12.3 (Margin Requirements).[5] In that filing, the Exchange amended Rule 12.3 to provide for universal spread margin rules and, among other changes, subparagraph (e)(1)(C) was deleted in its entirety. Subparagraph (e)(1)(D) of Rule 12.3 remained unchanged however, and was mistakenly not renumbered to account for the deletion of the previous provision. The purpose of this filing is to correct this oversight and to re-number subparagraph (e)(1)(D) to subparagraph (e)(2). No substantive changes to CBOE rules are being made by this proposal.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)[6] of the Act and the rules and regulations under the Act, in general, and furthers the objectives of Section 6(b)(5),[7] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest. The proposed correction will protect investors and the public interest by eliminating potential confusion that could be caused by a numbering error in CBOE's rules.

B. Self-Regulatory Organization's Statement on Burden on Competition

CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

(i) Significantly affect the protection of investors or the public interest;

(ii) Impose any significant burden on competition; and

(iii) Become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to Section 19(b)(3)(A)[8] of the Act and Rule 19b–4(f)(6)(iii)[9] thereunder.

A proposed rule change filed under Rule 19b–4(f)(6)[10] normally does not become operative prior to 30 days after the date of filing. However, pursuant to Rule 19b–4(f)(6)(iii),[11] the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest, provided that the Exchange has given the Commission written notice of its intent to file the proposed rule change, together with a brief description and text of the proposed rule change, at least five business days prior to the date of its filing. The proposed rule change corrects a numbering error in CBOE Rule 12.3 and does not present any substantive issues. Further, the Exchange satisfied the five day pre-filing requirement. Accordingly, the Commission believes that waiving the 30-day operative delays is consistent with the protection of investors and the public interest and, therefore, designates the proposed rule change as operative upon filing.

At any time within 60 days of the filing of this proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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

[4] 17 CFR 240.19b–4(f)(6).

[5] *See* Securities Exchange Act Release No. 67752 (August 29, 2012), 77 FR 54626 (September 5, 2012).

[6] 15 U.S.C. 78f(b).

[7] 15 U.S.C. 78f(b)(5).

[8] 15 U.S.C. 78s(b)(3)(A).

[9] 17 CFR 240.19b–4(f)(6)(iii).

[10] 17 CFR 240.19b–4(f)(6).

[11] 17 CFR 240.19b–4(f)(6)(iii).

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number SR–CBOE–2012–112 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–CBOE–2012–112. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR–CBOE–2012–112 and should be submitted on or before December 14, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[12]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–28383 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

[12] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–68253; File No. SR–ICC–2012–20]

Self-Regulatory Organizations; ICE Clear Credit LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Schedule 502 of the ICC Rules to Update the Contract Reference Obligation ISIN Associated With One Single Name Contract

November 16, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 5, 2012, ICE Clear Credit LLC (''ICC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by ICC. ICC filed the proposal pursuant to Section 19(b)(3)(A)(iii) of the Act[3], and Rule 19b–4(f)(3)[4] thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this Notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of Terms of Substance of the Proposed Rule Change

The purpose of the proposed rule change is to update the Contract Reference Obligation International Securities Identification Number (''Contract Reference Obligation ISIN'') in Schedule 502 of the ICC Rules in order to be consistent with the industry standard reference obligation for one single name contract that ICC currently clears (Nucor Corporation).

II. Self-Regulatory Organization's Statement of Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, ICC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. ICC has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.[5]

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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

[4] 17 CFR 240.19b–4(f)(3).

[5] The Commission has modified the text of the summaries prepared by ICC.

A. Self-Regulatory Organization's Statement of Purpose of, and Statutory Basis for, the Proposed Rule Change

ICC is updating the Contract Reference Obligation ISIN in Schedule 502 of the ICC Rules in order to be consistent with the industry standard reference obligation for one single name contract that ICC currently clears (Nucor Corporation). The Contract Reference Obligation ISIN update does not require any changes to the ICC risk management framework or the body of the ICC Rules. The only change being submitted is the update to the Contract Reference Obligation ISIN for Nucor Corporation in Schedule 502 of the ICC Rules.

Section 17A(b)(3)(F) of the Act[6] requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions. ICC believes that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to ICC, because the update to the Contract Reference Obligation ISIN for Nucor Corporation will facilitate the prompt and accurate settlement of securities transactions and contribute to the safeguarding of securities and funds associated with swap transactions, which are in the custody or control of ICC or for which it is responsible, by ensuring that ICC's internal records are up to date and reflect accurate information concerning a product that ICC clears.

B. Self-Regulatory Organization's Statement on Burden on Competition

ICC does not believe that the proposed rule change will have any impact or impose any burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments relating to the proposed rule change have not been solicited or received. ICC will notify the Commission of any written comments received by ICC.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(iii)[7] of the Act and Rule

[6] 15 U.S.C. 78q–1(b)(3)(F).

[7] 15 U.S.C. 78s(b)(3)(A)(iii).

19b–4(f)(3)[8] thereunder because it is concerned solely with the administration of the self-regulatory organization. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.[9]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*), or
- Send an email to *rule-comments@sec.gov.* Please include File No. SR–ICC–2012–20 on the subject line.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC, 20549–1090.

All submissions should refer to File Number SR–ICC–2012–20. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of ICE Clear Credit and on ICE Clear Credit's Web site at *https://www.theice.com/publicdocs/regulatory_filings/ICEClearCredit_110512.pdf.*

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–ICC–2012–20 and should be submitted on or before December 14, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[10]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–28384 Filed 11–21–12; 8:45 am]

BILLING CODE 8011–01–P

[8] 17 CFR 240.19b–4(f)(3).

[9] 15 U.S.C. 78s(b)(3)(C).

[10] 17 CFR 200.30–3(a)(12).

SMALL BUSINESS ADMINISTRATION

[Disaster Declaration #13387 and #13388]

Rhode Island Disaster #RI–00010

AGENCY: U.S. Small Business Administration.

ACTION: Notice.

SUMMARY: This is a Notice of the Presidential declaration of a major disaster for the State of Rhode Island (FEMA–4089–DR), dated 11/14/2012.

Incident: Hurricane Sandy.

Incident Period: 10/26/2012 through 10/31/2012.

Effective Date: 11/14/2012.

Physical Loan Application Deadline Date: 01/15/2013.

Economic Injury (Eidl) Loan Application Deadline Date: 08/14/2013.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration Processing and Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street SW., Suite 6050, Washington, DC 20416.

SUPPLEMENTARY INFORMATION: Notice is hereby given that as a result of the President's major disaster declaration on 11/14/2012, applications for disaster loans may be filed at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

Primary Counties: (Physical Damage and Economic Injury Loans): Newport, Washington.

Contiguous Counties: (Economic Injury Loans Only):

Rhode Island: Kent.

Connecticut: New London.

Massachusetts: Bristol.

The Interest Rates are:

	Percent
For Physical Damage:	
Homeowners with Credit Available Elsewhere	3.375
Homeowners without Credit Available Elsewhere	1.688
Businesses with Credit Available Elsewhere	6.000
Businesses without Credit Available Elsewhere	4.000
Non-Profit Organizations with Credit Available Elsewhere	3.125
Non-Profit Organizations without Credit Available Elsewhere	3.000
For Economic Injury:	
Businesses & Small Agricultural Cooperatives without Credit Available Elsewhere	4.000
Non-Profit Organizations without Credit Available Elsewhere	3.000

The number assigned to this disaster for physical damage is 133878 and for economic injury is 133880.

(Catalog of Federal Domestic Assistance Numbers 59002 and 59008).

Roger B. Garland,

Acting Associate Administrator for Disaster Assistance.

[FR Doc. 2012–28356 Filed 11–21–12; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

[Disaster Declaration #13374 and #13375]

New York Disaster Number NY–00131

AGENCY: U.S. Small Business Administration.

ACTION: Amendment 1.

SUMMARY: This is an amendment of the Presidential declaration of a major disaster for Public Assistance Only for the State of New York (FEMA–4085–DR), dated 11/03/2012.

Incident: Hurricane Sandy.

Incident Period: 10/27/2012 and continuing.

Effective Date: 11/13/2012.

Physical Loan Application Deadline Date: 01/02/2013.

Economic Injury (EIDL) Loan Application Deadline Date: 08/05/2013.

ADDRESSES: Submit completed loan applications to: U.S. Small Business

Administration, Processing and Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street SW., Suite 6050, Washington, DC 20416.

SUPPLEMENTARY INFORMATION: The notice of the President's major disaster declaration for Private Non-Profit organizations in the State of NEW YORK, dated 11/03/2012, is hereby amended to include the following areas as adversely affected by the disaster.

Primary Counties: Putnam, Sullivan, Ulster, Orange

All other information in the original declaration remains unchanged.

(Catalog of Federal Domestic Assistance Numbers 59002 and 59008)

Roger B. Garland,

Acting Associate Administrator for Disaster Assistance.

[FR Doc. 2012–28358 Filed 11–21–12; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

[Disaster Declaration #13309 and #13310]

West Virginia; Disaster Number WV–00029

AGENCY: U.S. Small Business Administration.

ACTION: Amendment 1.

SUMMARY: This is an amendment of the Presidential declaration of a major disaster for the State of West Virginia (FEMA–4071–DR), dated 09/19/2012.

Incident: Severe Storms and Straight-line Winds.

Incident Period: 06/29/2012 through 07/08/2012.

Effective Date: 10/22/2012.

Physical Loan Application Deadline Date: 11/19/2012.

EIDL Loan Application Deadline Date: 06/19/2013.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration, Processing and Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street, SW., Suite 6050, Washington, DC 20416.

SUPPLEMENTARY INFORMATION: The notice of the Presidential disaster declaration for the State of West Virginia, dated 09/19/2012 is hereby amended to include the following areas as adversely affected by the disaster:

Primary Counties: (Physical Damage and Economic Injury Loans): Boone, Cabell, Clay, Greenbrier, Jackson, Lincoln, Mason, Mcdowell, Mercer, Mingo, Monroe, Pocahontas, Roane, Tyler, Webster, Wood

Contiguous Counties: (Economic Injury Loans Only):

West Virginia: Calhoun, Doddridge, Lewis, Logan, Pendleton, Pleasants, Randolph, Ritchie, Upshur, Wayne, Wetzel, Wirt

Kentucky: Martin, Pike

Ohio: Athens, Gallia, Lawrence, Meigs, Monroe, Washington

Virginia: Alleghany, Bath, Bland, Buchanan, Craig, Giles, Highland, Tazewell.

All other information in the original declaration remains unchanged.

(Catalog of Federal Domestic Assistance Numbers 59002 and 59008)

James E. Rivera,

Associate Administrator for Disaster Assistance.

[FR Doc. 2012–28359 Filed 11–21–12; 8:45 am]

BILLING CODE 8025–01–P

SMALL BUSINESS ADMINISTRATION

Senior Executive Service: Performance Review Board Members

AGENCY: U.S. Small Business Administration.

ACTION: Notice of Members for the FY 2012 Performance Review Board.

SUMMARY: Title 5 U.S.C. 4314(c)(4) requires each agency to publish notification of the appointment of individuals who may serve as members of that Agency's Performance Review Board (PRB). The following individuals have been designated to serve on the FY 2012 Performance Review Board for the U.S. Small Business Administration.

1. Delorice Ford, PRB Chairperson, Assistant Administrator Hearings and Appeals

2. Nicholas Coutsos, Assistant Administrator for Congressional and Legislative Affairs

3. Nina Levine, Associate General Counsel for Financial Law and Lender Oversight

4. Pravina Raghavan, District Director, New York District Office

5. John A. Miller, Assistant Administrator for Financial Program Operations in Capital Access

6. Jonathan Swain, Chief of Staff

Karen G. Mills,

Administrator.

[FR Doc. 2012–28242 Filed 11–21–12; 8:45 am]

BILLING CODE 8025–01–P

SUSQUEHANNA RIVER BASIN COMMISSION

Commission Meeting

AGENCY: Susquehanna River Basin Commission.

ACTION: Notice.

SUMMARY: The Susquehanna River Basin Commission will hold its regular business meeting on December 14, 2012, in Annapolis, Maryland. Details concerning the matters to be addressed at the business meeting are contained in the **SUPPLEMENTARY INFORMATION** section of this notice.

DATES: December 14, 2012, at 8:30 a.m.

ADDRESSES: Lowe House Office Building, House of Delegates, Prince George's Delegation (Room #150), 6 Bladen Street, Annapolis, MD 21401. (The recommended parking and transportation option is to park at the Navy-Marine Corps Memorial Stadium and take the Annapolis Transit Trolley Shuttle from there—for all available parking options, see *http://www.downtownannapolis.org/_pages/transport/tr_parking.htm.*)

FOR FURTHER INFORMATION CONTACT: Richard A. Cairo, General Counsel, telephone: (717) 238–0423, ext. 306; fax: (717) 238–2436.

Opportunity To Appear and Comment

Interested parties are invited to attend the business meeting and encouraged to review the Commission's Public Meeting Rules of Conduct, which are posted on the Commission's Web site, *www.srbc.net.* As identified in the public hearing notice referenced below, written comments on the Regulatory Program projects that were the subject of the public hearing, and are listed for action at the business meeting, are subject to a comment deadline of November 26, 2012. Written comments pertaining to any other matters listed for action at the business meeting may be mailed to the Susquehanna River Basin Commission, 1721 North Front Street, Harrisburg, Pennsylvania 17102–2391, or submitted electronically through *http://www.srbc.net/pubinfo/publicparticipation.htm.* Any such comments mailed or electronically submitted must be received by the Commission on or before December 7, 2012, to be considered.

SUPPLEMENTARY INFORMATION: The business meeting will include actions or presentations on the following items: (1) Presentation on eel collection, stocking and research by the U.S. Fish and Wildlife Service; (2) presentation recognizing former alternate

Commissioner Herbert Sachs; (3) resolution concerning FY–2014 federal funding of the Susquehanna Flood Forecast and Warning System and National Streamflow Information Program; (4) Low Flow Protection Policy; (5) proposed rulemaking; (6) ratification/approval of grants; (7) administrative appeal filed by East Hempfield Township Municipal Authority; and (8) Regulatory Program projects. Projects listed for Commission action are those that were the subject of a public hearing conducted by the Commission on November 15, 2012, and identified in the notice for such hearing, which was published in 77 FR 64576, October 22, 2012.

Authority: Pub. L. 91–575, 84 Stat. 1509 *et seq.,* 18 CFR parts 806, 807, and 808.

Dated: November 9, 2012.

Paul O. Swartz,

Executive Director.

[FR Doc. 2012–28355 Filed 11–21–12; 8:45 am]

BILLING CODE 7040–01–P

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

[Docket No. FHWA–2012–0112]

Agency Information Collection Activities: Request for Comments for a New Information Collection

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Notice and request for comments.

SUMMARY: The FHWA invites public comments about our intention to request the Office of Management and Budget's (OMB) approval for a new information collection, which is summarized below under Supplementary Information. We are required to publish this notice in the **Federal Register** by the Paperwork Reduction Act of 1995.

DATES: Please submit comments by January 22, 2013.

ADDRESSES: You may submit comments identified by DOT Docket ID 2012–0112 by any of the following methods:

Web Site: For access to the docket to read background documents or comments received go to the Federal eRulemaking Portal: Go to *http://www.regulations.gov.* Follow the online instructions for submitting comments.

Fax: 1–202–493–2251.

Mail: Docket Management Facility, U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue, SE., Washington, DC 20590–0001.

Hand Delivery or Courier: U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590, between 9 a.m. and 5 p.m. ET, Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Rosemary Jones, 202–366–2042, Office of Real Estate Services, Federal Highway Administration, Department of Transportation, 1200 New Jersey Ave. SE., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Title: State Right-of-Way Operations Manuals.

Background: It is the responsibility of each State Department of Transportation (State) to acquire, manage and dispose of real property in compliance with the legal requirements of State and Federal laws and regulations. Part of providing assurance of compliance is to describe in a right-of-way procedural (operations) manual the organization, policies and procedures of the State to such an extent that these guide State employees, local acquiring agencies, and contractors who acquire and manage real property that is used for a federally funded transportation project. Procedural manuals assure the FHWA that the requirements of the Uniform Relocation Assistance and Real Property Acquisition Policies Act (Uniform Act) will be met. The State responsibility to prepare and maintain an up-to-date right-of-way procedural manual is set out in 23 CFR 710.201(c). The regulation allows States flexibility in determining how to meet the manual requirement. This flexibility allows States to prepare manuals in the format of their choosing, to the level of detail necessitated by State complexities. Each State decides how it will provide service to individuals and businesses affected by Federal or federally-assisted projects, while at the same time reducing the burden of government regulation. States are required to update manuals to reflect changes in Federal requirements for programs administered under Title 23 U.S.C. The State manuals may be submitted to FHWA electronically or made available by posting on the State Web site.

Respondents: 52 State Departments of Transportation, including the District of Columbia and Puerto Rico.

Frequency: Annually.

Estimated Average Burden per Response: 75 hours per respondent.

Estimated Total Annual Burden Hours: 75 hours for each of the 52 State Departments of Transportation. The total is 3,900 burden hours annually.

Public Comments Invited: You are asked to comment on any aspect of this information collection, including: (1) Whether the proposed collection is necessary for the FHWA's performance; (2) the accuracy of the estimated burdens; (3) ways for the FHWA to enhance the quality, usefulness, and clarity of the collected information; and (4) ways that the burden could be minimized, including the use of electronic technology, without reducing the quality of the collected information. The agency will summarize and/or include your comments in the request for OMB's clearance of this information collection.

Authority: The Paperwork Reduction Act of 1995; 44 U.S.C. Chapter 35, as amended; and 49 CFR 1.48.

Issued On: November 19, 2012.

Victoria Scott,

Business Operations Group Manager, Information Technology Division.

[FR Doc. 2012–28450 Filed 11–21–12; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

[Docket No. FHWA–2012–0113]

Agency Information Collection Activities: Request for Comments for a New Information Collection

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Notice and request for comments.

SUMMARY: The FHWA invites public comments about our intention to request the Office of Management and Budget's (OMB) approval for a new information collection, which is summarized below under **SUPPLEMENTARY INFORMATION**. We are required to publish this notice in the **Federal Register** by the Paperwork Reduction Act of 1995.

DATES: Please submit comments by January 22, 2013.

ADDRESSES: You may submit comments identified by DOT Docket ID 2012–0113 by any of the following methods:

Web site: For access to the docket to read background documents or comments received go to the Federal eRulemaking Portal: Go to *http://www.regulations.gov.* Follow the online instructions for submitting comments.

Fax: 1–202–493–2251.

Mail: Docket Management Facility, U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590–0001.

Hand Delivery or Courier: U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE., Washington, DC 20590, between 9 a.m. and 5 p.m. ET, Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Joyce Gottlieb, 202–366–3664, Office of Civil Rights, Federal Highway Administration, Department of Transportation, 1200 New Jersey Ave. SE., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Title: Federal-Aid Highway Construction Equal Employment Opportunity.

Background: Title 23, Part 140(a), requires the FHWA to ensure equal opportunity regarding contractors' employment practices on Federal-aid highway projects. To carry out this requirement, the contractors must submit to the State Transportation Agencies (STAs) on all work being performed on Federal-aid contracts during the month of July, a report on its employment workforce data. This report provides the employment workforce data on these contracts and includes the number of minorities, women, and non-minorities in specific highway construction job categories. This information is reported on Form PR–1391, Federal-Aid Highway Construction Contractors Summary of Employment Data. The statute also requires the STAs to submit a report to the FHWA summarizing the data entered on the PR–1391 forms. This summary data is provided on Form PR–1392, Federal-Aid Highway Construction Contractors Summary of Employment Data. The STAs and FHWA use this data to identify patterns and trends of employment in the highway construction industry, and to determine the adequacy and impact of the STA's and FHWA's contract compliance and on-the-job (OJT) training programs. The STAs use this information to monitor the contractors-employment and training of minorities and women in the traditional highway construction crafts. Additionally, the data is used by FHWA to provide summarization, trend analyses to Congress, DOT, and FHWA officials as well as others who request information relating to the Federal-aid highway construction EEO program. The information is also used in making decisions regarding resource allocation; program emphasis; marketing and promotion activities; training; and compliance efforts.

Respondents: 11,077 annual respondents for form PR–1391, and 52 STAs annual respondents for Form PR–1392, total of 11,129.

Frequency: Annually.

Estimated Average Burden per Response: FHWA estimates it takes 30 minutes for Federal-aid contractors to complete and submit Form PR–1391 and 8 hours for STAs to complete and submit Form PR–1392.

Estimated Total Amount Burden Hours: Form PR–1391- 5,539 hours per year; *Form PR–1392-* 416 hours per year, total of 5,955 hours annually.

Public Comments Invited: You are asked to comment on any aspect of this information collection, including: (1) Whether the proposed collection is necessary for the FHWA's performance; (2) the accuracy of the estimated burdens; (3) ways for the FHWA to enhance the quality, usefulness, and clarity of the collected information; and (4) ways that the burden could be minimized, including the use of electronic technology, without reducing the quality of the collected information. The agency will summarize and/or include your comments in the request for OMB's clearance of this information collection.

Authority: The Paperwork Reduction Act of 1995; 44 U.S.C. Chapter 35, as amended; and 49 CFR 1.48.

Issued On: November 19, 2012.

Victoria Scott,

Business Operations Group Manager, Information Technology Division.

[FR Doc. 2012–28448 Filed 11–21–12; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

Notice of Final Federal Agency Actions on Proposed Highway in California

AGENCY: Federal Highway Administration (FHWA), DOT.

ACTION: Notice; correction.

SUMMARY: This notice corrects an error in the FHWA notice published on October 10, 2012, at 77 FR 61654. That notice provided an incorrect reference to a statute of limitations timeframe, and an incorrect date.

DATES: This notice is effective November 23, 2012.

FOR FURTHER INFORMATION CONTACT: Manuel E. Sánchez, Senior Transportation Engineer/Border Engineer, Federal Highway Administration—California Division, 401 B Street, Suite 800, San Diego, CA 92101, Regular Office Hours: 6:30 a.m. to 4:00 p.m., Telephone: (619) 699–7336, Email: *manuel.sanchez@dot.gov,* or Bruce L. April, Deputy District Director—Environmental, Caltrans District 11, 4050 Taylor Street, MS 242, San Diego, CA 92110, Regular Office Hours: 8:00 a.m. to 5:00 p.m., Telephone: (619) 688–0100, Email: *Bruce_April@dot.ca.gov.*

SUPPLEMENTARY INFORMATION: On October 10, 2012, at 77 FR 61654, the FHWA published a notice regarding actions taken by the FHWA and other Federal agencies that are final within the meaning of 23 U.S.C. 139(l)(1). The actions relate to the proposed State Route 11 and Otay Mesa East Land Port of Entry project in the City and County of San Diego, State of California.

The original notice indicated that claims seeking judicial review of the Federal agency actions on the highway project will be barred unless the claim is filed on or before April 8, 2013, which represents 180 days after publication in the **Federal Register**. However, the recently enacted ''Moving Ahead for Progress in the 21st Century Act'' (MAP–21) (Sec. 1308, Pub. L. 112–141, 126 STAT. 405), amended 23 U.S.C. 139(l)(1) as of October 1, 2012, to provide that any claim seeking judicial review of the Federal agency actions on a highway project is barred unless the claim is filed 150 days after publication of a notice in the **Federal Register**. As such, any claim seeking judicial review of the above referenced highway project will be barred unless the claim is filed on or before March 9, 2013. Also, if the Federal law that authorizes judicial review of a claim provides a time period of less than 150 days for filing such a claim, then that shorter time period still applies.

Authority: 23 U.S.C. 139(l); Sec. 1308, Pub. L. 112–141, 126 Stat. 405.

Vincent P. Mammano,

Division Administrator, Federal Highway Administration, Sacramento, California.

[FR Doc. 2012–28409 Filed 11–21–12; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF TRANSPORTATION

Surface Transportation Board

[Docket No. FD 35692]

Eastside Community Rail, LLC; Acquisition and Operation Exemption; GNP RLY, Inc.

Eastside Community Rail, LLC (ECR), a noncarrier, has filed a verified notice of exemption under 49 CFR 1150.31 to acquire, pursuant to an Asset Purchase Agreement dated September 5, 2012,

between ECR and the Bankruptcy Trustee for GNP RLY, Inc. (GNP), all of GNP's assets, lease and operating rights including, *inter alia,* all assets and operating agreements pertaining to a line of railroad (the Line) [1] between approximately milepost 23.8 southwest of Woodinville and approximately milepost 38.25 in Snohomish, a distance of 14.45 miles, in King and Snohomish Counties, Wash.[2]

ECR states that, pending the closing of the transaction, ECR and Ballard Terminal Railroad Company (Ballard) entered into an Interim Operating Agreement with the Bankruptcy Trustee of GNP in which ECR will manage the assets of GNP and Ballard will continue to operate the Line in the same fashion that it did while operating the Line for GNP.[3]

ECR states that it plans to consummate the transaction on or after December 8, 2012. Unless stayed, the effective date of the exemption will be December 7, 2012 (30 days after the verified notice was filed).

ECR certifies that its projected annual revenues as a result of this transaction will not exceed $5 million and will not result in the creation of a Class II or Class I rail carrier.

If the verified notice contains false or misleading information, the exemption is void *ab initio.* Petitions to revoke the exemption under 49 U.S.C. 10502(d) may be filed at any time. The filing of a petition to revoke will not automatically stay the effectiveness of the exemption. Petitions to stay must be filed no later than November 30, 2012 (at least 7 days before the exemption becomes effective).

An original and 10 copies of all pleadings, referring to Docket No. FD 35692, must be filed with the Surface Transportation Board, 395 E Street SW., Washington, DC 20423–0001. In addition, a copy of each pleading must be served on Myles L. Tobin, Fletcher & Sippel LLC, 29 North Wacker Drive, Suite 920, Chicago, IL 60606–2832.

Board decisions and notices are available on our Web site at ''*www.stb.dot.gov.*''

Decided: November 19, 2012.

By the Board, Rachel D. Campbell, Director, Office of Proceedings.

Derrick A. Gardner,

Clearance Clerk.

[FR Doc. 2012–28391 Filed 11–21–12; 8:45 am]

BILLING CODE 4915–01–P

[1] Those rights encompass all of GNP's assets and operating agreements pertaining to the Line, including, but not limited to, the following: All of GNP's rights and interests under the Railroad Right-of-Way License between Port of Seattle and GNP, dated on or about December 18, 2009; all of GNP's rights and interests under the Operations Maintenance Agreement between the Port of Seattle and GNP, dated on or about December 18, 2009; all of GNP's rights and interests under the Running Rights and Railway Operations Agreement dated May 23, 2008 between GNP and Snohomish County; all of GNP's rights and interests in all real property and easements described in Quit Claim Deeds recorded under Snohomish County AF 20091218001535, 20091218001536, 20091218001537, 20091218001538, 20091218001539, 20091218001540 and King County AF 200912201438 and 20091220439; and all car hire agreements and interchange agreements.

[2] The Line previously was owned by BNSF Railway Company (BNSF). GNP was granted authority to acquire from BNSF an exclusive freight rail operating easement for operations on the Line in *GNP Rly Inc.—Acquisition & Operation Exemption—BNSF Railway,* FD 35213 (STB served Feb. 13, 2009). In 2011, GNP filed for bankruptcy in the United States Bankruptcy Court for the Western District of Washington.

[3] GNP indicates that Ballard has been operating the Line for several years as an agent of GNP. ECR states that it will be a non-operating common carrier on the Line, and that, once ECR acquires the Line, it will either sublease rights on the Line to Ballard or utilize Ballard as its agent for rail operations on the Line.

DEPARTMENT OF THE TREASURY

Submission for OMB Review; Comment Request

November 19, 2012.

The Department of the Treasury will submit the following information collection request to the Office of Management and Budget (OMB) for review and clearance in accordance with the Paperwork Reduction Act of 1995, Public Law 104–13, on or after the date of publication of this notice.

DATES: Comments should be received on or before December 24, 2012 to be assured of consideration.

ADDRESSES: Send comments regarding the burden estimate, or any other aspect of the information collection, including suggestion for reducing the burden, to (1) Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for Treasury, New Executive Office Building, Room 10235, Washington, DC 20503, or email at *OIRA_Submission@OMB.EOP.GOV* and (2) Treasury PRA Clearance Officer, 1750 Pennsylvania Ave. NW., Suite 8140, Washington, DC 20220, or email at *PRA@treasury.gov.*

FOR FURTHER INFORMATION CONTACT: Copies of the submission(s) may be obtained by calling (202) 927–5331, email at *PRA@treasury.gov*, or the entire information collection request may be found at *www.reginfo.gov.*

Terrorism Risk Insurance Program

OMB Number: 1505–0207.

Type of Review: Revision of a currently approved collection.

Title: Recoupment Provisions of the Terrorism Risk Insurance Act (TRIA).

Form: TRIP 04A & 04B.

Abstract: Section 103(e) of the Terrorism Risk Insurance Act of 2002 gives Treasury authority to recoup federal payments made under the Program through policyholder surcharges, up to a maximum annual limit. The Secretary is required to provide for insurers to collect these amounts and remit them to Treasury. In order to determine how and when to initiate the recoupment process Treasury will require information about industry aggregate total insured losses, insurer deductibles and reserves and may need to issue a ''data call'' to supplement existing industry reporting. If recoupment is initiated, insurers will be required to report and remit the Federal Terrorism Policy Surcharge. Treasury will require access to all books, documents, papers and records of an insurer that are pertinent to the Surcharge for the purpose of investigation, confirmation, audit and examination. The record keeping and reporting requirements will arise only after Treasury has initiated the recoupment process.

Affected Public: Private Sector: Businesses or other for-profits.

Estimated Total Burden Hours: 121,000.

OMB Number: 1505–0208.

Type of Review: Extension without change of a currently approved collection.

Title: Terrorism Risk Insurance Program Cap on Annual Liability.

Form: TRIP 05.

Abstract: Section 103 of the Terrorism Risk Insurance Act of 2002 (the Act), as amended by the Reauthorization Act, sets a limit on the annual liability for insured losses at $100 billion. This section requires the Secretary of the Treasury to notify Congress not later than 15 days after the date of an act of terrorism as to whether aggregate insured losses are estimated to exceed the cap. The Act, as amended, also requires the Secretary to determine the pro rata share of insured losses under the Program when insured losses exceed the cap, and to issue regulations for carrying this out. In order to meet these requirements, Treasury may need to obtain loss information from involved insurers. This would be accomplished by the issuance of a ''data call'' to ascertain insurer losses. In the event of the imposition on insurers of a ''pro rata loss percentage'', it will be necessary to determine compliance when processing insurer claims for payment of the Federal share of compensation.

Affected Public: Private Sector: Businesses or other for-profits.

Estimated Total Burden Hours: 1,000.

Dawn D. Wolfgang,

Treasury PRA Clearance Officer.

[FR Doc. 2012–28388 Filed 11–21–12; 8:45 am]

BILLING CODE 4810–25–P

DEPARTMENT OF THE TREASURY

Submission for OMB Review; Comment Request

November 19, 2012.

The Department of the Treasury will submit the following information collection request to the Office of Management and Budget (OMB) for review and clearance in accordance with the Paperwork Reduction Act of 1995, Public Law 104–13, on or after the date of publication of this notice.

DATES: Comments should be received on or before December 24, 2012 to be assured of consideration.

ADDRESSES: Send comments regarding the burden estimate, or any other aspect of the information collection, including suggestion for reducing the burden, to (1) Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for Treasury, New Executive Office Building, Room 10235, Washington, DC 20503, or email at *OIRA_Submission@OMB.EOP.GOV* and (2) Treasury PRA Clearance Officer, 1750 Pennsylvania Ave. NW., Suite 8140, Washington, DC 20220, or email at *PRA@treasury.gov.*

FOR FURTHER INFORMATION CONTACT: Copies of the submission(s) may be obtained by calling (202) 927–5331, email at *PRA@treasury.gov*, or the entire information collection request maybe found at *www.reginfo.gov.*

Financial Management Service (FMS)

OMB Number: 1510–0056.

Type of Review: Extension without change of a currently approved collection.

Title: ACH Vendor/Miscellaneous Payment Enrollment Form.

Form: SF–3881.

Abstract: Payment data will be collected from vendors doing business with the Federal Government. The Treasury Department, Financial Management Service, will use the information to electronically transmit payments to vendor's financial institutions.

Affected Public: Private Sector: Businesses or other for-profits, Not-for-profit institutions.

Estimated Total Burden Hours: 17,500.

Dawn D. Wolfgang,

Treasury PRA Clearance Officer.

[FR Doc. 2012–28423 Filed 11–21–12; 8:45 am]

BILLING CODE 4810–35–P

DEPARTMENT OF THE TREASURY

Submission for OMB Review; Comment Request

November 19, 2012.

The Department of the Treasury will submit the following information collection request to the Office of Management and Budget (OMB) for review and clearance in accordance with the Paperwork Reduction Act of 1995, Public Law 104–13, on or after the date of publication of this notice.

DATES: Comments should be received on or before December 24, 2012 to be assured of consideration.

ADDRESSES: Send comments regarding the burden estimate, or any other aspect of the information collection, including suggestion for reducing the burden, to (1) Office of Information and Regulatory Affairs, Office of Management and Budget, Attention: Desk Officer for Treasury, New Executive Office Building, Room 10235, Washington, DC 20503, or email at *OIRA_Submission@OMB.EOP.GOV* and (2) Treasury PRA Clearance Officer, 1750 Pennsylvania Ave. NW., Suite 8140, Washington, DC 20220, or email at *PRA@treasury.gov*.

FOR FURTHER INFORMATION CONTACT: Copies of the submission(s) may be obtained by calling (202) 927–5331, email at *PRA@treasury.gov,* or the entire information collection request maybe found at *www.reginfo.gov*.

Bureau of the Public Debt (BPD)

OMB Number: 1535–0063.

Type of Review: Revision of a currently approved collection.

Title: Request for Payment of Reissue of U.S. Savings Bonds Deposited in Safekeeping.

Form: PD F 4239.

Abstract: The information is necessary to request payment or reissue of Savings Bonds/Notes held in safekeeping when original safekeeping custody receipts are not available. The information on the form is used by the Department of the Treasury, Bureau of the Public Debt, to identify the securities involved, establish entitlement, and to obtain a certified request for payment or reissue. Without the information, the transaction cannot be completed.

Affected Public: Individuals or Households.

Estimated Total Burden Hours: 1,500.

OMB Number: 1535–0138.

Type of Review: Extension without change of a currently approved collection.

Title: TreasuryDirect.

Form: PD F 5512, 5444, 5446, 5511.

Abstract: The information is requested to establish a new TreasuryDirect account and process transactions.

Affected Public: Individuals or Households.

Estimated Total Burden Hours: 96,768.

Dawn D. Wolfgang,

Treasury PRA Clearance Officer.

[FR Doc. 2012–28429 Filed 11–21–12; 8:45 am]

BILLING CODE 4810–39–P

DEPARTMENT OF TRANSPORTATION

Office of the Secretary

Notice of Applications for Certificates of Public Convenience and Necessity and Foreign Air Carrier Permits Filed Under Subpart B (Formerly Subpart Q) During the Week Ending November 10, 2012

The following Applications for Certificates of Public Convenience and Necessity and Foreign Air Carrier Permits were filed under Subpart B (formerly Subpart Q) of the Department of Transportation's Procedural Regulations (See 14 CFR 301.201 et. seq.). The due date for Answers, Conforming Applications, or Motions to Modify Scope are set forth below for each application. Following the Answer period DOT may process the application by expedited procedures. Such procedures may consist of the adoption of a show-cause order, a tentative order, or in appropriate cases a final order without further proceedings.

Docket Number: DOT–OST–2012–0191.

Date Filed: November 5, 2012.

Due Date for Answers, Conforming Applications, or Motion to Modify Scope: November 26, 2012.

Description: Application of Anguilla Air Services Ltd. requesting a foreign air carrier permit and exemption authority to engage in charter foreign air transportation of persons, property and mail, between points in the British Virgin Islands and the United States.

Docket Number: DOT–OST–2012–0192.

Date Filed: November 7, 2012.

Due Date for Answers, Conforming Applications, or Motion to Modify Scope: November 28, 2012.

Description: Application of BH AIR Ltd. (''BH AIR'') requesting a foreign air carrier permit and an exemption authorizing BH AIR to conduct operations to and from the United States to the full extent authorized by the United States-European Union Air Transportation Agreement (''U.S.-E.U. Agreement''), including authority to engage in: (i) Scheduled and charter foreign air transportation of persons, property, cargo and mail from any point(s) behind any Member State(s) of the European Community, via any point(s) in any Member State(s) and via intermediate points to any point(s) in the United States and beyond; (ii) scheduled and charter foreign air transportation of persons, property, cargo and mail between any point(s) in the United States and any point(s) in any member of the European Common Aviation Area; (iii) other charters pursuant to the prior approval requirements; and (iv) transportation authorized by any additional route or other right(s) made available to European Community carriers in the future.

Barbara J. Hairston,

Acting Program Manager, Docket Operations, Federal Register Liaison.

[FR Doc. 2012–28398 Filed 11–21–12; 8:45 am]

BILLING CODE 4910–9X–P

DEPARTMENT OF THE TREASURY

Office of Foreign Assets Control

Designation of Seven Entities Pursuant to Executive Order 13448 or Executive Order 13464 and Amendment of an Existing Specially Designated National Listing

AGENCY: Office of Foreign Assets Control, Treasury.

ACTION: Notice.

SUMMARY: The Treasury Department's Office of Foreign Assets Control (''OFAC'') is publishing the names of seven entities whose property and interests in property are blocked pursuant to Executive Order 13464 of April 30, 2008 (''Blocking Property and Prohibiting Certain Transactions Related to Burma'') (''E.O. 13464'') or Executive Order 13448 of October 18, 2007 (''Blocking Property and Prohibiting Certain Transactions Related to Burma'') (''E.O. 13448''). OFAC is also amending the listing of a person whose property and interests in property were previously blocked.

DATES: The designation by the Director of OFAC of the seven entities named in this notice, pursuant to E.O. 13464 or E.O. 13448, and the amendment to an existing listing are effective November 16, 2012.

FOR FURTHER INFORMATION CONTACT: Assistant Director for Sanctions Compliance and Evaluation, Office of Foreign Assets Control, Department of the Treasury, Washington, DC 20220, Tel.: 202/622–2490.

SUPPLEMENTARY INFORMATION:

Electronic and Facsimile Availability

This document and additional information concerning OFAC are available from OFAC's Web site (*www.treasury.gov/ofac*) or via facsimile through a 24-hour fax-on-demand service, Tel.: 202/622–0077.

Background

On October 18, 2007, President George W. Bush signed E.O. 13448 pursuant to, *inter alia,* the International Emergency Economic Powers Act (50 U.S.C. 1701 *et seq.*) (IEEPA). In E.O. 13448, President George W. Bush expanded the national emergency declared in Executive Order 13047 of May 20, 1997, and took additional steps with respect to the Government of Burma's continued repression of the democratic opposition. The President identified twelve individuals and entities in the Annex to E.O. 13448.

Section 1 of E.O. 13448 blocks, with certain exceptions, all property and interests in property that are in, or thereafter come within, the United States, or within the possession or control of United States persons, of the persons listed in the Annex to E.O. 13448, as well as those persons determined by the Secretary of the Treasury, after consultation with the Secretary of State, to satisfy any of the criteria set forth in subparagraphs (b)(i)–(b)(vi) of Section 1 of E.O. 13448.

On November 16, 2012, the Director of OFAC, after consultation with the Department of State, designated, pursuant to one or more of the criteria set forth in Section 1 subparagraphs (b)(i)–(b)(vi) of E.O. 13448, the following four entities, whose names have been added to the list of Specially Designated Nationals and Blocked Persons and whose property and interests in property are blocked pursuant to E.O. 13448:

1. GOLD ENERGY CO. LTD., No. 74 Lan Thit Road, Insein Township, Rangoon, Burma; Taungngu (Tungoo) Branch, Karen State, Burma [BURMA].

2. GOLD OCEAN PTE LTD, 101 Cecil Street #08–08, Tong Eng Building, Singapore 069533, Singapore; 1 Scotts Road, #21–07/08 Shaw Centre, Singapore 228208, Singapore [BURMA].

3. GREAT SUCCESS PTE. LTD., 1 Scotts Road, #21/07–08 Shaw Centre, Singapore, 228208, Singapore; 101 Cecil Street #08–08, Tong Eng Building, Singapore, 069533, Singapore [BURMA].

4. GREEN LUCK TRADING COMPANY (a.k.a. GREEN LUCK TRADING COMPANY LIMITED), No. 61/62 Bahosi Development, Wadan Street, Lanmadaw Township, Rangoon, Burma; No. 74 Lan Thit Street, Insein Township, Rangoon, Burma [BURMA].

On April 30, 2008, President George W. Bush signed E.O. 13464, pursuant to, *inter alia,* the International Emergency Economic Powers Act (50 U.S.C. 1701 *et seq.*). In E.O. 13464, President George W. Bush took additional steps with respect to the national emergency declared in Executive Order 13047 of May 20, 1997 and expanded in E.O. 13448.

Section 1 of E.O. 13464 blocks, with certain exceptions, all property and interests in property that are in, or thereafter come within, the United States, or within the possession or control of any United States person, of the persons listed in the Annex to E.O. 13464, as well as those persons determined by the Secretary of the Treasury, after consultation with the Secretary of State, to satisfy any of the criteria set forth in subparagraphs (b)(i)–(b)(iii) of Section 1 of E.O. 13464.

On November 16, 2012, the Director of OFAC, after consultation with the Department of State, designated, pursuant to one or more of the criteria set forth in Section 1, subparagraphs (b)(i)–(b)(iii) of E.O. 13464, the following three entities, whose names have been added to the list of Specially Designated Nationals and Blocked Persons and whose property and interests in property are blocked pursuant to E.O. 13464:

1. ASIA PIONEER IMPEX PTE. LTD., 10 Anson Road, #23–16 International Plaza, Singapore 079903, Singapore [BURMA].

2. TERRESTRIAL PTE. LTD., 3 Raffles Place, #06–01 Bharat Building, Singapore 048617, Singapore; 10 Anson Road, #23–16 International Plaza, Singapore 079903, Singapore [BURMA].

3. ASIA GREEN DEVELOPMENT BANK (a.k.a. AGD BANK), 168 Thiri Yatanar Shopping Complex, Zabu Thiri Township, Nay Pyi Taw, Burma; 73/75 Sule Pagoda Road, Pabedan Township, Yangon, Burma; SWIFT/BIC AGDB MM MY [BURMA].

OFAC is also amending the Golden Aaron Pte. Ltd. listing on the Department of the Treasury's List of Specially Designated Nationals and Blocked Persons. The entry has been amended as:

GOLDEN AARON PTE. LTD. (a.k.a. CHINA FOCUS DEVELOPMENT; a.k.a. CHINA

FOCUS DEVELOPMENT LIMITED; a.k.a. CHINA FOCUS DEVELOPMENT LTD.), 3 Shenton Way, 10–01, Shenton House, Singapore 068805, Singapore; 101 Cecil Street, 08–08 Tong Eng Building, Singapore 069533, Singapore; China; Unit 2612A, Kuntai International Center, No. 12 Chaowai Street, Chaoyang District, Beijing 100020, China [BURMA] [JADE]

Dated: November 16, 2012.

Adam J. Szubin,

Director, Office of Foreign Assets Control.

[FR Doc. 2012–28360 Filed 11–21–12; 8:45 am]

BILLING CODE 4810–AL–P

DEPARTMENT OF VETERANS AFFAIRS

[OMB Control No. 2900–0001]

Agency Information Collection (Veteran's Application for Compensation and/or Pension): Activity Under OMB Review

AGENCY: Veterans Benefits Administration, Department of Veterans Affairs.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521), this notice announces that the Veterans Benefits Administration (VBA), Department of Veterans Affairs, will submit the collection of information abstracted below to the Office of Management and Budget (OMB) for review and comment. The PRA submission describes the nature of the information collection and its expected cost and burden; it includes the actual data collection instrument.

DATES: Comments must be submitted on or before December 24, 2012.

ADDRESSES: Submit written comments on the collection of information through *www.Regulations.gov* or to VA's OMB Desk Officer, OMB Human Resources and Housing Branch, New Executive Office Building, Room 10235, Washington, DC 20503 (202) 395–7316. Please refer to ''OMB Control No. 2900–0001'' in any correspondence.

FOR FURTHER INFORMATION CONTACT: Crystal Rennie, Enterprise Records Service (005R1B), Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 632–7492 Fax (202) 632–7583 or email *crystal.rennie@va.gov*. Please refer to ''OMB Control No. 2900–0001.''

SUPPLEMENTARY INFORMATION:

Titles:

a. Veteran's Application for Compensation and/or Pension, VA Form 21–526.

b. Veteran's Supplemental Claim Application, VA Form 21–526b.

c. Authorization and Consent Release Information to the Department of Veterans Affairs (VA), VA Form 21–4142.

OMB Control Number: 2900–0001.

Type of Review: Extension of a currently approved collection.

Abstracts:

a. Veterans complete VA Form 21–526 to initially apply for compensation and/or pension benefits.

b. Veterans who previously filed a claim using VA Form 21–526, and who wish to request an increase in a service connected condition, reopen their claim for a previously denied claim, and/or file a claim for a new service-connected condition must complete VA Form 21–526b. VA Form 21–526b will be used for supplemental disability or ancillary benefit claims.

c. Veterans who need VA's assistance in obtaining non-VA medical records must complete VA Form 21–4142.

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 OMB control number. The **Federal Register** Notice with a 60-day comment period soliciting comments on this collection of information was published on September 13, 2012, at pages 56710–56711.

Affected Public: Individuals or households.

Estimated Annual Burden:

a. VA Form 21–526—391,708.

b. VA Form 21–526b—50,000.

c. VA Form 21–4142—823.

Estimated Average Burden Per Respondent:

a. VA Form 21–526—1 hour.

b. VA Form 21–526b—15 minutes.

b. VA Form 21–4142—5 minutes.

Frequency of Response: On occasion.

Estimated Number of Respondents:

a. VA Form 21–526—391,708.

b. VA Form 21–526b—200,000.

c. VA Form 21–4142—3,292.

Dated: November 19, 2012.

By direction of the Secretary.

Robert C. McFetridge,

Director, Office of Regulations Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

[FR Doc. 2012–28445 Filed 11–21–12; 8:45 am]

BILLING CODE 8320–01–P

DEPARTMENT OF VETERANS AFFAIRS

[OMB Control No. 2900–0741]

Agency Information Collection (VA Subcontracting Report for Service Disabled Veteran-owned Small Business and Veteran-owned Small Business Concerns) Activities Under OMB Review

AGENCY: Office of Small and Disadvantaged Business Utilization, Department of Veterans Affairs.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521), this notice announces that the Office of Small and Disadvantaged Business Utilization (OSDBU), Department of Veterans Affairs, will submit the collection of information abstracted below to the Office of Management and Budget (OMB) for review and comment. The PRA submission describes the nature of the information collection and its expected cost and burden and includes the actual data collection instrument.

DATES: Comments must be submitted on or before December 24, 2012.

ADDRESSES: Submit written comments on the collection of information through *www.Regulations.gov;* or to VA's OMB Desk Officer, OMB Human Resources and Housing Branch, New Executive Office Building, Room 10235, Washington, DC 20503 (202) 395–7316. Please refer to ''OMB Control No. 2900–0741'' in any correspondence.

FOR FURTHER INFORMATION CONTACT: Crystal Rennie, Enterprise Records Service (005R1B), Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 632–7492, fax (202) 632–7583 or email *crystal.rennie@va.gov.* Please refer to ''OMB Control No. 2900–0741.''

SUPPLEMENTARY INFORMATION:

Title: VA Subcontracting Report for Service Disabled Veteran-owned Small Business and Veteran-owned Small Business Concerns, VA Form 0896a.

OMB Control Number: 2900–0741.

Type of Review: Extension of a previously approved collection.

Abstract: VA Form 0896a will be used to collect information from subcontractors to compare information obtained from subcontracting plans submitted by prime contractors in order to determine the accuracy of the data reported by prime contractors.

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 OMB

control number. The **Federal Register** Notice with a 60-day comment period soliciting comments on this collection of information was published on September 13, 2012, at page 56709–56710.

Affected Public: Business or other for-profit.

Estimated Annual Burden: 646 hours.

Estimated Average Burden per Respondent: 2 Hours.

Frequency of Response: One time.

Estimated Number of Respondents: 323.

Dated: November 19, 2012.

By direction of the Secretary.

Robert C. McFetridge,

Director, Office of Regulations Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

[FR Doc. 2012–28446 Filed 11–21–12; 8:45 am]

BILLING CODE 8320–01–P

DEPARTMENT OF VETERANS AFFAIRS

[OMB Control No. 2900–0744]

Agency Information Collection Activities (Call Center Satisfaction Survey) Under OMB Review

AGENCY: Veterans Benefits Administration, Department of Veterans Affairs.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–21), this notice announces that the Veterans Benefits Administration, Department of Veterans Affairs, will submit the collection of information abstracted below to the Office of Management and Budget (OMB) for review and comment. The PRA submission describes the nature of the information collection and its expected cost and burden and it includes the actual data collection instrument.

DATES: Comments must be submitted on or before December 24, 2012.

ADDRESSES: Submit written comments on the collection of information through *www.Regulations.gov;* or to VA's OMB Desk Officer, OMB Human Resources and Housing Branch, New Executive Office Building, Room 10235, Washington, DC 20503 (202) 395–7316. Please refer to ''OMB Control No. 2900–0744'' in any correspondence.

For Further Information or a Copy of the Submission Contact: Crystal Rennie, Enterprise Records Service (005R1B), Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 632–7492, FAX (202) 632–7583 or email: *crystal.rennie@va.gov.* Please refer to ''OMB Control No. 2900–0744.''

SUPPLEMENTARY INFORMATION:

Title: VBA Call Center Satisfaction Survey.

OMB Control Number: 2900–0744.

Type of Review: Extension of a currently approved collection.

Abstract: VBA maintains a commitment to improve the overall quality of service for Veterans. Feedback from Veterans regarding their recent experience to the VA call centers will provide VBA with three key benefits to: (1) Identify what is most important to Veterans; (2) determine what to do to improve the call center experience; and (3) serve to guide training and/or operational activities aimed at enhancing the quality of service provided to Veterans and active duty personnel.

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 OMB control number. The **Federal Register** Notice with a 60-day comment period soliciting comments on this collection of information was published on September 13, 2012, at page 56710.

Affected Public: Individuals or households.

Estimated Annual Burden: 3,600 hours.

Estimated Average Burden per Respondent: 6 minutes.

Frequency of Response: On occasion.

Estimated Number of Respondents: 36,000.

Dated: November 19, 2012.

By direction of the Secretary.

Robert C. McFetridge,

Director, Office of Regulations Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

[FR Doc. 2012–28447 Filed 11–21–12; 8:45 am]

BILLING CODE 8320–01–P

DEPARTMENT OF VETERANS AFFAIRS

[OMB Control No. 2900–New (NCA Emerging Burial Survey Needs)]

Agency Information Collection Activities Under OMB Review

AGENCY: National Cemetery Administration, Department of Veterans Affairs.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–21), this notice announces that the National Cemetery Administration (NCA), Department of Veterans Affairs, has submitted the collection of information abstracted below to the Office of Management and Budget (OMB) for review and comment. The PRA submission describes the nature of the information collection and its expected cost and burden; it includes the actual data collection instrument.

DATES: Comments must be submitted on or before December 24, 2012.

ADDRESSES: Submit written comments on the collection of information through *www.Regulations.gov;* or to VA's OMB Desk Officer, OMB Human Resources and Housing Branch, New Executive Office Building, Room 10235, Washington, DC 20503 (202) 395–7316. Please refer to ''OMB Control No. 2900-New (NCA Emerging Burial Survey Needs) in any correspondence.

FOR FURTHER INFORMATION CONTACT: Crystal Rennie, Enterprise Records Service (005R1B), Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 632–7492, FAX (202) 632–7583 or email: *crystal.rennie@va.gov.* Please refer to ''OMB Control No. 2900-New (NCA Emerging Burial Survey Needs).''

SUPPLEMENTARY INFORMATION:

Titles: NCA Emerging Burial Survey Needs.

a. 2012 Veterans Burial Benefits Survey

b. Focus Group

c. New and Emerging Burial Practices Study: Structured Interview Guide.

OMB Control Number: 2900-New (NCA Emerging Burial Survey Needs).

Type of Review: New data collection.

Abstract: NCA has over the past several years made significant efforts to evaluate its burial program. In 2008, NCA completed the first comprehensive evaluation of its burial benefits program, which included a nation-wide survey of Veterans that, among other things, assessed the reasons that Veterans choose—or do not choose—burial in a national cemetery. Although the survey assessed what types of interment practices were currently available through NCA and evaluated Veterans' preferences for existing interment practices, it did not determine Veterans' preferences for interment options that were beyond what was currently offered by VA at that time. NCA now seeks to both update the their understanding of the Veterans' satisfaction with NCA's current services, and to understand what additional internment options might be of interest to our Veterans and how they would view the inclusion of these options at the national cemeteries or other venues. The survey and focus groups will form the basis for review of

various policies and the performance of follow-on research into specific emerging interment options.

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 OMB control number. The **Federal Register** Notice with a 60-day comment period soliciting comments on this collection of information was published on September 13, 2012, at pages 56713–56714.

Affected Public: Individuals or households

Estimated Annual Burden:

a. 2012 Veterans Burial Benefits Survey—3,572 hours.

b. Focus Group—240 hours.

c. New and Emerging Burial Practices Study: Structured Interview Guide—75 hours.

Estimated Average Burden Per Respondent:

a. 2012 Veterans Burial Benefits Survey—14 minutes.

b. Focus Group—90 minutes.

c. New and Emerging Burial Practices Study: Structured Interview Guide—90 minutes.

Frequency of Response: One time.

Estimated Number of Respondents:

a. 2012 Veterans Burial Benefits Survey—15,307.

b. Focus Group—160.

c. New and Emerging Burial Practices Study: Structured Interview Guide—50.

Dated: November 19, 2012.

By direction of the Secretary.

Robert C. McFetridge,

Director, Office of Regulations Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

[FR Doc. 2012–28453 Filed 11–21–12; 8:45 am]

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DEPARTMENT OF VETERANS AFFAIRS

[OMB Control No. 2900–0525]

Agency Information Collection Activities Under OMB Review: VA MATIC Enrollment/Change

AGENCY: Veterans Benefits Administration, Department of Veterans Affairs.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521), this notice announces that the Veterans Benefits Administration (VBA), Department of Veterans Affairs, will submit the collection of information abstracted below to the Office of Management and Budget (OMB) for review and comment. The PRA submission describes the nature of the information collection and its expected cost and burden; it includes the actual data collection instrument.

DATES: Comments must be submitted on or before December 24, 2012.

ADDRESSES: Submit written comments on the collection of information through *www.Regulations.gov;* or to VA's OMB Desk Officer, OMB Human Resources and Housing Branch, New Executive Office Building, Room 10235, Washington, DC 20503 (202) 395–7316. Please refer to ''OMB Control No. 2900–0525'' in any correspondence.

FOR FURTHER INFORMATION CONTACT: Crystal Rennie, Enterprise Records Service (005R1B), Department of Veterans Affairs, 810 Vermont Avenue NW., Washington, DC 20420, (202) 461–7492, fax (202) 632–7583 or email *crystal.rennie@va.gov.* Please refer to ''OMB Control No. 2900–0525.''

SUPPLEMENTARY INFORMATION:

Title: VA MATIC Enrollment/Change, VA Form 29–0165.

OMB Control Number: 2900–0525.

Type of Review: Extension of a currently approved collection.

Abstract: Claimants complete VA Form 29–0165 to enroll in VA MATIC or change their financial institution from which VA currently deducts his/her Government Life Insurance premium.

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 OMB control number. The **Federal Register** Notice with a 60-day comment period soliciting comments on this collection of information was published on September 13, 2012, at pages 56711–56712.

Affected Public: Individuals or households.

Estimated Annual Burden: 1,250 hours.

Estimated Average Burden per Respondent: 15 minutes.

Frequency of Response: On occasion.

Estimated Number of Respondents: 5,000.

Dated: November 19, 2012.

By direction of the Secretary.

Robert C. McFetridge,

Director, Office of Regulations Policy and Management, Office of the General Counsel, Department of Veterans Affairs.

[FR Doc. 2012–28454 Filed 11–21–12; 8:45 am]

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FEDERAL REGISTER

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Part II

Securities and Exchange Commission

17 CFR Part 240
Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–68071; File No. S7–08–12]

RIN 3235–AL12

Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (''Dodd-Frank Act''), the Securities and Exchange Commission (''Commission''), pursuant to the Securities Exchange Act of 1934 (''Exchange Act''), is proposing capital and margin requirements for security-based swap dealers (''SBSDs'') and major security-based swap participants (''MSBSPs''), segregation requirements for SBSDs, and notification requirements with respect to segregation for SBSDs and MSBSPs. The Commission also is proposing to increase the minimum net capital requirements for broker-dealers permitted to use the alternative internal model-based method for computing net capital (''ANC broker-dealers'').

DATES: Comments should be received on or before January 22, 2013.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number S7–08–12 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–08–12. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments also are available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551–5525; Thomas K. McGowan, Deputy Associate Director, at (202) 551–5521; Randall W. Roy, Assistant Director, at (202) 551–5522; Mark M. Attar, Branch Chief, at (202) 551–5889; Sheila Dombal Swartz, Special Counsel, at (202) 551–5545; Valentina M. Deng, Attorney, at (202) 551–5778; or Teen I. Sheng, Attorney, at 202–551–5511, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–7010.

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I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Act into law.[1] Title VII of the Dodd-Frank Act (''Title VII'') established a new regulatory framework for OTC derivatives.[2] In this regard, Title VII was enacted, among other reasons, to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (i) Providing for the registration and regulation of SBSDs and MSBSPs; (ii) imposing clearing and trade execution requirements on standardized derivative products; (iii) creating recordkeeping and real-time reporting regimes; and (iv) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight.[3]

Section 764 of the Dodd-Frank Act added section 15F to the Exchange Act.[4] Section 15F(e)(1)(B) of the Exchange Act provides that the Commission shall prescribe capital and margin requirements for SBSDs and nonbank MSBSPs that do not have a prudential regulator (respectively, ''nonbank SBSDs'' and ''nonbank MSBSPs'').[5] Section 763 of the Dodd-Frank Act added section 3E to the Exchange Act.[6] Section 3E provides the Commission with authority to establish segregation requirements for SBSDs and MSBSPs.[7]

Section 4s(e)(1)(B) of the CEA provides that the CFTC shall prescribe capital and margin requirements for swap dealers and major swap participants for which there is not a prudential regulator (''nonbank swap dealers'' and ''nonbank swap participants'').[8] Section 15F(e)(1)(A) of the Exchange Act provides that the prudential regulators shall prescribe capital and margin requirements for bank SBSDs and bank MSBSPs, and section 4s(e)(1)(A) of the CEA provides that the prudential regulators shall prescribe capital and margin requirements for swap dealers and major swap participants for which there is a prudential regulator (''bank swap dealers'' and ''bank swap participants'').[9] The prudential regulators have proposed capital and margin requirements for bank swap dealers, bank SBSDs, bank swap participants, and bank MSBSPs.[10] The CFTC has proposed capital and margin requirements for nonbank swap dealers and nonbank major swap participants.[11] The CFTC also has adopted segregation requirements for cleared swaps and proposed segregation requirements for non-cleared swaps.[12]

Pursuant to sections 763 and 764 of the Dodd-Frank Act, the Commission is proposing to amend Rule 15c3–1 and Rule 15c3–3 and propose new Rules 18a–1 (including appendices to Rule 18a–1), 18a–2, 18a–3, and 18a–4 (including an exhibit to Rule 18a–4).[13] The proposed amendments and new rules would establish capital and margin requirements for nonbank SBSDs, including broker-dealers that are registered as SBSDs (''broker-dealer SBSDs''), and nonbank MSBSPs. They also would establish segregation requirements for SBSDs and notification requirements with respect to segregation for SBSDs and MSBSPs.

Further, the proposals also would increase the minimum net capital

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[1] *See* Public Law 111–203, 124 Stat. 1376 (2010).

[2] Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the ''Wall Street Transparency and Accountability Act of 2010.'' *See* Public Law 111–203 § 701. The Dodd-Frank Act assigns responsibility for the oversight of the U.S. OTC derivatives markets to the Commission, the Commodity Futures Trading Commission (''CFTC''), and certain ''prudential regulators,'' discussed below. The Commission has oversight authority with respect to a *security-based swap* as defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)), including to implement a registration and oversight program for a *security-based swap dealer* as defined in section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)) and a *major security-based swap participant* as defined in section 3(a)(67) of the Exchange Act (15 U.S.C. 78c(a)(67)). The CFTC has oversight authority with respect to a *swap* as defined in section 1(a)(47) of the Commodity Exchange Act (''CEA'') (7 U.S.C. 1(a)(47)), including to implement a registration and oversight program for a *swap dealer* as defined in section 1(a)(49) of the CEA (7 U.S.C. 1(a)(49)) and a *major swap participant* as defined in section 1(a)(33) of the CEA (7 U.S.C. 1(a)(33)). The Commission and the CFTC jointly have adopted rules to further define, among other things, those terms and the terms *swap, security-based swap, swap dealer, major swap participant, security-based swap dealer, and major security-based swap participant. See Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* Exchange Act Release No. 64372 (Apr. 29, 2011), 76 FR 29818 (May 23, 2011) (''*Product Definitions Proposing Release''*); *Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping,* Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48208 (Aug. 13, 2012) (Joint final rule with the CFTC) (''*Product Definitions Adopting Release''*); *Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant'',* Exchange Act Release No. 63452 (Dec. 7, 2010), 75 FR 80174 (Dec. 21, 2010) (Joint proposal with the CFTC) (''*Entity Definitions Proposing Release''*); and *Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant'',* Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596 (May 23, 2012) (Joint final rule with the CFTC) (''*Entity Definitions Adopting Release''*).

[3] *See* Public Law 111–203 §§ 701–774.

[4] *See id.* § 764; 15 U.S.C. 78o–10.

[5] *See* 15 U.S.C. 78o–10(e)(1)(B). Specifically, section 15F(e)(1)(B) of the Exchange Act provides that each registered SBSD and MSBSP for which there is not a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the Commission shall by rule or regulation prescribe. The term ''prudential regulator'' is defined in section 1(a)(39) of the CEA (7 U.S.C. 1(a)(39)) and that definition is incorporated by reference in section 3(a)(74) of the Exchange Act (15 U.S.C. 78c(a)(74)). Pursuant to the definition, the Board of Governors of the Federal Reserve System (''Federal Reserve''), the Office of the Comptroller of the Currency (''OCC''), the Federal Deposit Insurance Corporation (''FDIC''), the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the ''prudential regulators'') is the ''prudential regulator'' of an SBSD, MSBSP, swap participant, or major swap participant if the entity is directly supervised by that agency.

[6] *See* Public Law 111–203 § 763; 15 U.S.C. 78c–5.

[7] *See* 15 U.S.C. 78c–5(a)–(g). Section 3E of the Exchange Act does not distinguish between bank and nonbank SBSDs and bank and nonbank MSBSPs, and, consequently, provides the Commission with the authority to establish segregation requirements for SBSDs and MSBSPs, whether or not they have a prudential regulator. *Id.*

[8] *See* 7 U.S.C. 6s(e)(1)(B).

[9] *See* 15 U.S.C. 78o–10(e)(1)(A); 7 U.S.C. 6s(e)(1)(A).

[10] *See Margin and Capital Requirements for Covered Swap Entities,* 76 FR 27564 (May 11, 2011) (''*Prudential Regulator Margin and Capital Proposing Release''*). The prudential regulators, as part of their proposed margin requirements for non-cleared security-based swaps, proposed a segregation requirement for collateral received as margin. *Id.*

[11] *See Capital Requirements of Swap Dealers and Major Swap Participants,* 76 FR 27802 (May 12, 2011) (''*CFTC Capital Proposing Release''*); *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants,* 76 FR 23732 (Apr. 28, 2011) (''*CFTC Margin Proposing Release''*). The CFTC reopened the comment period for the CFTC Margin Proposing Release to allow interested parties to comment on the CFTC proposed rules in light of the proposals discussed in the international consultative paper. *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants,* 77 FR 41109 (July 12, 2012).

[12] *See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions,* 77 FR 6336 (Feb. 7, 2012) and *Protection of Collateral of Counterparties to Non-cleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy,* 75 FR 75432 (Dec. 3, 2010).

[13] *See* 17 CFR 240.15c3–1; 17 CFR 240.15c3–3.

requirements and establish liquidity requirements for ANC broker-dealers.[14] An ANC broker-dealer is a broker-dealer that has been approved by the Commission to use internal value-at-risk (''VaR'') models to determine market risk charges for proprietary securities and derivatives positions and to take a credit risk charge in lieu of a 100% charge for unsecured receivables related to OTC derivatives transactions (hereinafter, collectively ''internal models''). The proposed amendments applicable to ANC broker-dealers are designed to account for their large size, the scale of their custodial activities, and the potential substantial leverage they may take on if they become more active in the security-based swap markets under the Dodd-Frank Act reforms, which, among other things, require dealers in security-based swaps to register with the Commission.[15] Finally, some of the proposed amendments to Rule 15c3–1 would apply to broker-dealers that are not registered as SBSDs. These proposed amendments are designed to maintain a consistent capital treatment for security-based swaps and swaps under Rule 15c3–1 and proposed new Rule 18a–1.

As discussed in detail below, the proposals for capital, margin, and segregation requirements for SBSDs and MSBSPs are based in large part on existing capital, margin, and segregation requirements for broker-dealers (''broker-dealer financial responsibility requirements'').[16] The broker-dealer financial responsibility requirements served as the model for the proposals because the financial markets in which SBSDs and MSBSPs are expected to operate are similar to the financial markets in which broker-dealers operate. In addition, as discussed below, the objectives of the broker-dealer financial responsibility requirements are similar to the objectives underlying the proposals. Moreover, the broker-dealer financial responsibility requirements have existed for many years and have facilitated the prudent operation of broker-dealers.[17] Consequently, they provide a reasonable template for building a financial responsibility program for SBSDs and MSBSPs. Furthermore, it is expected that some nonbank SBSDs also will register as broker-dealers in order to be able to offer customers a broader range of services than a nonbank SBSD not registered as a broker-dealer (''stand-alone SBSD'') would be permitted to engage in. Therefore, establishing consistent financial responsibility requirements would avoid potential competitive disparities between stand-alone SBSDs and broker-dealer SBSDs.

However, the Commission recognizes that there may be other approaches to establishing financial responsibility requirements that may be appropriate—including, for example, applying a standard based on the international capital standard for banks (''Basel Standard'')[18] in the case of entities that are part of a bank holding company, as has been proposed by the CFTC.[19] In general, the bank capital model requires the holding of specified levels of capital as a percentage of ''risk weighted assets.''[20] It does not require generally a full capital deduction for unsecured receivables, given that banks, as lending entities, are in the business of extending credit to a range of counterparties.

This approach could promote a consistent view and management of capital within a bank holding company structure. The Commission is not proposing this approach, however, both because of the distinctions between bank and nonbank dealer business models and access to backstop liquidity, as well as uncertainties as to how a bank capital standard would in practice affect valuations and the conduct of business in a nonbank entity; but the Commission is specifically seeking comment on this approach. In addition, detailed comment is requested below on alternative financial responsibility frameworks that could serve as a model for establishing financial responsibility requirements for SBSDs and MSBSPs.

The minimum financial and customer protection requirements proposed today—like other financial tests that market participants use in the ordinary course of business to manage risk or to comply with applicable regulations—incorporate many specific numerical thresholds, limits, deductions, and ratios.[21] The Commission recognizes that each such quantitative requirement could be read by some to imply a definitive conclusion based on quantitative analysis of that requirement and its alternatives.

The Commission notes in this regard that the specific quantitative requirements included in this proposal have not been derived directly from econometric or mathematical models, nor has the Commission performed a detailed quantitative analysis of the likely economic consequences of the specific quantitative requirements being included in this proposal. As discussed in the economic analysis below, there are a number of challenges presented in conducting such a quantitative analysis in a robust fashion. Accordingly, the selection of a particular quantitative requirement proposed below reflects a qualitative assessment by the Commission regarding the appropriate financial standard for an identified issue. In making such assessments and in turn selecting proposed quantitative requirements, the Commission has drawn from its experiences in regulating broker-dealers and has frequently looked to comparable quantitative elements in the existing broker-dealer financial responsibility regime (*e.g.,* the current capital charges in the existing broker-dealer net capital rule) or, where appropriate, the existing or proposed regulations of the prudential regulators,

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[14] *See* 17 CFR 240.15c3–1(a)(7); 17 CFR 240.15c3–1e.

[15] *See, e.g.,* 15 U.S.C. 78o–10(a)(1) (''It shall be unlawful for any person to act as a security-based swap dealer unless the person is registered as a security-based swap dealer with the Commission.'').

[16] *See infra* section II.A.1. of this release (describing generally the broker-dealer capital standards); section II.B.1. of this release (describing generally the broker-dealer margin standards); section II.C.1. of this release (describing generally the broker-dealer segregation requirements).

[17] For example, one of the objectives of the broker-dealer financial responsibility requirements is to protect customers from the consequences of the financial failure of a broker-dealer in terms of safeguarding customer securities and funds held by the broker-dealer. It should be noted that the Securities Investor Protection Corporation (''SIPC''), since its inception in 1971, has initiated customer protection proceedings for only 324 broker-dealers, which is less than 1% of the approximately 39,200 broker-dealers that have been members of SIPC during that timeframe. From 1971 through December 31, 2011, approximately 1% of the $117.5 billion of cash and securities distributed for accounts of customers came from the SIPC fund rather than debtors' estates. *See* SIPC, *Annual Report 2011,* available at *http://www.sipc.org/Portals/0/PDF/2011_Annual_Report.pdf* (''*SIPC 2011 Annual Report*'').

[18] The Basel Standard was developed by the Basel Committee on Banking Supervision of the Bank for International Settlements (''BCBS''). More information about the Basel Standard is available at the Web site of the Bank for International Settlements (''BIS'') at *http://www.bis.org/bcbs/index.htm.*

[19] *CFTC Capital Proposing Release,* 76 FR 27802.

[20] The prudential regulators also have proposed capital rules that would require a covered swap entity to comply with the regulatory capital rules already made applicable to that covered swap entity as part of its prudential regulatory regime. *Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27568. The prudential regulators note that they have ''had risk-based capital rules in place for banks to address over-the-counter derivatives since 1989 when the banking agencies implemented their risk-based capital adequacy standards * * * based on the first Basel Accord.'' *Id.*

[21] For example, the proposed capital requirements would include in the formula that determines minimum net capital an amount generally equal to 8% of the amount of margin that nonbank SBSDs would be required to collect from counterparties. Similarly, the capital and margin proposals, in setting ''haircut'' requirements to reflect market risk for certain types of security-based swaps, propose to use a numerical grid that establishes specific deductions depending on spread and tenor, among other factors.

FINRA, or the CFTC with respect to similar activities. For example, the Commission may propose using a specified haircut percentage (*e.g.,* 15%, as opposed to a percentage that is higher or lower) because it believes, based on its experience regulating markets, that such percentage should be sufficient to cover a severe market movement. The Commission has used these comparable quantitative requirements as a reasonable starting point for purposes of the various proposals because, as noted above, there are substantial similarities between the proposed rules and those other regimes in terms of the relevant markets, entities, and regulatory objectives, and because many nonbank SBSDs may also be subject to the existing broker-dealer financial responsibility requirements.

The Commission invites comment, including relevant data and analysis, regarding all aspects of the various quantitative requirements reflected in the proposed rules. In particular, data and comment from market participants and other interested parties regarding the likely effect of each proposed quantitative requirement, the effect of such requirements in the aggregate, and potential alternative requirements will be particularly useful to the Commission in evaluating modifications to the proposals. Commenters are also requested to describe in detail any econometric or mathematical models or economic analyses of data, to the extent they exist, that they believe would be relevant for evaluating or modifying any quantitative provisions contained in the proposals.

The Commission staff consulted with the prudential regulators and the CFTC in drafting the proposals discussed in this release.[22] In addition, the proposals of the prudential regulators and the CFTC were considered in developing the Commission's proposed capital, margin, and segregation requirements for SBSDs and MSBSPs. The Commission's proposals differ in some respects from proposals of the prudential regulators and the CFTC, and such differences are described below in connection with the relevant proposals. While some differences are based on differences in the activities of securities firms, banks, and commodities firms, or differences in the products at issue, other differences may reflect an alternative approach to balancing the relevant policy choices and considerations. Where these differences exist, comment is sought on the advantages and disadvantages of each proposal and whether a given proposal is appropriate based on differences in the business models of the types of entities that would be subject to the respective proposal, the risks of these entities, and any other factors commenters believe relevant.[23]

The capital, margin, and segregation requirements ultimately adopted, like other requirements established under the Dodd-Frank Act, could have a substantial impact on international commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions. In particular, intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the Commission's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. This could, among other potential impacts, affect the ability of intermediaries and other market participants based in the U.S. to participate in non-U.S. markets, the ability of non-U.S.-based intermediaries and other market participants to participate in U.S. markets, and whether and how international firms make use of global ''booking entities'' to centralize risks related to security-based swaps. These issues have been the focus of numerous comments to the Commission and other regulators, Congressional inquiries, and other public dialogue.[24]

The potential international implications of the proposed capital, margin, and segregation requirements warrant further consideration. However, consistent with the Commission's general approach with respect to its other proposals under Title VII, these implications are recognized here but not fully addressed. Instead, the Commission intends to publish a comprehensive release seeking public comment on the full spectrum of issues relating to the application of Title VII to cross-border security-based swap transactions and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act. This approach will provide market participants, foreign regulators, and other interested parties with an opportunity to consider, as an integrated whole, the proposed approach to the cross-border application of Title VII, including capital, margin, and segregation requirements.

II. Proposed Rules and Rule Amendments

A. Capital

1. Introduction

Section 15F(e)(1)(B) of the Exchange Act requires that the Commission prescribe capital requirements for nonbank SBSDs and nonbank MSBSPs.[25] The Commission also has concurrent authority under section 15(c)(3) of the Exchange Act to prescribe capital requirements for broker-dealers.[26] The existing broker-dealer capital requirements are contained in

[22] *See* 15 U.S.C. 78o–10(e)(3)(D)(i) (''The prudential regulators, the [CFTC], and the [Commission] shall periodically (but not less frequently than annually) consult on the minimum capital requirements and minimum initial and variation margin requirements.'').

[23] *See* 15 U.S.C. 78o–10(e)(3)(D)(ii) (providing that the prudential regulators, the CFTC, and the Commission ''shall, to the maximum extent practicable establish and maintain comparable minimum capital requirements and minimum initial and variation margin requirements, including the use of noncash collateral,'' for SBSDs and swap dealers).

[24] *See, e.g.,* letter from Senator Tim Johnson, Chairman of the U.S. Senate Committee on Banking, Housing, and Urban Affairs, and Congressman Barney Frank, Ranking Member of the U.S. House Committee on Financial Services, to the CFTC, Commission, Federal Reserve, and FDIC (Oct. 4, 2011), available at *http://www.sec.gov/comments/s7-25-11/s72511-34.pdf* (''Given the global nature of this market, U.S. regulators should avoid creating opportunities for international regulatory arbitrage that could increase systemic risk and reduce the competitiveness of U.S. firms abroad''); letter from Barclays Bank PLC, BNP Paribas S.A., Credit Suisse AG, Deutsche Bank AG, HSBC, Nomura Securities International, Inc., Rabobank Nederland, Royal Bank of Canada, The Royal Bank of Scotland Group PLC, Societe Generale, The Toronto-Dominion Bank, and UBS AG, to the CFTC, Commission, and Federal Reserve (Feb. 17, 2011), available at *http://www.sec.gov/comments/s7-39-10/s73910-25.pdf* (''[T]he home country regulator has the greatest interest in and is in the best position to protect a foreign bank swap dealer under its primary supervision by setting appropriate margin requirements or functionally equivalent capital charges for non-cleared swaps''); letter from Carlos Tavares, Vice-Chairman of European Securities and Markets Authority, to the Commission (Jan. 17, 2011), available at *http://www.sec.gov/comments/s7-35-10/s73510-19.pdf* (''if the foreign supervision were not taken into account * * * a foreign [entity would] be subject to multiple regimes * * * [which would be] very challenging for regulated entities and would significantly raise the costs for both the industry and supervisors''); BCBS, Board of the International Organization of Securities Commissions (''IOCSO''), Consultative Document, *Margin Requirements for Non-centrally-cleared Derivatives* (July 2012), available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD387.pdf* (consultative document seeking comment on margin requirements for non-centrally-cleared derivatives).

[25] 15 U.S.C. 78o–10(e)(1)(B).

[26] 15 U.S.C. 78o(c)(3). Section 771 of the Dodd-Frank Act states that unless otherwise provided by its terms, its provisions relating to the regulation of the security-based swap markets do not divest any appropriate Federal banking agency, the Commission, the CFTC, or any other Federal or State agency, of any authority derived from any other provision of applicable law. *See* Public Law 111–203 § 771. In addition, section 15F(e)(3)(B) of the Exchange Act provides that nothing in section 15F ''shall limit, or be construed to limit, the authority'' of the Commission ''to set financial responsibility rules for a broker or dealer * * * in accordance with Section 15(c)(3).'' 15 U.S.C. 78o–8(e)(3)(B).

Rule 15c3–1,[27] including seven appendices to Rule 15c3–1.[28] The minimum capital requirements for stand-alone SBSDs would be contained in proposed new Rule 18a–1,[29] and the minimum capital requirements for broker-dealer SBSDs would be contained in Rule 15c3–1, as proposed to be amended. Proposed Rule 18a–1 would be structured similarly to Rule 15c3–1 and would contain many provisions that correspond to those in Rule 15c3–1.[30]

As described above, the capital and other financial responsibility requirements for broker-dealers generally provide a reasonable template for crafting the corresponding requirements for nonbank SBSDs. For example, among other considerations, the objectives of capital standards for both types of entities are similar. Rule 15c3–1, described in detail below, is a net liquid assets test that is designed to require a broker-dealer to maintain sufficient liquid assets to meet all obligations to customers and counterparties and have adequate additional resources to wind-down its business in an orderly manner without the need for a formal proceeding if it fails financially.[31] In turn, the objective of the proposed capital standards for nonbank SBSDs is to protect customer assets and mitigate the consequences of a firm failure, while allowing these firms the flexibility in how they conduct a security-based swaps business.

In addition, the Dodd-Frank Act divided responsibility for SBSDs by providing the prudential regulators with authority to prescribe the capital and margin requirements for bank SBSDs and the Commission with authority to prescribe capital and margin requirements for nonbank SBSDs.[32] This division also suggests it may be appropriate to model the capital requirements for nonbank SBSDs on the capital standards for broker-dealers, while the capital requirements for bank SBSDs are modeled on capital standards for banks (as reflected in the proposal by the prudential regulators).[33] Certain operational, policy, and legal differences appear to support this distinction between nonbank SBSDs and bank SBSDs. First, based on the Commission staff's understanding of the activities of nonbank dealers in over-the counter (''OTC'') derivatives, nonbank SBSDs are expected to engage in a securities business with respect to security-based swaps that is more similar to the dealer activities of broker-dealers than to the activities of banks; indeed, some broker-dealers likely will be registered as nonbank SBSDs.[34] Second, existing capital standards for banks and broker-dealers reflect, in part, differences in their funding models and access to certain types of financial support, and those same differences also will exist between bank SBSDs and nonbank SBSDs. For example, banks obtain funding through customer deposits and can obtain liquidity through the Federal Reserve's discount window, whereas broker-dealers do not—and nonbank SBSDs will not—have access to these sources of funding and liquidity. Third, Rule 15c3–1 currently contains provisions designed to address dealing in OTC derivatives by broker-dealers and, therefore, to some extent already can accommodate this type of activity (although, as discussed below, proposed amendments to Rule 15c3–1 would be designed to more specifically address the risks of security-based swaps and the potential for increased involvement of broker-dealers in the security-based swaps markets).[35]

For these reasons, the proposed capital standard for nonbank SBSDs is a net liquid assets test modeled on the broker-dealer capital standard in Rule 15c3–1.[36] However, the Commission

[27] 17 CFR 240.15c3–1.

[28] 17 CFR 240.15c3–1a (Options); 17 CFR 240.15c3–1b (Adjustments to net worth and aggregate indebtedness for certain commodities transactions); 17 CFR 240.15c3–1c (Consolidated computations of net capital and aggregate indebtedness for certain subsidiaries and affiliates); 17 CFR 240.15c3–1d (Satisfactory subordination agreements); 17 CFR 240.15c3–1e (Deductions for market and credit risk for certain brokers or dealers); 17 CFR 240.15c3–1f (Optional market and credit risk requirements for OTC derivatives dealers); 17 CFR 240.15c3–1g (Conditions for ultimate holding companies of certain brokers or dealers).

[29] *See* proposed new Rule 18a–1.

[30] For example, proposed new Rule 18a–1 would include four appendices: Appendix A (proposed new Rule 18a–1a); Appendix B (proposed new Rule18a–1b); Appendix C (proposed new Rule 18a–1c); and Appendix D (proposed new Rule 18a–1d). The appendices would correspond to the following appendices to Rule 15c3–1: Appendix A (Options) (17 CFR 240.15c3–1a); Appendix B (Adjustments to net worth and aggregate indebtedness for certain commodities transactions) (17 CFR 240.15c3–1b); Appendix C (Consolidated computations of net capital and aggregate indebtedness for certain subsidiaries and affiliates) (17 CFR 240.15c3–1c); and Appendix D (Satisfactory subordination agreements) (17 CFR 240.15c3–1d).

[31] *See Net Capital Rule,* Exchange Act Release No. 38248 (Feb. 6, 1997), 62 FR 6474 (Feb. 12, 1997) (''Rule 15c3–1 requires registered broker-dealers to maintain sufficient liquid assets to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the need for a formal proceeding.''). As indicated, the goal of the rule is to require a broker-dealer to hold sufficient liquid net capital to meet all obligations to creditors, except for creditors who agree to subordinate their claims to all other creditors. As discussed in more detail below, Rule 15c3–1d (Appendix D to Rule 15c3–1) sets forth minimum requirements for a subordinated loan agreement. *See* 17 CFR 240.15c3–1d. Typically, affiliates of the broker-dealer (*e.g.,* the firm's holding company) or individual owners of the broker-dealer make subordinated loans to the broker-dealer. If the broker-dealer fails financially and is liquidated, the obligations of the broker-dealer to all other creditors would need to be paid in full before the obligations of the broker-dealer to a subordinated lender are paid.

[32] *See* 15 U.S.C. 78o–10, in general; 15 U.S.C. 78o–10(e)(2)(A)–(B), in particular.

[33] The prudential regulators have proposed capital requirements for bank SBSDs and bank swap dealers that are based on the capital requirements for banks. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27582.

[34] *Id.*

[35] *See* 17 CFR 240.15c3–1f and 17 CFR 240.15c3–1e. *See also Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* Exchange Act Release No. 49830 (June 8, 2004), 69 FR 34428 (June 21, 2004) (''*Alternative Net Capital Requirements Adopting Release''*); *OTC Derivatives Dealers,* Exchange Act Release No. 40594 (Oct. 23, 1998), 63 FR 59362 (Nov. 3, 1998).

[36] As noted above, the prudential regulators similarly proposed capital standards for bank SBSDs based on the capital standards for banks. *See Prudential Regulator Margin and Capital Proposing Release* 76 FR 27564. The CFTC has proposed three different capital standards for nonbank swap dealers. First, a futures commission merchant (''FCM'') that is registered as a swap dealer would be subject to the CFTC's net capital rule for FCMs, which is similar to the Commission's net capital rule for broker-dealers in that it imposes a net liquid assets test. *See CFTC Capital Proposing Release,* 76 FR 27802. Second, a swap dealer that is not an FCM *and not* affiliated with a U.S. bank holding company would be subject to a ''tangible net equity'' capital standard (the CFTC proposal defines *tangible net equity* as equity determined under U.S. generally accepted accounting principles (''GAAP''), and excludes goodwill and other intangible assets). Third, a swap dealer that is not an FCM *and is* affiliated with a U.S. bank holding company would be subject to the capital standard that applies to U.S. banking institutions. *Id.* The proposed capital standard for nonbank SBSDs would not make such distinctions and, therefore, all nonbank SBSDs would be subject to the net liquid assets test embodied in Rule 15c3–1 (*i.e.,* regardless of whether they are registered as broker-dealers or affiliates of U.S. bank holding companies). The CFTC proposed a tangible net equity requirement for certain swap dealers to address the probability that commercial entities (*e.g.,* entities engaged in agricultural or energy businesses) may need to register as swap dealers and that imposing a net liquid assets test could require them to engage in significant corporate restructuring and potentially cause undue costs because their equity is comprised of physical and other non-current assets. Differences between the swaps markets and the security-based swaps markets may make a single capital standard more workable for nonbank SBSDs. The swaps market is significantly larger than the security-based swaps market and has many more active participants that are commercial entities. *See* BIS, *OTC Derivatives Market Activity in the Second Half of 2010,* Monetary and Economic Department, (May 2011), available at *http://www.bis.org/publ/otc_hy1105.pdf.* It is expected that financial institutions will comprise a large segment of the security-based swaps market as is currently the case and that these entities are more likely to have affiliates dedicated to OTC derivatives trading and affiliates that are broker-dealers registered with the Commission. *See infra* section V.A. of this release (providing an overview of the security-based swaps markets). Consequently, these affiliates—because their capital structures are geared towards securities trading or because they already are broker-dealers—would be

recognizes that there may be alternative approaches to financial responsibility requirements that may be appropriate.[37] Accordingly, in the requests for comment below on the various capital standards, commenters are encouraged: (1) To consider alternative approaches to capital for nonbank SBSDs generally; (2) for nonbank SBSDs that are broker-dealers, to identify what, if any, specific amendments to Rule 15c3–1 and its appendices they believe would not be appropriate for broker-dealers; and (3) for stand-alone SBSDs, to identify what, if any, specific provisions in proposed new Rule 18a–1 and its appendices (including those modeled on provisions in Rule 15c3–1 and its appendices) they believe would not be appropriate for stand-alone SBSDs.

The capital standard in Rule 15c3–1—that serves as a model for the proposed capital standard for nonbank SBSDs—is a net liquid assets test. This standard is designed to promote liquidity; the rule allows a broker-dealer to engage in activities that are part of conducting a securities business (*e.g.,* taking securities into inventory) but in a manner that places the firm in the position of holding at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities (*e.g.,* money owed to customers, counterparties, and creditors).[38] For example, Rule 15c3–1 allows securities positions to count as allowable net capital, subject to standardized or internal model-based haircuts.[39] The rule, however, does not permit most unsecured receivables to count as allowable net capital.[40] This aspect of the rule severely limits the ability of broker-dealers to engage in activities, such as unsecured lending, that generate unsecured receivables. The rule also does not permit fixed assets or other illiquid assets to count as allowable net capital, which creates disincentives for broker-dealers to own real estate and other fixed assets that cannot be readily converted into cash. For these reasons, Rule 15c3–1 incentivizes broker-dealers to confine their business activities and devote capital to activities such as underwriting, market making, and advising on and facilitating customer securities transactions.

Rule 15c3–1 requires broker-dealers to maintain a minimum level of net capital (meaning highly liquid capital) at all times.[41] The rule requires that a broker-dealer perform two calculations: (1) A computation of the minimum amount of net capital the broker-dealer must maintain;[42] and (2) a computation of the amount of net capital the broker-dealer is maintaining.[43] The minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying one of two financial ratios: the 15-to-1 aggregate indebtedness to net capital ratio or the 2% of aggregate debit items ratio.[44]

In computing net capital, the broker-dealer must, among other things, make certain adjustments to net worth such as deducting illiquid assets and taking other capital charges and adding qualifying subordinated loans.[45] The amount remaining after these deductions is defined as ''tentative net capital.'' [46] The final step in computing net capital is to take prescribed percentage deductions (''standardized haircuts'') from the mark-to-market value of the proprietary positions (*e.g.,* securities, money market instruments, and commodities) that are included in its tentative net capital.[47] The standardized haircuts are designed to account for the market risk inherent in these positions and to create a buffer of liquidity to protect against other risks associated with the securities business.[48] ANC broker-dealers and a type of limited purpose broker-dealer that deals solely in OTC derivatives (''OTC derivative dealers'') are permitted, with Commission approval, to calculate net capital using internal models as the basis for taking market risk and credit risk charges in lieu of the standardized haircuts for classes of positions for which they have been approved to use models.[49] Rule 15c3–1 imposes substantially higher minimum capital requirements for ANC broker-dealers and OTC derivatives dealers, as compared to other types of broker-dealers, because, among other reasons, the use of internal models to compute net capital can substantially reduce the deductions for securities and money market positions as compared with the standardized haircuts.[50] Consequently, the higher minimum capital requirements are designed to account for risks that may not be addressed by the internal models. A broker-dealer must ensure that its net capital exceeds

able to more readily adhere to a net liquid assets test. In addition, many broker-dealers currently are affiliates within bank holding companies. Consequently, these broker-dealers are subject to Rule 15c3–1, while their bank affiliates are subject to bank capital standards.

[37] *CFTC Capital Proposing Release,* 76 FR 27802.

[38] *See, e.g., Interpretation Guide to Net Capital Computation for Brokers and Dealers,* Exchange Act Release No. 8024 (Jan. 18, 1967), 32 FR 856 (Jan. 25, 1967) (''Rule 15c3–1 (17 CFR 240.15c3–1) was adopted to provide safeguards for public investors by setting standards of financial responsibility to be met by brokers and dealers. The basic concept of the rule is liquidity; its object being to require a broker-dealer to have at all times sufficient liquid assets to cover his current indebtedness.'') (footnotes omitted); *Net Capital Treatment of Securities Positions, Obligations and Transactions in Suspended Securities,* Exchange Act Release No. 10209 (June 8, 1973), 38 FR 16774 (June 26, 1973) (Commission release of a letter from the Division of Market Regulation) (''The purpose of the net capital rule is to require a broker or dealer to have at all times sufficient liquid assets to cover its current indebtedness. The need for liquidity has long been recognized as vital to the public interest and for the protection of investors and is predicated on the belief that accounts are not opened and maintained with broker-dealers in anticipation of relying upon suit, judgment and execution to collect claims but rather on a reasonable demand one can liquidate his cash or securities positions.''); *Net Capital Requirements for Brokers and Dealers,* Exchange Act Release No. 15426 (Dec. 21, 1978), 44 FR 1754 (Jan. 8, 1979) (''The rule requires brokers or dealers to have sufficient cash or liquid assets to protect the cash or securities positions carried in their customers' accounts. The thrust of the rule is to insure that a broker or dealer has sufficient liquid assets to cover current indebtedness.''); *Net Capital Requirements for Brokers and Dealers,* Exchange Act Release No. 26402 (Dec. 28, 1989), 54 FR 315 (Jan. 5, 1989) (''The rule's design is that broker-dealers maintain liquid assets in sufficient amounts to enable them to satisfy promptly their liabilities. The rule accomplishes this by requiring broker-dealers to maintain liquid assets in excess of their liabilities to protect against potential market and credit risks.'') (footnote omitted).

[39] *See* 17 CFR 240.15c3–1(c)(2)(vi); 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f.

[40] *See* 17 CFR 240.15c3–1(c)(2)(iv).

[41] *See* 17 CFR 240.15c3–1.

[42] *See* 17 CFR 240.15c3–1(a).

[43] *See* 17 CFR 240.15c3–1(c)(2). The computation of net capital is based on the definition of *net capital* in paragraph (c)(2) of Rule 15c3–1. *Id.*

[44] *See* 17 CFR 240.15c3–1(a).

[45] *See* 17 CFR 240.15c3–1(c)(2)(i)–(xiii).

[46] *See* 17 CFR 240.15c3–1(c)(15).

[47] *See* 17 CFR 240.15c3–1(c)(2)(vi).

[48] *See, e.g., Uniform Net Capital Rule,* Exchange Act Release No. 13635 (June 16, 1977), 42 FR 31778 (June 23, 1977) (''[Haircuts] are intended to enable net capital computations to reflect the market risk inherent in the positioning of the particular types of securities enumerated in [the rule]''); *Net Capital Rule,* Exchange Act Release No. 22532 (Oct. 15, 1985), 50 FR 42961 (Oct. 23, 1985) (''These percentage deductions, or 'haircuts', take into account elements of market and credit risk that the broker-dealer is exposed to when holding a particular position.''); *Net Capital Rule,* Exchange Act Release No. 39455 (Dec. 17, 1997), 62 FR 67996 (Dec. 30, 1997) (''Reducing the value of securities owned by broker-dealers for net capital purposes provides a capital cushion against adverse market movements and other risks faced by the firms, including liquidity and operational risks.'') (footnote omitted).

[49] *See* 17 CFR 240.15c3–1(a)(5) and (a)(7); 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f. As part of the application to use internal models, an entity seeking to become an ANC broker-dealer or an OTC derivatives dealer must identify the types of positions it intends to include in its model calculation. *See* 17 CFR 240.15c3–3e(a)(1)(iii); 17 CFR 240.15c3–1f(a)(1)(ii). After approval, an ANC broker-dealer and OTC derivatives dealer must obtain Commission approval to make a material change to the model, including a change to the types of positions included in the model. *See* 17 CFR 240.15c3–1e(a)(8); 17 CFR 240.15c3-f(a)(3).

[50] *See* 17 CFR 240.15c3–1(a)(5) and (a)(7).

its minimum net capital requirement at all times.[51]

A different capital standard than the net liquid assets test is proposed for nonbank MSBSPs. As discussed in more detail below, proposed Rule 18a–2 would require nonbank MSBSPs to maintain positive tangible net worth.[52] The Commission preliminarily believes that a tangible net worth standard—as opposed to the net liquid assets test—is more workable for nonbank MSBSPs because these entities may engage in a diverse range of business activities different from, and broader than, the securities activities conducted by broker-dealers or SBSDs (and, to the extent they did not, they likely would be required to register as an SBSD and/or broker-dealer).[53] Consequently, requiring nonbank MSBSPs to adhere to a capital standard based on a net liquid assets test could restrict these entities from engaging in commercial activities that are part of their core business models. For example, some of these entities may engage in manufacturing and supply activities that generate large amounts of unsecured receivables and require substantial fixed assets.[54] Accordingly, as discussed below, proposed Rule 18a–2 is not modeled on Rule 15c3–1 because of the expected differences between nonbank SBSDs and broker-dealers, on the one hand, and the entities that may register as nonbank MSBSPs, on the other hand.

Request for Comment

The Commission generally requests comment on the proposals to impose a net liquid assets test capital standard for nonbank SBSDs and a tangible net worth standard for nonbank MSBSPs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Will the entities that register as nonbank SBSDs engage in a securities business with respect to security-based swaps that is similar to the securities business conducted by broker-dealers? If not, describe how the securities activities of nonbank SBSDs will differ from the securities activities of broker-dealers.

2. Will some broker-dealers register as nonbank SBSDs? If so, which types of broker-dealers and which types of activities do these broker-dealers currently engage in?

3. Should there be different capital standards for nonbank SBSDs depending on whether they are registered as broker-dealers or affiliated with bank holding companies, or not registered as broker-dealers and not affiliated with bank holding companies? If so, explain why. If not, explain why not. For example, should stand-alone SBSDs be subject to a tangible net worth standard or, if affiliated with a bank holding company, the bank capital standard? Would different standards create competitive advantages? If so, explain why. If different capital standards would be appropriate, explain the appropriate capital standard that should apply to each of these classes of nonbank SBSDs.

4. Generally, is there a level of capital under which counterparties will not transact with a dealer in OTC derivatives because the counterparty credit risk is too great? If so, identify that level of capital.

5. Will stand-alone SBSDs seek to effect transactions in securities OTC derivatives products other than security-based swaps, such as OTC options, that would necessitate registration as a broker-dealer? If so, would registering as a limited purpose broker-dealer under the provisions applicable to OTC derivatives dealers provide a workable alternative to registering as a full-service broker-dealer? For example, would there be conflicts between the proposed capital, margin, and segregation requirements for SBSDs and the existing requirements for OTC derivatives dealers? If so, identify the conflicts.

6. Should the requirements for OTC derivatives dealers be amended (by exemptive relief or otherwise) to accommodate firms that want to deal in security-based swaps? If so, explain how the requirements should be amended and why.

7. Should the Commission exempt nonbank SBSDs engaged in activities with respect to securities OTC derivatives products other than security-based swaps from any requirements applicable to OTC derivatives dealers? Please identify which requirements and explain why.

8. As discussed below, the proposed minimum net capital requirements would differ substantially for stand-alone SBSDs that are approved to use models in computing net capital (*i.e.,* a $20 million fixed-dollar minimum net capital requirement and $100 million tentative net capital requirement) compared to broker-dealer SBSDs approved to use models (*i.e.,* a $1 billion fixed-dollar minimum net capital requirement and $5 billion tentative net capital requirement). In general, because the definition of ''security-based swap dealer'' in the Dodd-Frank Act does not include acting as a broker or agent in security-based swaps, entities engaging in brokerage activities with respect to security-based swaps could be required to register as broker-dealers. To the extent these broker-dealer SBSDs wanted to use models to compute net capital, they would be subject to the higher minimum net capital requirements. Accordingly, in order to avoid being subject to higher minimum net capital requirements applicable to broker-dealer SBSDs approved to use models to compute net capital, a stand-alone SBSD may need to limit the activity it could conduct on behalf of customers so that it does not fall within the definition of a ''broker'' under the Exchange Act and, thereby, need to register as a broker-dealer. Commenters are requested to address this issue, including any potential changes to the proposed capital requirements for stand-alone SBSDs and broker-dealer SBSDs discussed below. For example, should broker-dealer SBSDs approved to use internal models to compute net capital and that register as broker-dealers only in order to conduct brokerage activities with respect to security-based swaps, and that do not conduct a general business in securities with customers, be subject to the minimum net capital requirements applicable to stand-alone SBSDs approved to use internal models? If so, explain why. If not, explain why not. If different capital standards would be appropriate, explain the appropriate capital standard that should apply to this class of broker-dealer SBSDs and whether any limitations should apply, including with respect to the types of broker activities in which the nonbank SBSD may engage in order to qualify for a particular capital treatment. Alternatively, or in addition, should the Commission allow OTC derivatives dealers (which are subject to a $20 million fixed-dollar minimum net capital requirement and $100 million tentative net capital requirement) to be dually registered as nonbank SBSDs and/or amend the rules for OTC derivatives dealers to conduct a broader range of activities than are currently

[51] 17 CFR 240.15c3–1(a).

[52] *See* proposed new Rule 18a–2.

[53] An entity will need to register with the Commission as an MSBSP and, consequently, be subject to proposed new Rule 18a–2 if it falls within the definition of *major security-based swap participant* in section 3(a)(67) of the Exchange Act (15 U.S.C. 78c(a)(67)) as further defined by the Commission by rule. *See Entity Definitions Adopting Release,* 77 FR 30596.

[54] *See CFTC Capital Proposing Release,* 76 FR at 27807 (proposing a tangible net equity test for major swap participants that are not part of bank holding companies noting that although these firms ''may have significant amounts of balance sheet equity, it may also be the case that significant portions of their equity is comprised of physical and other noncurrent assets, which would preclude the firms from meeting FCM capital requirements without engaging in significant corporate restructuring and incurring potentially undue costs.'').

permitted? If the Commission took this action, should it also remove the exemption for OTC derivatives dealers from membership in a self-regulatory organization (''SRO'')?

9. Describe the types of entities that may need to register as MSBSPs and how the activities that these entities engage in would impact the entity's capital position.

10. Should nonbank MSBSPs be subject to a net liquid assets test capital standard (in contrast to a tangible net worth test)? If so, explain why. If not, explain why not.

2. Proposed Capital Rules for Nonbank SBSDs

As discussed in detail below, proposed new Rule 18a–1 would prescribe capital requirements for stand-alone SBSDs and amendments to Rule 15c3–1 would prescribe capital requirements for broker-dealer SBSDs. Proposed new Rule 18a–1 would require a stand-alone SBSD to compute net capital using standardized haircuts prescribed in the rule (including standardized haircuts specifically for security-based swaps and swaps) or, alternatively, with Commission approval, to use internal models for positions for which the stand-alone SBSD has been approved to use internal models. Under the proposed amendments to Rule 15c3–1, a broker-dealer SBSD would be required to use the existing standardized haircuts in the rule plus proposed new additional standardized haircuts specifically for security-based swaps and swaps. A broker-dealer SBSD that seeks to compute net capital using internal models would need to apply to the Commission for approval to operate as an ANC broker-dealer. A nonbank SBSD permitted to use internal models to compute net capital (whether a stand-alone SBSD subject to proposed new Rule 18a–1 or an ANC broker-dealer subject to Rule 15c3–1, as amended) would need to comply with additional requirements as compared to a nonbank SBSD that is not approved to use internal models. This would be consistent with the existing requirements in Rule 15c3–1, which impose additional requirements on ANC broker-dealers and OTC derivatives dealers as compared with other broker-dealers.[55] Finally, the amendments to Rule 15c3–1 would apply to broker-dealers that are not registered as SBSDs to the extent they hold positions in security-based swaps and swaps.

a. Computing Required Minimum Net Capital

Rule 15c3–1 prescribes the minimum net capital requirement for a broker-dealer as the greater of a fixed-dollar amount specified in the rule and an amount determined by applying one of two financial ratios: the 15-to-1 aggregate indebtedness to net capital ratio or the 2% of aggregate debit items ratio.[56] The proposed capital requirements for nonbank SBSDs would use a similar framework. Under the proposals, there would be different minimum net capital requirements for stand-alone SBSDs that are not approved to use internal models, broker-dealer SBSDs that are not approved to use internal models, stand-alone SBSDs that are approved to use internal models, and broker-dealer SBSDs that are approved to use internal models (*i.e.,* ANC broker-dealers). The following table provides a summary of the proposed minimum net capital requirements, which are discussed in the following sections.

Proposed Minimum Capital Requirements

Type of Registrant	Tentative Net Capital	Net Capital	
		Fixed Dollar	Financial Ratio
Stand-alone SBSD (not using internal models)	N/A	$20 million	8% margin factor
Stand-alone SBSD (using internal models)	$100 million	$20 million	8% margin factor
Broker-dealer SBSD (not using internal models)	N/A	$20 million	8% margin factor + Rule 15c3-1 ratio
Broker-dealer SBSD (using internal models)	$5 billion	$1 billion	8% margin factor + Rule 15c3-1 ratio

i. Stand-alone SBSDs Not Using Internal Models

A stand-alone SBSD would be subject to the capital requirements set forth in proposed new Rule 18a–1. Under this proposed new rule, a stand-alone SBSD that is not approved to use internal models to compute haircuts would be required to maintain minimum net capital of not less than the greater of $20 million or 8% of the firm's *risk margin amount* (''8% margin factor'').[57] The term *risk margin amount* would be defined as the sum of: (1) The greater of the total margin required to be delivered by the nonbank SBSD with respect to security-based swap transactions cleared for security-based swap customers at a clearing agency or the amount of the deductions that would apply to the cleared security-based swap positions of the security-based swap customers pursuant to paragraph (c)(1)(vi) of Rule 18a–1; and (2) the total *margin* amount calculated by the stand-alone SBSD with respect to non-cleared security-based swaps pursuant to proposed new Rule 18a–3.[58] Accordingly, to determine its minimum net capital requirement, a stand-alone SBSD would need to calculate the amount equal to the 8% margin factor.[59] The firm's minimum net capital requirement would be the greater of $20 million or the amount equal to the 8% margin factor.[60]

The proposed $20 million fixed-dollar minimum requirement would be the same as the fixed-dollar minimum

[55] *See, e.g.,* 17 CFR 240.15c3–1(a)(5) and (a)(7); 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f; 17 CFR 240.15c3–4.

[56] *See* 17 CFR 240.15c3–1(a).

[57] *See* paragraph (a)(1) of proposed new Rule 18a–1. The rationales for these minimum requirements are discussed below.

[58] *See* paragraph (c)(6) of proposed new Rule 18a–1. The components of the *risk margin amount* are discussed in detail below.

[59] *See* paragraphs (a)(1) and (c)(6) of proposed new Rule 18a–1.

[60] *See* paragraph (a)(1) of proposed new Rule 18a–1.

requirement applicable to OTC derivatives dealers and already familiar to existing market participants.[61] OTC derivatives dealers are limited purpose broker-dealers that are authorized to trade in certain derivatives, including security-based swaps, and to use internal models to calculate net capital. They are required to maintain minimum tentative net capital of $100 million and minimum net capital of $20 million.[62] These current fixed-dollar minimums have been the minimum capital standards for OTC derivative dealers for over a decade, and are substantially lower than the fixed-dollar minimums in Rule 15c3–1 currently applicable to ANC broker-dealers, which use internal models to calculate net capital.[63] In addition, available data regarding the current population of broker-dealers suggests that these minimums would not prevent new entrants in the security-based swap market.[64] To date, there have been no indications that these minimums are not adequately meeting the objective of requiring OTC derivatives dealers to maintain sufficient levels of regulatory capital to account for the risks inherent in their activities.

At the same time, the proposed $20 million fixed-dollar minimum requirement for stand-alone SBSDs that do not use internal models to calculate net capital would be substantially higher than the fixed-dollar minimums in Rule 15c3–1 currently applicable to broker-dealers that do not use internal models (*i.e.,* that are not ANC broker-dealers or OTC derivatives dealers).[65] Under the proposals, stand-alone SBSDs that do not use models would not be able to avail themselves of such minimums and would be subject to the same $20 million minimum net capital requirement as OTC derivatives dealers, even though they would not be using models like such derivatives dealers. In other words, the same minimum net capital requirement will apply to stand-alone SBSDs regardless of whether or not they use models.

This level of minimum capital may be appropriate because of the nature of the business of a stand-alone SBSD and the differences from the business of a broker-dealer or OTC derivatives dealer. Generally, OTC derivatives, such as security-based swaps, are contracts between a dealer and its counterparty. Consequently, the counterparty's ability to collect amounts owed to it under the contract depends on the financial wherewithal of the dealer. In contrast, the returns on financial instruments held by a broker-dealer for an investor (other than a derivative issued by the broker-dealer) are not linked to the financial wherewithal of the broker-dealer holding the instrument for the customer. Accordingly, if a stand-alone SBSD fails, the counterparty may not be able to liquidate the contract or replace the contract with a new counterparty without incurring a loss on the position. The entities that will register and operate as nonbank SBSDs should be sufficiently capitalized to minimize the risk that they cannot meet their obligations to counterparties, particularly given that the counterparties will not be limited to other dealers but will include customers and other counterparties as well.

In addition, stand-alone SBSDs will not be subject to the same limitations that apply to OTC derivative dealers in effecting transactions with customers and engaging in dealing activities.[66] Therefore, the failure of a stand-alone SBSD could have a broader adverse impact on a larger number of market participants, including customers and counterparties.[67] The proposed capital requirements for this group of firms, in part, are meant to account for this potential broader impact on market participants.[68]

Consequently, stand-alone SBSDs that do not use internal models would be subject to the same $20 million fixed-dollar minimum net capital requirement that applies to OTC derivatives dealers. The same firms would not, however, be subject to a minimum tentative net capital requirement, which is applied to firms that use internal models to account for risks that may not be fully captured by the models.[69]

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[61] *See* 17 CFR 240.15c3–1(a)(5). The CFTC proposed a $20 million fixed-dollar minimum net capital requirement for FCMs that are registered as swap dealers, regardless of whether the firm is approved to use internal models to compute regulatory capital. *See CFTC Capital Proposing Release,* 76 FR 27802.

Further, the CFTC proposed a $20 million fixed-dollar ''tangible net equity'' minimum requirement for swap dealers and major swap participants that are not FCMs *and are not* affiliated with a U.S. bank holding company. Finally, the CFTC proposed a $20 million fixed-dollar Tier 1 capital minimum requirement for swap dealers and major swap participants that are not FCMs *and are* affiliated with a U.S. bank holding company (the term ''Tier 1 capital'' refers to the regulatory capital requirement for U.S. banking institutions). *Id.*

[62] *See* 17 CFR 240.15c3–1(a)(5). When adopting the capital requirements for OTC derivatives dealers, the Commission stated ''[t]he minimum tentative net capital and net capital requirements are necessary to ensure against excessive leverage and risks other than credit or market risk, all of which are now factored into the current haircuts. Further, while the mathematical assumptions underlying VaR may be useful in projecting possible daily trading losses under 'normal' market conditions, VaR may not help firms measure losses that fall outside of normal conditions, such as during steep market declines. Accordingly, the minimum capital requirements provide additional safeguards to account for possible extraordinary losses or decreases in liquidity during times of stress which are not incorporated into VaR calculations.'' *See OTC Derivatives Dealers,* 63 FR 59362.

[63] Paragraph (a)(7) of Rule 15c3–1 currently requires that ANC broker-dealers at all times maintain tentative net capital of not less than $1 billion and net capital of not less than $500 million. 17 CFR 240.15c3–1(a)(7).

[64] *See infra* section V.B.2.a.i. of this release (economic analysis discussion based on year-end 2011 data showing that approximately 270 broker-dealers maintain net capital of $20 million or more).

[65] For example, a broker-dealer that carries customer accounts has a fixed-dollar minimum requirement of $250,000; a broker-dealer that does not carry customer accounts but engages in proprietary securities trading (defined as more than ten trades a year) has a fixed-dollar minimum requirement of $100,000; and a broker-dealer that does not carry accounts for customers or otherwise does not receive or hold securities and cash for customers, and does not engage in proprietary trading activities, has a fixed-dollar minimum requirement of $5,000. *See* 17 CFR 240.15c3–1(a)(2).

[66] *See* 17 CFR 240.3b-12; 17 CFR 240.15a–1. Rule 3b–12, defining the term OTC derivatives dealer, provides, among other things, that an OTC derivatives dealer's securities activities must be limited to: (1) Engaging in dealer activities in eligible OTC derivative instruments (as defined in the rule) that are securities; (2) issuing and reacquiring securities that are issued by the dealer, including warrants on securities, hybrid securities, and structured notes; (3) engaging in cash management securities activities (as defined in Rule 3b–14 (17 CFR 240.3b–14)); (4) engaging in ancillary portfolio management securities activities (as defined in the rule); and (5) engaging in such other securities activities that the Commission designates by order. *See* 17 CFR 240.3b–12. Rule 15a–1, governing the securities activities of OTC derivatives dealers, provides that an OTC derivatives dealer must effect transactions in OTC derivatives with most types of counterparties through an affiliated Commission-registered broker-dealer that is not an OTC derivatives dealer. *See* 17 CFR 240.15a–1.

[67] The proposal is consistent with the CFTC's proposed capital requirements for nonbank swap dealers, which impose $20 million fixed-dollar minimum requirements regardless of whether the firm is approved to use internal models to compute regulatory capital. *See CFTC Capital Proposing Release,* 76 FR 27802.

[68] As discussed above, stand-alone SBSDs would be subject to a minimum ratio amount based on the 8% margin factor. OTC derivatives dealers are not subject to a minimum ratio amount.

[69] OTC derivatives dealers are subject to a $100 million minimum tentative net capital requirement. ANC broker-dealers are currently subject to a $1 billion minimum tentative net capital requirement. The minimum tentative net capital requirements are designed to address risks that may not be captured when using internal models rather than standardized haircuts to compute net capital. *See OTC Derivatives Dealers,* 63 FR at 59384; *Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities; Proposed Rule,* Exchange Act Release No. 48690 (Oct. 24, 2003), 68 FR 62872, 62875 (Nov. 6, 2003) (''We expect that net capital charges will be reduced for broker-dealers that use the proposed alternative net capital computation. The present haircut structure is designed so that firms will have a sufficient capital base to account for, in addition to market and credit risk, other types of risk, such

The proposed 8% margin factor would be part of determining the stand-alone SBSD's minimum net capital requirement. As noted above, the stand-alone SBSD would determine this amount by adding:

- The greater of the total margin required to be delivered by the stand-alone SBSD with respect to security-based swap transactions cleared for security-based swap customers at a clearing agency or the amount of the deductions that would apply to the cleared security-based swap positions of the security-based swap customers pursuant to paragraph (c)(1)(vi) of Rule 18a–1; [70] and
- The total *margin* amount calculated by the stand-alone SBSD with respect to non-cleared security-based swaps pursuant to paragraph (c)(1)(i)(B) of proposed new Rule 18a–3.[71]

The total of these two amounts—*i.e.,* the risk margin amount—would be multiplied by 8% to determine the amount of the 8% margin factor, which, if greater than the $20 million fixed-dollar amount, would be the stand-alone SBSD's minimum net capital requirement.[72] This proposed 8% margin factor ratio requirement is similar to an existing requirement in the CFTC's net capital rule for FCMs.[73] Further, the CFTC has proposed a similar requirement for swap dealers and major swap participants registered as FCMs.[74] Under the CFTC's proposal, an FCM would be required to maintain adjusted net capital that is equal to or greater than 8% of the risk margin required for customer and non-customer exchange-traded futures and swaps positions that are cleared by a derivatives clearing organization (''DCO'').[75] The CFTC's proposed 8% of margin, or risk-based capital rule, ''is intended to require FCMs to maintain a minimum level of capital that is associated with the level of risk associated with the customer positions that the FCM carries.'' [76] Based on Commission staff experience with dually-registered broker-dealer/FCMs, the Commission preliminarily believes that the 8% margin factor would serve as a reasonable measure to ensure that a firm's minimum capital requirement increases or decreases in tandem with the level of risk arising from customer futures transactions. Consequently, the 8% margin factor is being proposed to provide a similar adjustable minimum net capital requirement for nonbank SBSDs with respect to their security-based swap activity.[77]

Under the proposed rule, nonbank SBSDs—including stand-alone SBSDs that are not approved to use internal models to calculate net capital—would be subject to a minimum net capital requirement that increases in tandem with an increase in the risks associated with nonbank SBSD's security-based swap activities.[78] Without the 8% margin factor, the minimum net capital requirement for a nonbank SBSD would be the same (*i.e.,* $20 million) regardless of the volume, size, and risk of its outstanding security-based swap transactions.

The amount computed under the 8% margin factor generally would increase as the stand-alone SBSD increased the volume, size, and risk of its security-based swap transactions. Specifically, the proposed definition of the term *risk margin amount* is designed to link the stand-alone SBSD's minimum net capital requirement to its cleared and non-cleared security-based swap activity. For example, the definition in proposed new Rule 18a–1 provides that, for cleared security-based swaps, the amount is the greater of the margin required to be collected or the amount of the deductions that would apply pursuant to proposed new Rule 18a–1 (*i.e.,* the amount of the deductions using standardized haircuts).[79] The margin requirement for cleared security-based swap positions generally should increase with the volume, size, and risk of the positions as would the amount of the standardized haircuts applicable to the positions. Further, the ''greater of'' provision is designed to ensure that the 8% margin factor requirement is based on, at a minimum, the standardized haircuts as these provide a uniform approach for all cleared security-based

as operational risk, leverage risk, and liquidity risk. Raising the minimum tentative net capital requirement to $1 billion and net capital requirement to $500 million is one way to ensure that firms that use the alternative capital computation maintain sufficient capital reserves to account for these other risks. In addition, based on our experience, firms must have this scale of operations in order to have developed internal risk management control systems necessary to support reliable VaR computations.'').

[70] *See* paragraph (c)(6) of proposed new Rule 18a–1. As discussed below in section II.B. of this release, nonbank SBSDs will be subject to margin requirements imposed by clearing agencies pursuant to which nonbank SBSDs will be required to collect collateral from customers relating to the customers' cleared security-based swap transactions. The amount of collateral required to be collected as a result of customers' cleared security-based swap transactions would be used to determine the first component of the *risk margin amount.* This amount would be added to the second component of the risk margin amount relating to non-cleared security-based swaps and that amount would be multiplied by 8% to determine the 8% margin factor. However, if the margin requirements of the clearing agencies require the stand-alone SBSD to collect total collateral in an amount that is less than the deductions the firm would apply to the customers' cleared security-based swap positions under proposed new Rule 18a–1, the stand-alone SBSD would need to add the amount of the deductions to the second component of the risk margin amount relating to non-cleared security-based swaps and multiply that amount by 8% to determine the 8% margin factor.

[71] *See* paragraph (c)(6) of proposed new Rule 18a–1. As discussed below in section II.B. of this release, proposed new Rule 18a–3 would establish margin requirements for nonbank SBSDs with respect to non-cleared security-based swaps. *See* proposed new Rule 18a–3. The proposed rule would define the term *margin* to mean the amount of *positive equity* in an account of a counterparty. *See* paragraph (b)(5) of proposed new Rule 18a–3. Under the proposed rule, a nonbank SBSD would be required to calculate daily a *margin* amount for the account of each counterparty to a non-cleared security-based swap. *See* paragraph (c)(1)(i)(B) of proposed new Rule 18a–3. These calculations of counterparty *margin* amounts for the purposes of proposed new Rule 18a–3 would be used to determine the component of the *risk margin amount* relating to non-cleared security-based swaps. This amount would be added to the first component relating to cleared security-based swaps, and the total amount would be multiplied by 8% to determine the 8% margin factor.

[72] *See* paragraphs (a)(1) and (c)(6) of proposed new Rule 18a–1.

[73] *See* 17 CFR 1.17(a)(1)(i)(B). *See also Minimum Financial and Related Reporting Requirements for Futures Commission Merchants and Introducing Brokers,* 69 FR 49784 (Aug. 12, 2004). The CFTC proposed the 8% risk margin requirement to establish a margin-based capital computation identical to the margin-based minimum net capital computation that several futures self-regulatory organizations, including one derivatives clearing organization, adopted for their respective member-FCMs. *Id.* at note 16.

[74] *See CFTC Capital Proposing Release,* 76 FR 27802. The 8% risk margin calculation under the CFTC's proposal relates to cleared swaps or futures transactions, whereas the 8% margin factor proposed in new Rule 18a–1 would be based on cleared and non-cleared security-based swaps. As discussed below, the proposed minimum net capital requirement is based on a nonbank SBSD's cleared and non-cleared security-based swap activity in order to account for the risks of both types of positions.

[75] *See CFTC Capital Proposing Release,* 76 FR 27802.

[76] *Id.* at 27807.

[77] As discussed below in section II.A.2.b.iv. of this release, an 8% multiplier is used for purposes of calculating credit risk charges under Appendix E to Rule 15c3–1. While this is a different calculation than the proposed 8% margin factor, using an 8% multiplier for purposes of computing regulatory capital requirements is an international standard. *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428, note 42 (describing the 8% multiplier in Appendix E to Rule 15c3–1 as being ''consistent with the calculation of credit risk in the OTC derivatives dealers rules and with the Basel Standard'' and as being ''designed to dampen leverage to help ensure that the firm maintains a safe level of capital.'').

[78] As discussed below in sections II.A.2.a.ii., II.A.2.a.iii., and II.A.2.a.iv. of this release, the 8% margin factor would be used to compute the minimum net capital requirement for all nonbank SBSDs.

[79] For a stand-alone SBSD approved to use internal models and an ANC broker-dealer, it would be the amount of the deductions determined using a VaR model, except for types of positions for which the firm has not been approved to use a VaR model.

swaps, whereas margin requirements for cleared security-based swaps will vary over time and across different clearing agencies.

As proposed, the 8% margin factor is determined using the greater of required margin or standardized haircuts with respect to cleared security-based swaps *plus* the margin amount for non-cleared security-based swaps calculated under proposed new Rule 18a–3.[80] Thus, the 8% margin factor would be based on a stand-alone SBSD's activity in both cleared and non-cleared security-based swaps. As noted above, the goal of the provision is to require the stand-alone SBSD to increase its net capital in tandem with an increase in the risk of its security-based swap transactions. The proposal does not limit the computation to only cleared security-based swaps, as proposed by the CFTC, because such a limitation would allow the stand-alone SBSD to increase the amount of its non-cleared security-based swaps positions without a corresponding increase in net capital. This could create greater risk to the stand-alone SBSD's customers because—as discussed above—their ability to collect amounts owing on security-based swaps depends on the ability of the stand-alone SBSD to meets its obligations.

Request for Comment

The Commission generally requests comment on the proposed minimum net capital requirements in proposed new Rule 18a–1 for stand-alone SBSDs that are not approved to use internal models to compute net capital. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed $20 million minimum net capital requirement for stand-alone SBSDs not using internal models appropriate? If not, explain why not. What minimum amount would be more appropriate? For example, should the minimum fixed-dollar amount be greater than $20 million to account for the broader range of activities that stand-alone SBSDs will be able to engage in as compared with OTC derivatives dealers? If so, explain why. If it should be a greater amount, how much greater should it be (*e.g.,* $30 million, $50 million, $100 million, or some other amount)? Alternatively, should the minimum fixed-dollar amount be less than $20 million because these firms will not be using internal models to compute net capital? If so, explain why. If it should be a lower amount, how much lower (*e.g.,* $15 million, $10 million, $5 million, or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be more appropriate for broker-dealer SBSDs that are not approved to use internal models.

2. Is the proposed definition of *risk margin amount* appropriate? If not, explain why and suggest modifications to the definition. For example, are there modifications that could make the definition more accurately reflect the nonbank SBSD's risk exposure from dealing in security-based swaps? If so, describe the modifications and explain why they would achieve this result.

3. Is the component of the *risk margin amount* definition addressing margin delivered for cleared swaps appropriate? If not, explain why not. Would the definition be more appropriate if this component was dropped so that the first prong of the definition only incorporated the haircuts for cleared security-based swaps?

4. Should the proposed definition of *risk margin amount* only address cleared security-based swaps, consistent with the CFTC's proposal? If so, explain why, including how the risk of non-cleared security-based swap activities could be addressed through other measures.

5. Is the component of the *risk margin amount* definition addressing margin collected for non-cleared security-based swaps appropriate? If not, explain why not.

6. Is the 8% margin factor an appropriate metric for determining a nonbank SBSD's minimum net capital requirement in terms of increasing a nonbank SBSD's minimum net capital requirement as the risk of its security-based swap activities increases? If not, explain why not. For example, should the percentage be greater than 8% (*e.g.,* 10%, 12%, or some other percentage)? If so, identify the percentage and explain why it would be preferable. Should the percentage be less than 8% (*e.g.,* 6%, 4%, or some other percentage)? If so, identify the percentage and explain why it would be preferable.

7. Should the 8% multiplier be tiered as the amount of the risk margin amount increases? If so, explain why. For example, should the multiplier decrease from 8% to 6% for the amount of the risk margin amount that exceeds a certain threshold, such as $1 billion or $5 billion? If so, explain why. Should the amount of the multiplier increase from 8% to 10% for the amount of the risk margin amount that exceeds a certain threshold such as $1 billion or $5 billion? If so, explain why.

8. Should the 8% margin factor be an adjustable ratio (*e.g.,* increase to 10% or decrease to 6%)? For example, should the multiplier adjust periodically if certain conditions occur? If so, explain the conditions under which the 8% multiplier would adjust upward or downward and why having an adjustable ratio would be appropriate.

9. Would the 8% margin factor be a sufficient minimum net capital requirement without the $20 million fixed-dollar minimum? If so, explain why.

10. Are there metrics other than a fixed-dollar minimum and the 8% margin factor for calculating required minimum capital that would more appropriately reflect the risk of nonbank SBSDs? If so, identify them and explain why they would be preferable. For example, instead of an absolute fixed-dollar minimum, should the minimum net capital requirement be linked to a scalable metric such as the size of the nonbank SBSD or the amount of the deductions taken by the nonbank SBSD when computing net capital? For any scalable minimum net capital requirements identified, explain how the computation would work in practice and how the minimum requirement would address the same objectives of a fixed-dollar minimum.

11. Would the 8% margin factor address the risk of extremely large nonbank SBSDs? If not, explain why not. For example, if the customer margin requirements for cleared and non-cleared security-based swaps carried by the nonbank SBSD were low because the positions were hedged or otherwise not high risk, the 8% margin

[80] Proposed new Rule 18a–3 would require a nonbank SBSD to calculate daily a margin amount for the account of each counterparty to a non-cleared security-based swap. *See* paragraph (c)(1)(i)(B) of proposed new Rule 18a–3. As discussed below in section II.B. of this release, a nonbank SBSD would be required to perform this calculation even though proposed new Rule 18a–3 would not require the nonbank SBSD to collect collateral from all counterparties to collateralize the margin amount. For example, the Commission is proposing that collateral need not be collected from *commercial end users.* Nonetheless, the calculation of the *margin* amount for purposes of proposed new Rule 18a–3 would determine the non-cleared security-based swap component of the *risk margin amount* regardless of whether the nonbank SBSD would be required to collect collateral from the counterparty to collateralize the margin amount. In other words, the amount of the *risk margin amount* would be based on the calculation required by proposed new Rule 18a–3 for all counterparties to non-cleared security-based swaps and not on whether the stand-alone SBSD would be required to collect collateral from a counterparty to collateralize the *margin* amount. As discussed in section II.B. of this release, this is designed to ensure that the *risk margin amount* is based on all non-cleared security-based swap activity of the stand-alone SBSD and not just on security-based swap activity that would require the firm to collect collateral.

factor may not increase in tandem with the level of the nonbank SBSD's security-based swap activity. In this case, would the 8% margin factor adequately address the risk of the nonbank SBSD, particularly if it carried substantial security-based swap positions? If not, explain why not. Would the 8% margin factor be necessary for small nonbank SBSDs? If not, explain why not.

12. Would the 8% margin factor provide an appropriate and workable restraint on the amount of leverage incurred by stand-alone SBSDs not using internal models because the amount of minimum net capital would increase as the risk margin amount increases? If not, explain why not. Is there another measure that would more accurately and effectively address the leverage risk of these firms? If so, identify the measure and explain why it would be more accurate and effective.

13. Should the 8% margin factor be applied to margin related to cleared and non-cleared swap transactions in addition to security-based swap transactions? For example, the provision could require that 8% of the margin required for cleared and non-cleared swaps be added to the 8% of margin required for cleared and non-cleared security-based swaps in determining the minimum net capital requirement. Would this be a workable approach to address the fact that the CFTC's proposed 8% margin requirement would not apply to swap dealers that are not registered as FCMs and, with respect to dually-registered FCM swap dealers, it would apply only to cleared swaps? Including swaps in the 8% margin factor calculation would provide for equal treatment of security-based swaps and swaps in determining a minimum net capital requirement. Would this be a workable approach? If so, explain why. If not, explain why not.

14. Would the 8% margin factor be practical as applied to a portfolio margin account that contains security-based swaps and swaps? If so, explain why. If not, explain why not.

15. What will be the practical impacts of the 8% margin factor? For example, what will be the effect on transaction costs, liquidity in security-based swaps, availability of capital to support security-based swap transactions generally and/or for non-security-based swap-related uses, use of security-based swaps for hedging purposes, risk management at SBSDs, the costs for potential new SBSDs to participate in the security-based swap markets, etc.? How would these impacts increase or decrease if the 8% margin factor were set at a higher or lower percentage?

ii. Broker-Dealer SBSDs Not Using Internal Models

A broker-dealer that registers as an SBSD would continue to be subject to the capital requirements in Rule 15c3–1, as proposed to be amended to account for security-based swap activities. Proposed amendments to paragraph (a) of Rule 15c3–1 would establish minimum net capital requirements for a broker-dealer SBSD that is not approved to use internal models to compute net capital.[81] Under these proposed amendments, the broker-dealer SBSD would be subject to the same $20 million fixed-dollar minimum net capital requirement as a stand-alone SBSD that does not use internal models.[82] As discussed above in section II.A.2.a.i. of this release, the proposed $20 million fixed-dollar minimum would be consistent with the current fixed-dollar minimum that applies to OTC derivatives dealers, which has been used as a minimum capital standard for OTC derivative dealers for over a decade.

In addition, a broker-dealer SBSD that does not use internal models would be required to use the 8% margin factor to compute its minimum net capital amount. As discussed above in section II.A.2.a.i. of this release, the 8% margin factor is designed to adjust the broker-dealer SBSD's minimum net capital requirement in tandem with the risk associated with the broker-dealer SBSD's security-based swap activity. Without the 8% margin factor, the minimum net capital requirement for a broker-dealer SBSD would be the same (*i.e.,* $20 million) regardless of the number, size, and risk of its outstanding security-based swap transactions. Consequently, the proposed rule would include the 8% margin factor in order to increase the broker-dealer SBSD's net capital requirement as the risk of its security-based swap activities increases.

Moreover, the broker-dealer SBSD—as a broker-dealer—would be subject to the existing financial ratio requirements in Rule 15c3–1 and, therefore, would need to include the applicable financial ratio amount when determining the firm's minimum net capital requirement.[83] A broker-dealer's minimum net capital requirement is the greater of the applicable fixed-dollar amount and one of two alternative financial ratios. The first financial ratio requirement provides that a broker-dealer must not permit its aggregate indebtedness to all other persons to exceed 1500% of its net capital (*i.e.,* a 15-to-1 aggregate indebtedness to net capital requirement).[84] This is the default financial ratio requirement that all broker-dealers must apply unless they affirmatively elect to be subject to the second financial ratio requirement by notifying their designated examining authority of the election.[85] The second financial ratio requirement provides that a broker-dealer must not permit its net capital to be less than 2% of aggregate debit items (*i.e.,* customer-related obligations to the broker-dealer).[86]

The proposed amendments to Rule 15c3–1 would provide that a broker-dealer SBSD that is not approved to use internal models would be required to maintain a minimum net capital level of not less than the greater of: (1) $20 million or (2) the financial ratio amount required pursuant to paragraph (a)(1) of Rule 15c3–1 *plus* the 8% margin factor.[87] Thus, the proposed minimum net capital requirement for a broker-dealer SBSD would incorporate the requirement in Rule 15c3–1 that a broker-dealer maintain the greater of a fixed-dollar amount or one of the two financial ratio amounts, as applicable.[88] The financial ratio requirements in Rule 15c3–1 are designed to link the broker-dealer's minimum net capital requirement to the level of its securities activities. For example, the aggregate debit ratio requirement is designed for broker-dealers that carry customer securities and cash.[89] This provision increases the minimum net capital requirement for these broker-dealers as they increase their debit items by engaging in margin lending and facilitating of customer short-sale

[81] *See* proposed new paragraph (a)(10) of Rule 15c3–1.

[82] *Id.*

[83] *See* 17 CFR 240.15c3–1(a)(1); proposed new paragraph (a)(10)(i) of Rule 15c3–1. Currently, all broker-dealers, including the ANC broker-dealers, are subject either to the aggregate indebtedness standard or the aggregate debit items (alternative standard) financial ratio requirements.

[84] *See* 17 CFR 240.15c3–1(a)(1)(i). Stated another way, the broker-dealer must maintain, at a minimum, an amount of net capital equal to 1/15th (or 6.67%) of its aggregate indebtedness. This financial ratio generally is used by smaller broker-dealers that do not hold customer securities and cash.

[85] *See* 17 CFR 240.15c3–1(a)(1)(i)–(ii).

[86] *See* 17 CFR 240.15c3–1(a)(1)(ii). Customer debit items—computed pursuant to Rule 15c3–3—consist of, among other things, margin loans to customers and securities borrowed by the broker-dealer to effectuate deliveries of securities sold short by customers. *See* 17 CFR 240.15c3–3; 17 CFR 240.15c3–3a. This ratio generally is used by larger broker-dealers that hold customer securities and cash.

[87] *See* proposed new paragraph (a)(10)(i) of Rule 15c3–1.

[88] *Id.*

[89] *See Net Capital Requirements for Brokers and Dealers,* Exchange Act Release No. 17208 (Oct. 9, 1980), 45 FR 69915 (Oct. 22, 1980).

transactions.[90] The proposal to combine the Rule 15c3–1 financial ratios with the 8% margin factor in a broker-dealer SBSD's computation of its minimum net capital requirement is designed to require the broker-dealer SBSD to maintain a capital cushion to support its traditional securities activities (*e.g.,* margin lending) and its security-based swap activities.

Request for Comment

The Commission generally requests comment on the proposed minimum net capital requirements for broker-dealer SBSDs that are not approved to use internal models. Commenters are referred to the general questions above in section II.A.2.a.i. of this release about the 8% margin factor as applied broadly to nonbank SBSDs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed $20 million minimum net capital requirement appropriate for broker-dealer SBSDs that are not approved to use internal models? If not, explain why not. What minimum amount would be more appropriate? For example, should the minimum fixed-dollar amount be greater than $20 million to account for the broader range of activities that broker-dealer SBSDs will be able to engage in (*e.g.,* traditional securities activities such as margin lending), as compared with stand-alone SBSDs and OTC derivatives dealers? If it should be a greater amount, how much greater should it be (*e.g.,* $30 million, $50 million, $100 million, or some other amount)? Alternatively, should the minimum fixed-dollar amount be less than $20 million because these firms will not be using internal models to compute net capital? If it should be a lower amount, how much lower (*e.g.,* $15 million, $10 million, $5 million or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be preferable for broker-dealer SBSDs that are not approved to use internal models.

2. Is combining the 8% margin factor requirement with the applicable Rule 15c3–1 financial ratio requirement an appropriate way to determine a minimum net capital requirement for broker-dealer SBSDs that are not approved to use internal models? If not, explain why not.

3. Would the 8% margin factor combined with the Rule 15c3–1 financial ratio provide an appropriate and workable restraint on the amount of leverage incurred by broker-dealer SBSDs not using internal models? If not, explain why not. Is there another measure that would more accurately and effectively address the leverage risk of these firms? If so, identify the measure and explain why it would be more accurate and effective.

iii. Stand-Alone SBSDs Using Internal Models

As discussed above, a stand-alone SBSD would be subject to the capital requirements in proposed new Rule 18a–1.[91] Rule 18a–1 would permit stand-alone SBSDs to apply to use internal models to compute net capital.[92] In terms of minimum capital requirements, a stand-alone SBSD that has been approved to use internal models would be required to maintain: (1) a minimum tentative net capital level of not less than $100 million; and (2) a minimum net capital level of not less than the greater of $20 million or the 8% margin factor.[93] The proposed minimum net capital requirement for stand-alone SBSDs using internal models (*i.e.,* the greater of $20 million or the 8% margin factor) is the same as the proposed minimum net capital requirement for stand-alone SBSDs and broker-dealer SBSDs not using internal models (though the latter would need to incorporate the Rule 15c3–1 financial ratio requirement into their minimum net capital computations).

A stand-alone SBSD approved to use internal models also would be subject to a minimum tentative net capital requirement of $100 million.[94] This proposed minimum tentative net capital requirement would be consistent with the current minimum tentative net capital requirement applicable to OTC derivatives dealers.[95] A minimum tentative net capital requirement is designed to operate as a prudential control on the use of internal models for regulatory capital purposes.[96] Tentative net capital is the amount of net capital maintained by a broker-dealer before applying the standardized haircuts or using internal models to determine deductions on the mark-to-market value of proprietary positions to arrive at the broker-dealer's amount of net capital.[97] OTC derivatives dealers, therefore, compute tentative net capital before using internal VaR models to take the market risk deductions. The minimum tentative net capital requirement is designed to account for the fact that VaR models, while more risk sensitive than standardized haircuts, tend to substantially reduce the amount of the deductions to tentative net capital in comparison to the standardized haircuts because the models recognize more offsets between related positions (*i.e.,* positions that show historical correlations) than the standardized haircuts.[98] In addition, VaR models may

[90] *See* 17 CFR 240.15c3–1(a)(1)(ii); 17 CFR 240.15c3–3a.

[91] *See* proposed new Rule 18a–1.

[92] *See* paragraphs (a)(2) and (d) of proposed new Rule 18a–1; the discussion below in section II.A.2.b.iii. of this release.

[93] *See* paragraph (a)(2) of proposed Rule 18a–1. As discussed above in section II.A.2.a.i. of this release, the 8% margin factor is designed to adjust the stand-alone SBSD's minimum net capital requirement in tandem with the risk associated with the broker-dealer firm's security-based swap activity.

[94] *See* paragraph (a)(2) of proposed new Rule 18a–1.

[95] Both ANC broker-dealers and OTC derivatives dealers—entities that use internal models—are subject to a minimum tentative net capital requirement. *See* 17 CFR 240.15c3–1(a)(5) and (a)(7).

[96] *OTC Derivatives Dealers,* 63 FR at 59384 (''The final rule contains the minimum requirements of $100 million in tentative net capital and $20 million in net capital. The minimum tentative net capital and net capital requirements are necessary to ensure against excessive leverage and risks other than credit or market risk, all of which are now factored into the current haircuts. Further, while the mathematical assumptions underlying VaR may be useful in projecting possible daily trading losses under 'normal' market conditions, VaR may not help firms measure losses that fall outside of normal conditions, such as during steep market declines. Accordingly, the minimum capital requirements provide additional safeguards to account for possible extraordinary losses or decreases in liquidity during times of stress which are not incorporated into VaR calculations.''). *See also Alternative Net Capital Requirements Adopting Release,* 69 FR at 34431 (''The current haircut structure [use of the standardized haircuts] seeks to ensure that broker-dealers maintain a sufficient capital base to account for operational, leverage, and liquidity risk, in addition to market and credit risk. We expect that use of the alternative net capital computation [internal models] will reduce deductions for market and credit risk substantially for broker-dealers that use that method. Moreover, inclusion in net capital of unsecured receivables and securities that do not have a ready market under the current net capital rule will reduce the liquidity standards of Rule 15c3–1. Thus, the alternative method of computing net capital and, in particular, its requirements that broker-dealers using the alternative method of computing [*sic*] maintain minimum tentative net capital of at least $1 billion, maintain net capital of at least $500 million, notify the Commission that same day if their tentative net capital falls below $5 billion, and comply with Rule 15c3–4 are intended to provide broker-dealers with sufficient capital reserves to account for market, credit, operational, and other risks.'') (Text in brackets added).

[97] *See* 17 CFR 240.15c3–1(c)(10).

[98] *See OTC Derivatives Dealers,* 63 FR 53962. *See Net Capital Rule,* Exchange Act Release No. 39456 (Dec. 17, 1997), 62 FR 68011 (Dec. 30, 1997) (concept release considering the extent to which statistical models should be used in setting the capital requirements for a broker-dealer's proprietary positions) (''For example, the current method of calculating net capital by deducting fixed percentages from the market value of securities can allow only limited types of hedges without becoming unreasonably complicated. Accordingly, the net capital rule recognizes only certain specified hedging activities, and the Rule does not account

not capture all risks and, therefore, having a minimum tentative net capital requirement (*i.e.,* one that is not derived using the VaR model) is designed to require that capital be sufficient to withstand events that the model may not take into account (*e.g.,* extraordinary losses or decreases in liquidity during times of stress that are not incorporated into VaR calculations).[99] Consequently, the proposed $100 million minimum tentative net capital requirement is designed to provide a sufficient liquid capital cushion for stand-alone SBSDs that use models, just as it has done in practice for entities registered as OTC derivatives dealers.[100]

Request for Comment

The Commission generally requests comment on the proposed capital requirements for stand-alone SBSDs using internal models. Commenters are referred to the general questions above in section II.A.2.a.i. of this release about the 8% margin factor as applied broadly to nonbank SBSDs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed minimum net capital requirement of $20 million appropriate for stand-alone SBSDs that are approved to use internal models, in comparison to OTC derivatives dealers which are more limited by the activities they are permitted to conduct (such as being prohibited from effecting transactions with customers)? If not, explain why not. What minimum amount would be more appropriate? For example, should the minimum fixed-dollar amount be greater than $20 million to account for the use of internal models? If it should be a greater amount, how much greater should it be (*e.g.,* $30 million, $50 million, $100 million, or some other amount)? Alternatively, should the minimum fixed-dollar amount be less than $20 million? If it should be a lower amount, how much lower (*e.g.,* $15 million, $10 million, $5 million or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be more appropriate for stand-alone SBSDs that are approved to use internal models.

2. Is it necessary to impose a minimum tentative net capital requirement for stand-alone SBSDs using internal models to capture additional risks not incorporated into VaR models (consistent with those tentative minimum met capital requirements imposed on OTC derivatives dealers)? If not, why not?

3. Is the proposed amount of the minimum tentative net capital level of $100 million for stand-alone SBSDs using internal models appropriate? If not, explain why not. For example, should the minimum tentative net capital amount be greater than $100 million to account for the use of internal models? If it should be a greater amount, how much greater should it be (*e.g.,* $150 million, $200 million, $250 million, or some other amount)? Should it be a lesser amount (*e.g.,* $75 million, $50 million, or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be more appropriate for stand-alone SBSDs that are approved to use internal models.

4. Are there metrics other than a fixed-dollar minimum tentative net capital requirement that would more appropriately reflect the risk of nonbank SBSDs? If so, identify them and explain why they would be preferable. For example, instead of an absolute fixed-dollar minimum tentative net capital requirement, should the minimum tentative net capital requirement be linked to a scalable metric such as the size of a nonbank SBSD? For any scalable minimum tentative net capital requirements identified, explain how the computation would work in practice and how the minimum requirement would address the same objectives of a fixed-dollar minimum. Would the 8% margin factor provide an appropriate and workable restraint on the amount of leverage incurred by stand-alone SBSDs that are approved to use internal models? Is there another measure that would more accurately and effectively address the leverage risk of these firms? If so, identify the measure and explain why it would be more accurate and effective.

iv. Broker-Dealer SBSDs Using Internal Models and ANC Broker-Dealers

Under the current requirements of Rule 15c3–1, a broker-dealer that seeks to use internal models to compute net capital must apply to the Commission to become an ANC broker-dealer.[101] If the application is granted, the ANC broker-dealer is able to take less than 100% deductions for unsecured receivables from OTC derivatives counterparties (non-ANC broker-dealers must deduct these receivables in full) and can use VaR models in lieu of the standardized haircuts to take deductions on their proprietary positions in securities and money market instruments to the extent the firm has been approved to use an internal model for the type of position.[102] It is expected that some broker-dealer SBSDs would seek to use internal models to compute net capital—as have some broker-dealers—by applying to become ANC broker-dealers. Broker-dealer SBSDs using internal models would be subject to the existing provisions and proposed amendments to those provisions currently applicable to ANC broker-dealers.

Under the proposed amendments, the current net capital requirements for ANC broker-dealers in Rule 15c3–1 would be enhanced to account for the firms' large size, the scale of their custodial activities, and the potential that they may become substantially more active in the security-based swap markets under the Dodd-Frank Act's OTC derivatives reforms. As discussed in more detail below, the proposed enhancements would include increasing the minimum tentative net capital and minimum net capital requirements; increasing the ''early warning'' notice threshold; narrowing the types of unsecured receivables for which ANC broker-dealers may take a credit risk charge in lieu of a 100% deduction; and requiring ANC broker-dealers to comply with a new liquidity requirement.[103]

Currently, an ANC broker-dealer must maintain minimum tentative net capital of at least $1 billion and minimum net capital of at least $500 million.[104] In addition, an ANC broker-dealer must provide the Commission with an ''early warning'' notice when its tentative net capital falls below $5 billion.[105] These relatively high minimum capital requirements (as compared with the requirements for other types of broker-

for historical correlations between foreign securities and U.S. securities or between equity securities and debt securities. By failing to recognize offsets from these correlations between and within asset classes, the fixed percentage haircut method may cause firms with large, diverse portfolios to reserve capital that actually overcompensates for market risk.'' *Id.* ''The primary advantage of incorporating models into the net capital rule is that a firm would be able to recognize, to a greater extent, the correlations and hedges in its securities portfolio and have a comparatively smaller capital charge for market risk.'').

[99] *See OTC Derivatives Dealers,* 63 FR 59362; *Alternative Net Capital Requirements Adopting Release,* 69 FR 34428. Further, the deductions to tentative net capital taken by nonbank SBSDs and broker-dealers are intended to create a pool of new liquid assets that can be used for any risk assumed by the firm and not only market risk. A tentative net capital requirement also serves as a capital buffer for these other risks to offset the narrower type of risk intended to be covered by calculating net capital using internal models.

[100] *OTC Derivatives Dealers,* 63 FR 59362.

[101] *See* 17 CFR 240.15c3–1e.

[102] *Id.*

[103] *See* proposed amendments to 17 CFR 240.15c3–1; 17 CFR 240.15c3–1e.

[104] *See* 17 CFR 240.15c3–1(a)(7)(i).

[105] *See* 17 CFR 240.15c3–1(a)(7)(ii).

dealers) reflect the substantial and diverse range of business activities engaged in by ANC broker-dealers and their importance as intermediaries in the securities markets.[106] Further, the heightened capital requirements reflect the fact that, as noted above, VaR models are more risk sensitive but also may not capture all risks and generally permit substantially reduced deductions to tentative net capital as compared to the standardized haircuts.[107]

The proposals to strengthen the requirements for ANC broker-dealers are made in response to issues that arose during the 2008 financial crisis, recognizing the large size of these firms, and the scale of their custodial responsibilities. The proposals also are based on the Commission staff's experience supervising the ANC broker-dealers. The financial crisis demonstrated the risks to financial firms when market conditions are stressed and how the failure of a large firm can accelerate the further deterioration of market conditions.[108] The proposals are designed to bolster the ANC broker-dealer net capital rules to ensure that these firms continue to maintain sufficient capital reserves to account for market, credit, operational, and other risks.[109] While the rationale for these enhancements exists irrespective of whether the ANC broker-dealers ultimately register as SBSDs, the proposed increased capital requirements also are designed to account for increased security-based swap activities by these firms. FOCUS Report data and the Commission staff's supervision of the ANC broker-dealers indicate that these firms currently do not engage in a substantial business in security-based swaps.[110] It is expected, however, that they may increase their security-based swap activities after the Dodd-Frank Act's OTC derivatives reforms are implemented and become effective because security-based swap activities will need to be conducted in regulated entities.[111] Consequently, financial institutions that currently deal in security-based swaps will need to register as an SBSD or register one or more affiliates as an SBSD. To the extent they want to offer securities products and services beyond those related to security-based swaps, they also will need to be registered as broker-dealers. Using an existing broker-dealer—particularly an ANC broker-dealer that already is capitalized and has risk management systems and personnel in place—could provide efficiencies that create incentives to register the same entity as a nonbank SBSD.

Under the proposed amendments to Rule 15c3–1, ANC broker-dealers would be required to maintain: (1) Tentative net capital of not less than $5 billion; and (2) net capital of not less than the greater of $1 billion or the financial ratio amount required pursuant to paragraph (a)(1) of Rule 15c3–1 *plus* the 8% margin factor.[112] FOCUS Report data indicates that the six current ANC broker-dealers report capital levels in excess of these proposed increased minimum requirements. While raising the tentative net capital requirement under Rule 15c3–1 from $1 billion to $5 billion would be a significant increase, the existing ''early warning'' notice requirement for ANC broker-dealers is $5 billion.[113] This $5 billion ''early warning'' threshold acts as a *de facto* minimum tentative net capital requirement since ANC broker-dealers seek to maintain sufficient levels of tentative net capital to avoid the necessity of providing this regulatory notice. Accordingly, the objective in raising the minimum capital requirements for ANC broker-dealers is not to require the six existing ANC broker-dealers to increase their current capital levels (as they already maintain tentative net capital in excess of $5 billion).[114] Rather, the goal is to establish new higher minimum requirements designed to ensure that the ANC broker-dealers continue to maintain high capital levels and that any new ANC broker-dealer entrants maintain capital levels commensurate with their peers.

As indicated above, the proposed amendments to Rule 15c3–1 would require an ANC broker-dealer to incorporate the 8% margin factor into its net capital calculation.[115] Consequently, an ANC broker-dealer would be required at all times to maintain tentative net capital of not less than $5 billion and net capital of not less than the greater of $1 billion or the sum of the ratio requirement under paragraph (a)(1) of Rule 15c3–1 and eight percent (8%) of the risk margin amount for security-based swaps carried by the ANC broker-dealer.[116]

Under the proposal, an ANC broker-dealer would be required to provide early warning notification to the Commission if its tentative net capital fell below $6 billion.[117] The purpose of an ''early warning'' notice requirement is to require a broker-dealer to provide notice when its level of regulatory capital falls to a level that approaches its required minimum capital requirement but is sufficiently above the minimum that the Commission and SROs can increase their monitoring of the firm before the minimum is breached. The proposed increase in the minimum tentative net capital requirement to $5 billion necessitates a corresponding increase in the ''early warning'' threshold to an amount above $5 billion. Existing early warning thresholds for OTC derivatives dealers include a requirement to provide notice when the firm's tentative net capital falls below an amount that is 120% of the firm's required minimum tentative net capital amount.[118] The proposed new ''early warning'' threshold for ANC broker-dealers of $6 billion in tentative net capital is modeled on this requirement and is equal in percentage terms (120%) to the amount that the early warning level exceeds the minimum tentative net capital

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[106] For example, based on data from broker-dealer FOCUS Reports, the six ANC broker-dealers collectively hold in excess of one trillion dollars' worth of customer securities. Under Rule 17a–5 (17 CFR 240.17a–5), broker-dealers must file periodic reports on Form X–17A–5 (Financial and Operational Combined Uniform Single Reports, ''FOCUS Reports''). Unless an exception applies, the Commission's rules deem all reports filed under Rule 17a–5 confidential. 17 CFR 240.17a–5(a)(3). The FOCUS Report requires, among other financial information, a balance sheet, income statement, and net capital and customer reserve computations. The FOCUS Report data used in this release is year-end 2011 FOCUS Report data.

[107] *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[108] *See, e.g., World Economic Outlook: Crisis and Recovery,* International Monetary Fund (''IMF'') (Apr. 2009), available at *http://www.imf.org/external/pubs/ft/weo/2009/01/pdf/text.pdf.*

[109] *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[110] The ANC broker-dealers are subject to ongoing Commission staff supervision, which includes monthly meetings with senior staff of the ANC broker-dealers. This supervision program provides the Commission with information about the current practices of the ANC broker-dealers.

[111] This expectation is based on information gathered as part of the ANC broker-dealer supervision program.

[112] *See* proposed amendments to paragraph (a)(7)(i) of Rule 15c3–1.

[113] *See* 17 CFR 240.15c3–1(a)(7)(i).

[114] The ANC broker-dealers report to the Commission staff, as part of the ANC broker-dealer supervision program, levels of tentative net capital that generally are well in excess of $6 billion, which, as discussed below, is the proposed new ''early warning'' threshold for ANC broker-dealers.

[115] *See* proposed amendments to paragraph (a)(7)(i) of Rule 15c3–1. As discussed above in section II.A.2.a.i. of this release, the 8% margin factor is designed to adjust the firm's minimum net capital requirement in tandem with the risk associated with the broker-dealer firm's security-based swap activity.

[116] *See* proposed amendments to paragraph (a)(7)(i) of Rule 15c3–1.

[117] *See* proposed amendments to paragraph (a)(7)(ii) of Rule 15c3–1. As noted above, the ANC broker-dealers report to the Commission staff tentative net capital levels that generally are well in excess of $6 billion.

[118] *See* 17 CFR 240.17a–11(c)(3).

requirement for OTC derivatives dealers.

The rules applicable to ANC broker-dealers provide that the Commission may impose additional conditions on an ANC broker-dealer under certain circumstances.[119] In particular, paragraph (e) of Appendix E to Rule 15c3–1 establishes a non-exclusive list of circumstances under which the Commission may restrict the business of an ANC broker-dealer, including when the firm's tentative net capital falls below the early warning threshold.[120] In this event, the Commission—if it finds it is necessary or appropriate in the public interest or for the protection of investors—may impose additional conditions on the firm, including requiring the firm to submit to the Commission a plan to increase its tentative net capital (to an amount above the early warning level).[121] Additional restrictions could include restricting the ANC broker-dealer's business on a product-specific, category-specific, or general basis; requiring the firm to file more frequent reports with the Commission; modifying the firm's internal risk management controls or procedures; requiring the firm to compute deductions for market and credit risk using standardized haircuts; or imposing any other additional conditions, if the Commission finds that imposition of other conditions is necessary or appropriate in the public interest or for the protection of investors.[122]

Request for Comment

The Commission generally requests comment on the proposed minimum capital requirements for ANC broker-dealers. Commenters are referred to the general questions above in section II.A.2.a.i. of this release about the 8% margin factor as applied broadly to nonbank SBSDs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed increased minimum net capital requirement from $500 million to $1 billion for ANC broker-dealers appropriate? If not, explain why not. What minimum amount would be preferable? For example, should the minimum fixed-dollar amount be greater than $1 billion to account for the large size of these firms and the scale of their custodial activities? If so, explain why. If it should be a greater amount, how much greater should it be (*e.g.,* $1.5 billion, $2 billion, $3 billion, or some other amount)? Alternatively, should the minimum fixed-dollar amount be less than $1 billion? If so, explain why. If it should be a lower amount, how much lower (*e.g.,* $950 million, $900 million, $850 million, $800 million, $750 million, or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be preferable.

2. Is the proposed increase in the minimum tentative net capital level for ANC broker-dealers appropriate? If not, explain why not. For example, should the minimum tentative net capital amount be greater than $5 billion to account for the use of internal models and the large size of these firms and the scale of their custodial activities? If it should be a greater amount, how much greater should it be (*e.g.,* $6 billion, $8 billion, $10 billion, or some other amount)? Should it be lesser amount (*e.g.,* $4 billion, $3 billion, $2 billion or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be preferable.

3. Is the proposed increase in the early warning threshold from $5 billion to $6 billion for ANC broker-dealers appropriate? If not, explain why not. For example, should the minimum tentative net capital amount be greater than $6 billion, given that the current early warning threshold ($5 billion) is five times the current tentative net capital requirement ($1 billion)? If the early warning level should be a greater amount, how much greater should it be (*e.g.,* $8 billion, $10 billion, $12 billion, $20 billion, $25 billion, or some other amount)? Should it be lesser amount (*e.g.,* $5.8 billion, 5.5 billion, or some other amount)? If a greater or lesser alternative amount is recommended, explain why it would be preferable.

4. Is it appropriate to require broker-dealer SBSDs to become ANC broker-dealers in order to use internal models? For example, would it be appropriate to permit broker-dealer SBSDs to use internal models but subject them to lesser minimum capital requirements than the ANC broker-dealers? If so, explain why. In addition, provide suggested alternative minimum capital requirements.

5. Is combining the 8% margin factor requirement with the applicable Rule 15c3–1 financial ratio requirement an appropriate way to determine a minimum net capital requirement for ANC broker-dealers? If not, explain why not.

6. Would the 8% margin factor provide an appropriate and workable restraint on the amount of leverage incurred by ANC broker-dealers? If not, explain why not. Is there another measure that would more accurately and effectively address the leverage risk of these firms? If so, identify the measure and explain why it would be more accurate and effective.

Additional Request for Comment on VaR-Based Capital Charges

On June 7, 2012, the OCC, the FDIC, and the Federal Reserve (collectively, the ''Banking Agencies'') approved a joint final rule (''Final Rule'') regarding market risk capital rules.[123] Certain portions of the Final Rule relate to the use of financial models for regulatory capital purposes. Generally, the Banking Agencies stated that the Final Rule is designed to ''better capture positions for which the market risk capital rules are appropriate; to reduce procyclicality; enhance the rules' sensitivity to risks that are not adequately captured under current methodologies; and increase transparency through enhanced disclosures.'' The effective date for the Final Rule is January 1, 2013.

Under the Final Rule, the capital charge for market risk is the sum of: (1) Its VaR-based capital requirement; (2) its stressed VaR-based capital requirement; (3) any specific risk add-ons; (4) any incremental risk capital requirement; (5) any comprehensive risk capital requirement; and (6) any capital requirement for *de minimis* exposures. Generally, the qualitative and quantitative requirements for the Banking Agencies' VaR-based capital requirement are similar to the VaR-based capital requirements for ANC broker-dealers, OTC derivatives dealers, and, as proposed, for nonbank SBSDs approved to use internal models.

The Banking Agencies' stressed VaR-based capital requirement is a new requirement that banks calculate a VaR measure with model inputs calibrated to reflect historical data from a continuous 12-month period that reflects a period of significant financial stress appropriate to the bank's current portfolio. The stressed VaR requirement is designed to address concerns that the Banking Agencies' existing VaR-based measure, due to inherent limitations, proved inadequate in producing capital requirements appropriate to the level of losses incurred at many banks during the financial crisis and to mitigate

[119] *See* 17 CFR 240.15c3–1e(e)(1).

[120] *Id.*

[121] *Id. See also Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[122] *See* 17 CFR 240.15c3–1e(e).

[123] *Risk Based Capital Guidelines: Market Risk,* Federal Reserve, FDIC, OCC, 77 FR 53059 (Aug. 30, 2012).

procyclicality in the existing market risk capital requirement for banks.

The Final Rule also specifies modeling standards for specific risk and eliminates the current option for a bank to model some but not all material aspects of specific risk for an individual portfolio of debt or equity positions. To address concerns about the ability to model specific risk of securitization products, the Final Rule would require a bank to calculate an additional capital charge ''add-on'' for certain securitization positions that are not correlation trading positions.

Further, under the Final Rule, a bank that measures the specific risk of a portfolio of debt positions using internal models is required to calculate an incremental risk measure for those positions using an internal model (an incremental risk model). Generally, incremental risk consists of the risk of default and credit migration risk of a position. Under the Final Rule, an internal model used to calculate capital charges for incremental risk must measure incremental risk over a one-year time horizon and at a one-tail, 99.9% confidence level, either under the assumption of a constant level of risk, or under the assumption of constant positions.

A bank may measure all material price risk of one or more portfolios of correlation trading positions using a comprehensive risk model. Among the requirements for using a comprehensive risk model is that the model measure comprehensive risk consistent with a one-year time horizon and at a one-tail, 99.9% confidence level, under the assumption of either a constant level of risk or constant positions.

The Commission seeks comment on whether the Final Rule adopted by the Banking Agencies for calculating market risk capital requirements should be required for ANC broker-dealers, OTC derivatives dealers, and nonbank SBSDs that have approval to use internal models for regulatory capital purposes, and, if so, which aspects of the proposed rules of the Banking Agencies would be appropriate in this context.

b. Computing Net Capital

i. The Net Liquid Assets Test

The net liquid assets test embodied in Rule 15c3–1 is being proposed as the regulatory capital standard for all nonbank SBSDs (*i.e.,* stand-alone SBSDs and broker-dealer SBSDs) because these firms, as previously noted, are expected to engage in a securities business with respect to security-based swaps that is similar to the dealer activities of broker-dealers and because some broker-dealers likely will be registered as nonbank SBSDs. In addition, Rule 15c3–1 currently contains provisions designed to address dealing in OTC derivatives by broker-dealers.[124] Furthermore, Rule 15c3–1 has been the capital standard for broker-dealers since 1975 and, generally, it has promoted the maintenance of prudent levels of capital. As discussed in section II.A.1. of this release, the net liquid assets test is designed to promote liquidity; the rule allows a broker-dealer to engage in activities that are part of conducting a securities business (*e.g.,* taking securities into inventory) but in a manner that places the firm in the position of holding at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities (*e.g.,* money owed to customers, counterparties, and creditors). Consequently, under the proposed rules, this standard—the net liquid assets test—would be applied to all categories of nonbank SBSDs. The objective is to require the nonbank SBSD to maintain sufficient liquidity so that if it fails financially it can meet all unsubordinated obligations to customers and counterparties and have adequate resources to wind-down in an orderly manner without the need for a formal proceeding.

The net liquid assets test is imposed through the mechanics of how a broker-dealer is required to compute net capital pursuant to Rule 15c3–1. These requirements are set forth in paragraph (c)(2) of Rule 15c3–1, which defines the term ''net capital.'' [125] The first step is to compute the broker-dealer's net worth under GAAP.[126] Next, the broker-dealer must make certain adjustments to its net worth to calculate net capital.[127] These adjustments are designed to leave the firm in a position where each dollar of unsubordinated liabilities is matched by more than a dollar of highly liquid assets.[128] There are thirteen categories of net worth adjustments required by the rule.[129] The most significant adjustments are briefly discussed below.

The first adjustment permits the broker-dealer to add back to net worth liabilities that are subordinated to all other creditors pursuant to a loan agreement that meets requirements set forth in Appendix D to the net capital rule.[130] Appendix D prescribes a number of requirements for a loan to qualify for the ''add-back'' treatment.[131] For example, the loan agreement must provide that the broker-dealer cannot repay the loan at term if doing so would reduce its net capital to certain levels above the minimum requirement.[132]

The second adjustment to net worth is that the broker-dealer must add unrealized gains and deduct unrealized losses in the firm's accounts, mark-to-market all long and short positions in listed options, securities, and commodities as well as add back certain deferred tax liabilities.[133]

The third adjustment is that the broker-dealer must deduct from net worth any asset that is not readily convertible into cash.[134] This means the broker-dealer must deduct the following types of assets (among others): real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and other expenses; goodwill; and most unsecured receivables.[135] An additional adjustment is that the broker-dealer must deduct 100% of the carrying value of securities for which there is no ''ready market'' or which cannot be publicly offered or sold because of statutory, regulatory, or contractual arrangements or other restrictions.[136]

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[124] *See* 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f.

[125] *See* 17 CFR 240.15c3–1(c)(2).

[126] *See id. See also, e.g.,* Computation of Net Capital on FOCUS Report Part II, available at *http://sec.gov/about/forms/formx-17a-5_2.pdf.* Net worth is to be computed in accordance with GAAP. *See* Interpretation Rule 15c3–1(c)(2)/01 by the Financial Industry Regulatory Authority (''FINRA''), available at *http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/interpretationsfor/p037763.pdf.*

[127] *See* 17 CFR 240.15c3–1(c)(2).

[128] *See, e.g., Net Capital Requirements for Brokers and Dealers,* 54 FR at 315 (''The [net capital] rule's design is that broker-dealers maintain liquid assets in sufficient amounts to enable them to satisfy promptly their liabilities. The rule accomplishes this by requiring broker-dealers to maintain liquid assets in excess of their liabilities to protect against potential market and credit risks.'') (footnote omitted).

[129] *See* 17 CFR 240.15c3–1(c)(2)(i)–(xiii).

[130] *See* 17 CFR 240.15c3–1(c)(2)(ii); 17 CFR 240.15c3–1d.

[131] *See* 17 CFR 240.15c3–1d(b).

[132] *See* 17 CFR 240.15c3–1d(b)(8). The restriction on repayment, if triggered, makes the subordinated loan take on the characteristics of permanent capital in that the loan cannot be repaid until such time as the conditions preventing repayment no longer exist. Other requirements for the subordinated loan include that the agreement shall: (1) Have a term of at least one year; (2) effectively subordinate any right of the lender to receive any *payment* (a defined term) 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-dealer arising out of any matter occurring prior to the date on which the related *payment obligation* (a defined term) matures; and (3) provide that the cash proceeds thereof shall be used and dealt with by the broker-dealer as part of its capital and shall be subject to the risks of the broker-dealer's business. 17 CFR 240.15c3–1d(b)(1), (3), and (4).

[133] *See* 17 CFR 240.15c3–1(c)(2)(i).

[134] *See* 17 CFR 240.15c3–1(c)(2)(iv).

[135] *Id.*

[136] *See* 17 CFR 240.15c3–1(c)(2)(vii). Rule 15c3–1 defines *ready market* to include a recognized established securities market in which there exists

After making these and other adjustments and taking charges required under Appendix B to Rule 15c3–1,[137] the broker-dealer is left with an amount of adjusted net worth that is defined in the rule as ''tentative net capital.'' [138]

As discussed in more detail below, the final step in the process of computing net capital is to take deductions from tentative net capital to account for the market risk inherent in the proprietary positions of the broker-dealer and to create a buffer of extra liquidity to protect against other risks associated with the securities business.[139] Most broker-dealers use the standardized haircuts prescribed in Rule 15c3–1 to determine the amount of the deductions they must take from tentative net capital. ANC broker-dealers and OTC derivatives dealers may use internal VaR models to determine the amount of the deductions for positions for which they have been approved to use VaR models.[140] For all other types of positions, they must use standardized haircuts. The standardized haircuts prescribe deductions in amounts that are based on the type of security or money market instrument and, in the case of certain debt instruments, the time-to-maturity of the bond.[141] Under the VaR model approach, the amount of the deductions is based on an estimate of the maximum potential loss the portfolio of securities would be expected to incur over a fixed time period at a certain probability level.

In order to comply with the proposed net liquid assets test capital standard for nonbank SBSDs, broker-dealer SBSDs would be required to comply with the existing provisions of Rule 15c3–1 and proposed amendments to the rule designed to account for security-based swap activities. Consequently, a broker-dealer SBSD would compute its net capital pursuant to the provisions described above. Stand-alone SBSDs would be subject to the net liquid assets test capital standard through application of proposed new Rule 18a–1.[142] The mechanics of computing net capital in Rule 18a–1 would be the same as the existing mechanics for computing net capital in Rule 15c3–1.[143]

ii. Standardized Haircuts for Security-Based Swaps

As discussed above, Rule 15c3–1 provides two alternative approaches for taking the deductions to tentative net capital to compute net capital: standardized haircuts and internal VaR models.[144] ANC broker-dealers and OTC derivatives dealers are permitted to use internal VaR models to take deductions for types of positions for which they have been approved to use the models. For all other types of positions, they must use the standardized haircuts. Broker-dealers that are not ANC broker-dealers or OTC derivatives dealers must use the standardized haircuts for all positions. The same approach is being proposed for nonbank SBSDs.[145] Under this proposal, a nonbank SBSD would be required to apply standardized haircuts to its proprietary positions unless the Commission approves the firm to use internal models for those positions.

Nonbank SBSDs would be required to apply the standardized haircuts currently set forth in Rule 15c3–1 for securities positions for which they have not been approved to use internal models.[146] The standardized haircuts in Rule 15c3–1 prescribe differing deduction amounts for a variety of classes of securities, including, for example: securities guaranteed as to principal or interest by the government of the United States (''U.S. government securities'');[147] certain municipal securities;[148] Canadian debt obligations;[149] certain types of mutual funds;[150] certain types of commercial paper, bankers acceptances, and certificates of deposit;[151] certain nonconvertible debt securities;[152] certain convertible debt securities;[153]

independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom. *See* 17 CFR 240.15c3–1(c)(11). The rule also provides that a *ready market* will be deemed to exist where the securities have been accepted as collateral for a loan by a bank as defined in section 3(a)(6) of the Exchange Act and where the broker-dealer demonstrates to its designated examining authority that such securities adequately secure such loans. *Id.* The rule further provides that indebtedness will be deemed to be adequately secured when the excess of the market value of the collateral over the amount of the indebtedness is sufficient to make the loan acceptable as a fully secured loan to banks regularly making secured loans to broker-dealers. *See* 17 CFR 240.15c3–1(c)(5).

[137] 17 CFR 240.15c3–1b.

[138] *See* 17 CFR 240.15c3–1(c)(15). Tentative net capital—net worth after the adjustments—is the amount by which highly liquid assets plus subordinated debt of the broker-dealer exceeds total liabilities. *See* 17 CFR 240.15c3–1(c)(15). Hence, the adjustments to net worth required by Rule 15c3–1 impose the net liquid assets test.

[139] *See, e.g., Uniform Net Capital Rule,* 42 FR 31778 (''[Haircuts] are intended to enable net capital computations to reflect the market risk inherent in the positioning of the particular types of securities enumerated in [the rule]''); *Net Capital Rule,* 50 FR 42961 (''These percentage deductions, or 'haircuts', take into account elements of market and credit risk that the broker-dealer is exposed to when holding a particular position.''); *Net Capital Rule,* 62 FR 67996 (''Reducing the value of securities owned by broker-dealers for net capital purposes provides a capital cushion against adverse market movements and other risks faced by the firms, including liquidity and operational risks.'') (footnote omitted).

[140] *See* 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f.

[141] *See* 17 CFR 240.15c3–1(c)(2)(vi).

[142] *See* proposed new Rule 18a–1.

[143] *Compare* 17 CFR 240.15c3–1(c)(2), *with* paragraph (c)(1) of proposed new Rule 18a–1.

[144] *See* 17 CFR 240.15c3–1(a)(5), (a)(7), and (c)(2)(vi). *See also* 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f.

[145] *See* section II.A.1. of this release.

[146] *See* 17 CFR 240.15c3–1(c)(2)(vi); paragraph (c)(1)(vi) of proposed new Rule 18a–1. As proposed, paragraph (c)(1)(vi) of proposed new Rule 18a–1 would incorporate by reference the standardized haircuts in paragraph (c)(2)(vi) of Rule 15c3–1 rather than repeat them in the rule text.

[147] *See* 17 CFR 240.15c3–1(c)(2)(vi)(A).

[148] *See* 17 CFR 240.15c3–1(c)(2)(vi)(B). To qualify for the deductions under this paragraph, the municipal security cannot be traded flat or in default as to principal or interest (a bond is traded flat if it is sold or traded without accrued interest). *Id.* A municipal security that does not meet this condition would be subject to the deductions prescribed in the catchall provisions discussed below in the paragraph accompanying this footnote or the 100% deduction to net worth for securities that do not have a ready market discussed above in section II.A.2.b.i. of this release. *See* 17 CFR 240.15c3–1(c)(2)(iv), (c)(2)(vi)(J), and (c)(2)(vi)(K).

[149] *See* 17 CFR 240.15c3–1(c)(2)(vi)(C).

[150] *See* 17 CFR 240.15c3–1(c)(2)(vi)(D).

[151] *See* 17 CFR 240.15c3–1(c)(2)(vi)(E). To qualify for the deductions under this paragraph, the instrument must have a fixed rate of interest or be sold at a discount and be rated in one of the three highest categories by at least two nationally recognized statistical rating organizations (''NRSROs''). *Id.* If the instrument does not meet these conditions, it is subject to the deductions prescribed in the catchall provisions discussed below in the paragraph accompanying this footnote or the 100% deduction to net worth for securities that do not have a ready market discussed above in section II.A.2.b.i. of this release. *See* 17 CFR 240.15c3–1(c)(2)(iv), (c)(2)(vi)(J), and (c)(2)(vi)(K). Pursuant to section 939A of the Dodd-Frank Act, the Commission has proposed substituting the NRSRO-rating requirement in this provision and other provisions of Rule 15c3–1 with a different standard of creditworthiness. *See* Public Law 111–203 § 939A and *Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934,* Exchange Act Release No. 64352 (Apr. 27, 2011), 76 FR 26550 (May 6, 2011) (''*Reference Removal Release*'').

[152] *See* 17 CFR 240.15c3–1(c)(2)(vi)(F). To qualify for the deductions under this paragraph, a nonconvertible debt security must have a fixed interest rate and a fixed maturity date, not be traded flat or in default as to principal or interest, and be rated in one of the four highest rating categories by at least two NRSROs. *Id.* If the nonconvertible debt security does not meet these conditions it is subject to the deductions prescribed in the catchall provisions discussed below in the paragraph accompanying this footnote or the 100% deduction to net worth for securities that do not have a ready market discussed above in section II.A.2.b.i. of this release. *See* 17 CFR 240.15c3–1(c)(2)(iv), (c)(2)(vi)(J), and (c)(2)(vi)(K). Pursuant to section 939A of the Dodd-Frank Act, the Commission has proposed substituting the NRSRO-rating requirement in this provision with a different standard of creditworthiness. *See* Public Law 111–203 § 939A; *Reference Removal Release,* 76 FR 26550.

[153] *See* 17 CFR 240.15c3–1(c)(2)(vi)(G).

certain cumulative, nonconvertible preferred stock;[154] and certain options.[155] The rule also contains catchall provisions to account for securities that are not included in these specific classes of securities.[156] Generally, the catchall provisions impose higher deductions than the deductions in the specifically identified classes of securities.[157] Further, as discussed above in section II.A.2.b.i. of this release, if a security does not have a ''ready market,'' it is subject to the 100% deduction from net worth.[158]

Security-based swaps currently are not an identified class of securities in Rule 15c3–1.[159] The proposed amendments to Rule 15c3–1 and proposed new Rule 18a–1 would establish standardized deductions for security-based swaps that would apply to broker-dealers registered as nonbank SBSDs and broker-dealers that are not registered as SBSDs (in the case of Rule 15c3–1), and to stand-alone SBSDs (in the case of Rule 18a–1).[160] Some broker-dealers may engage in a *de minimis* amount of security-based swap activity, which would allow them to take advantage of an exemption from the definition of ''security-based swap dealer'' and not require them to register as SBSDs.[161] Rule 15c3–1 currently requires broker-dealers to take haircuts on their proprietary security-based swap positions as they must for all proprietary positions. Because there are no specific standardized haircuts for security-based swaps, a broker-dealer currently is required to apply a deduction based on the existing provisions (*e.g.,* the catchall provisions). For certain types of OTC derivatives, the deduction is the notional amount of the derivative multiplied by the deduction that would apply to the underlying instrument referenced by the derivative.[162]

The proposals would establish two separate sets of standardized haircuts for security-based swaps: one applicable to security-based swaps that are credit default swaps and one applicable to other security-based swaps.[163]

Credit Default Swaps

The proposed standardized haircuts for cleared and uncleared security-based swaps that are credit default swaps (''CDS security-based swaps'') are designed to account for the unique attributes of these positions.[164] A CDS security-based swap is an instrument in which the ''protection buyer'' makes a series of payments to the ''protection seller'' and, in return, the ''protection seller'' is obligated to make a payment to the ''protection buyer'' if a credit event occurs with respect to one or more entities referenced in the contract or with respect to certain types of obligations of the entity or entities referenced in the contract.[165] The credit events that can trigger a payment obligation of the protection seller on a CDS security-based swap referencing a corporate entity typically include the bankruptcy of the entity or entities referenced in the contract and the non-payment of interest and/or principal on one or more of specified type(s) of obligations issued by the entity or entities referenced in the contract.[166] In the case of a CDS security-based swap that references an asset-backed security, the credit events may include a principal write-down, a failure to pay interest, and an interest shortfall.[167] CDS security-based swaps referencing both asset-backed securities and corporate entities can include other standardized and customized credit events.

In addition to the entity or asset-backed security to which they reference, CDS security-based swaps are defined by the amount of protection purchased (the notional amount) and the tenor of the contract (*e.g.,* 1, 3, 5, 7, or 10 years). For example, a protection buyer can enter into a credit default swap referencing XYZ Company with a notional amount of $10 million and a tenor of five years. If XYZ Company suffers a credit event (as defined in the contract) during the five-year period before the contract expires, the protection seller must pay the protection buyer $10 million less the then-current market value of $10 million of obligations issued or guaranteed by XYZ Company.[168] To receive this protection, the protection buyer must pay the protection seller periodic (typically quarterly) payments over the five-year term of the contract and possibly an additional upfront amount. The cumulative amount of annual payments can be expressed as a ''spread'' in basis points.[169] The spread at which a CDS security-based swap trades is based on the market's estimation of the risk that XYZ Company will suffer a credit event (as defined in the contract) that triggers the credit seller's payment obligation as

[154] *See* 17 CFR 240.15c3–1(c)(2)(vi)(H). To qualify for the deductions under this paragraph, a nonconvertible preferred stock must rank prior to all other classes of stock of the same issuer, be rated in one of the four highest rating categories by at least two NRSROs, and not be in arrears as to dividends. *Id.* If the nonconvertible preferred stock does not meet these conditions, it is subject to the deductions prescribed in the catchall provisions discussed below in the paragraph accompanying this footnote or the 100% deduction to net worth for securities that do not have a ready market discussed above. *See* 17 CFR 240.15c3–1(c)(2)(iv), (c)(2)(vi)(J), and (c)(2)(vi)(K). Pursuant to section 939A of the Dodd-Frank Act, the Commission has proposed substituting the NRSRO-rating requirement in this provision with a different standard of creditworthiness. *See* Public Law 111–203 § 939A; *Reference Removal Release,* 76 FR 26550.

[155] *See* 17 CFR 240.15c3–1(c)(2)(vi); 17 CFR 240.15c3–1a.

[156] *See* 17 CFR 240.15c3–1(c)(2)(vi)(J)–(K).

[157] *Compare* 17 CFR 240.15c3–1(c)(2)(vi)(A)–(H), *with* 17 CFR 240.15c3–1(c)(2)(vi)(J)–(K).

[158] *See* 17 CFR 240.15c3–1(c)(2)(vii).

[159] *See* 17 CFR 240.15c3–1(c)(2)(vi).

[160] *See* proposed new paragraph (c)(2)(vi)(O) of Rule 15c3–1; paragraph (c)(1)(vi) of proposed new Rule 18a–1.

[161] *See* section 3(a)(71) of the Exchange Act (15 U.S.C. 78c(a)(71)) (defining the term *security-based swap dealer*); *Entity Definitions Adopting Release,* 77 FR 30596; *Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants,* Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784 (Oct. 24, 2011) (''*SBSD Registration Proposing Release*'').

[162] *See Net Capital Rule,* Exchange Act Release No. 32256 (May 6, 1993), 58 FR 27486, 27490 (May 10, 1993).

[163] *See* proposed new paragraph (c)(2)(vi)(O) of Rule 15c3–1; paragraph (c)(1)(vi) of proposed new Rule 18a–1.

[164] *See* section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)) (defining the term *security-based swap*) and *Product Definitions Adopting Release,* 77 FR 48207 (Joint Commission and CFTC release adopting interpretative guidance and rules to, among other things, further define the types of credit default swaps that would meet the definition of *security-based swap*).

[165] *See Product Definitions Adopting Release,* 77 FR 48207. *See also The Credit Default Swap Market—Report,* IOSCO FR05/12 (June 2012) available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD385.pdf.*

[166] *See Product Definitions Adopting Release,* 77 FR at 48267.

[167] *Id.* at 48267, note 682.

[168] While most CDS security-based swaps currently use a standardized ''Auction Settlement'' mechanism to determine the amount of payment due from a protection seller to the protection buyer after the occurrence of a credit event, in some contracts the protection buyer is required to deliver obligations issued or guaranteed by the entity referenced in the contract to the protection seller. The protection seller can use the value of those obligations to offset the payment to the protection buyer.

[169] Most CDS security-based swaps currently trade with contractually standardized fixed rates (100 basis points or 500 basis points for standard North American corporate CDS security-based swaps). Buyers and sellers of protection agree on upfront payments to adjust the value of the contract from the contractual fixed rate to the rate which reflects the credit risks perceived by the market. For example, if the market spread for a one-year CDS security-based swap on XYZ Company is 200 basis points per annum and the notional amount is $10 million, a CDS security-based swap with a standardized 100-basis points fixed rate would have quarterly payments of $25,000 (for $100,000 in annual payments) and an upfront payment of approximately $100,000. *See http://www.cdsmodel.com/cdsmodel/* for documentation on the standard model to convert an upfront payment on a CDS security-based swap to a spread (or vice-versa) and *https://www.theice.com/cds/Calculator.shtml* for an implementation of the standard model.

well as the market's assessment of the size of that payment. The greater the estimated risk that a credit event will occur (or the greater the expected payment contingent upon a credit event occurring), the higher the spread (*i.e.,* the cost of buying the protection).

The proposed standardized haircuts for CDS security-based swaps would be based on a ''maturity grid'' approach.[170] Rule 15c3–1 currently uses maturity grids to prescribe standardized haircuts for various classes of debt instruments.[171] The grids impose a sliding scale of haircuts with the largest deductions applying to bonds with the longest period of time-to-maturity.[172] The grids also permit broker-dealers to completely or partially net long and short positions in these classes of debt instruments when the maturities of long and short positions are in the same category, subcategory, or, in some cases, between certain adjacent categories.[173] The permitted netting allows the broker-dealer to reduce its required deductions.[174]

The proposed grid for CDS security-based swaps would prescribe the applicable deduction based on two variables: the length of time to maturity of the CDS security-based swap contract and the amount of the current offered basis point spread on the CDS security-based swap.[175] As discussed above, the maturity grids for debt instruments in Rule 15c3–1 require increased capital charges as maturity increases. Similarly, the vertical axis of the proposed grid for CDS security-based swaps (presented in the first column of the grid) would contain nine maturity categories ranging from 12 months or less (the smallest deduction) to 121 months and longer (the largest deduction).[176] The horizontal axis in the proposed maturity grid (presented in the top row of the grid) would contain six spread categories ranging from 100 basis points or less (the smallest deduction) to 700 basis points and above (the largest deduction).[177] Similar to the current ''haircut'' grids under Rule 15c3–1, the proposed grid for CDS security-based swaps is designed to be risk sensitive by specifying a range of maturity and spread buckets.

The number of maturity and spread categories in the proposed grid for CDS security-based swaps is based on Commission staff experience with the maturity grids for other securities in Rule 15c3–1 and, in part, on FINRA Rule 4240.[178] While FINRA Rule 4240 is one reference point, the maturity grid it specifies does not appear to have been widely used by market participants, in part because a significant amount of business in the current CDS security-based swap market is conducted by entities that are not members of FINRA.[179] Accordingly, the proposed grid draws largely on Commission staff experience and reasoned judgments about the appropriate specifications, and, as detailed below, the Commission requests comment and empirical data as to whether these specifications or others appropriately reflect the unique attributes of CDS security-based swaps.

The horizontal ''spread'' axis is designed to address the specific credit risk associated with the obligor or obligation referenced in the contract. As noted above, the spread increases as the protection seller's estimation of the likelihood of a credit event occurring increases. Therefore, the net capital deduction—which is designed to address the risk inherent in the instrument—should increase as the spread increases. Combining the two components (maturity and spread) in the grid results in the smallest deduction (1% of notional) required for a short CDS security-based swap with a maturity of 12 months or less and a spread of 100 basis points or below and the largest deduction (50% of notional) required for a short CDS security-based swap with a maturity of 121 months or longer and a spread of 700 basis points or more. The deduction for an unhedged short position in a CDS security-based swap (*i.e.,* when the nonbank SBSD is the seller of protection) would be the applicable percentage specified in the grid. The deduction for an unhedged long position in a CDS security-based swap (*i.e.,* when the nonbank SBSD is the buyer of protection) would be 50% of the applicable deduction in the grid.[180]

The proposed deduction requirements for CDS security-based swaps would permit a nonbank SBSD to net long and short positions where the credit default swaps reference the same entity (in the case of CDS securities-based swaps referencing a corporate entity) or

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[170] *See* proposed new paragraph (c)(2)(vi)(O)(*1*) of Rule 15c3–1; paragraph (c)(1)(vi)(A) of proposed new Rule 18a–1.

[171] *See* 17 CFR 240.15c3–1(c)(2)(vi)(A), (B), (C), (E), and (G). *See also* FINRA Rule 4240 (which prescribes margin requirements for CDS security-based swaps and includes a maturity-grid approach), available in the FINRA Manual at *http://www.finra.org*; *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1, to Implement an Interim Pilot Program with Respect to Margin Requirements for Certain Transactions in Credit Default Swaps,* Exchange Act Release No. 59955 (May 22, 2009), 74 FR 25586 (May 28, 2009) (File No. SR–FINRA 2009–012); *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Extend the Implementation of FINRA Rule 4240 (Margin Requirements for Credit Default Swaps),* Exchange Act Release No. 66528 (Mar. 7, 2012) (File No. SR–FINRA–2012–014) (extending interim pilot program until July 17, 2012); *Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend the Implementation of FINRA Rule 4240 (Margin Requirements for Credit Default Swaps),* Exchange Act Release No. 67449 (July 17, 2012) (extending interim pilot program until July 17, 2013).

[172] *Id.* For example, the grid for certain nonconvertible debt securities has nine maturity categories (this class of debt instrument includes corporate debt and asset-backed securities). *See* 17 CFR 240.15c3–1(c)(2)(vi)(F)(*1*). Each category prescribes a different deduction and the amounts of the deductions increase as the maturity increases. *Id.* The following table shows the maturity categories and corresponding deductions for these securities:

Time to Maturity and Deduction

Less than 1 year—2.0%

1 year but less than 2 years—3.0%

2 years but less than 3 years—5.0%

3 years but less than 5 years—6.0%

5 years but less than 10 years—7.0%

10 years but less than 15 years—7.5%

15 years but less than 20 years—8.0%

20 years but less than 25 years—8.5%

25 years or more—9%

[173] *See* 17 CFR 240.15c3–1(c)(2)(vi)(A), (B), (C), (E), and (G).

[174] Netting would be permitted under the proposed rule for cleared and non-cleared CDS because the CDS will have the same underlying reference obligation and similar time to maturity and spread factors.

[175] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*i*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*1*) of proposed new Rule 18a–1. The current offered spread would be the spread on the CDS security-based swap offered by the market at the time of the net capital computation and not the spread specified under the terms of the contract.

[176] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*i*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*1*) of proposed new Rule 18a–1.

[177] *Id.*

[178] *See Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Amend FINRA Rule 4240 (Margin Requirements for Credit Default Swaps),* Exchange Act Release No. 66527 (Mar. 7, 2012) (File No. SR–FINRA–2012–015) (in which FINRA amended the maturity grid in Rule 4240 in the interest of regulatory clarity and efficiency, and based upon FINRA's experience in the administration of the rule).

[179] Broker-dealers historically have not participated in a significant way in security-based swap trading, in part, because the Exchange Act has not previously defined security-based swaps as ''securities'' and, therefore, they have not been required to be traded through registered broker-dealers. Existing broker-dealer capital requirements, however, make it relatively costly to conduct these activities in broker-dealers, as discussed in section II.A.2. of this release. As a result, security-based swap activities, including CDS transactions, currently are generally concentrated in entities that are affiliated with the parent companies of broker-dealers, but not in broker-dealers themselves.

[180] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*ii*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*2*) of proposed new Rule 18a–1. The approach of taking 100% of the applicable deduction for short positions in CDS security-based swaps and 50% for long positions in CDS security-based swaps is consistent with FINRA Rule 4240 and is designed to account for the greater risk inherent in short CDS security-based swaps.

obligation (in the case of CDS securities-based swaps referencing an asset-backed security), reference the same credit events that would trigger payment by the seller of protection, reference the same basket of obligations that would determine the amount of payment by the seller of protection upon the occurrence of a credit event, and are in the same or adjacent maturity and spread categories (as long as the long and short positions each have maturities within three months of the other maturity category).[181] In this case, the nonbank SBSD would need to take the specified percentage deduction only on the notional amount of the excess long or short position.[182]

A reduced deduction also could be taken for long and short CDS security-based swap positions in the same maturity and spread categories and that reference corporate entities in the same industry sector.[183] In this case, the market risk of the offsetting positions is mitigated to the extent that macroeconomic factors similarly impact companies in a particular industry sector, because corporate entities in the same industry sector would likely be similarly impacted by market events affecting that specific industry. The proposed rule would not identify a specific source for determining industry sector classifications in order to provide firms flexibility and to avoid requiring firms to rely on a specific commercial entity to comply with the rule. Instead, a nonbank SBSD would need to use an industry sector classification system that is reasonable in terms of grouping types of companies with similar business activities and risk characteristics, and document the industry sector classification system used for the purposes of the rule.[184] A nonbank SBSD could use a third-party's classification system or develop its own classification system, subject to these limitations. The nonbank SBSD would need to be able to demonstrate the reasonableness of the system it uses.

Reduced deductions also would apply for strategies where the firm is long (short) a bond or asset-backed security and long (short) protection through a CDS security-based swap referencing the same underlying bond or asset-backed security. In the case where the nonbank SBSD is long a bond or an asset-backed security and long protection through a credit default swap, the nonbank SBSD would be required to take 50% of the deduction required on the bond (*i.e.,* no deduction would be required with respect to the CDS security-based swap and a lesser deduction would apply to the bond than would be the case if it were not paired with a CDS security-based swap).[185] In other words, the deduction the nonbank SBSD would take if it held the bond in isolation would be reduced by one-half to account for the protection provided by the CDS security-based swap referencing the bond. This reduced deduction for the long bond position reflects the risk-reducing effects of the protection provided by the long CDS security-based swap position. If the nonbank SBSD is short a bond or asset-backed security and short protection through a credit default swap, the nonbank SBSD would be required to take the deduction required on the bond or asset-backed security (*i.e.,* no deduction would be required with respect to the CDS security-based swap).[186]

Non-Credit Default Swaps

Security-based swaps that are not credit default swaps (each, a ''non-CDS security-based swap'') can be divided into two broad categories: those that reference equity securities and those that reference debt instruments.[187] Total return swaps are an example of a non-CDS security-based swap. A total return swap is an instrument that requires one of the counterparties (the seller) to make a payment to the other counterparty (the buyer) that is based on the price appreciation of, and income from, the underlying security referenced by the security-based swap.[188] The buyer in return makes a payment that is based on a variable interest rate plus any depreciation of the underlying security referenced by the security-based swap.[189] The ''total return'' consists of the price appreciation or depreciation plus any interest or income.[190]

The proposed standardized haircut for a non-CDS security-based swap would be the deduction currently prescribed in Rule 15c3–1 applicable to the instrument referenced by the security-based swap multiplied by the contract's notional amount.[191] For example, the standardized haircut for an exchange traded equity security typically is 15%.[192] Consequently, under the proposal, the standardized haircut for a non-CDS security-based swap referencing an exchange traded equity security would be a deduction equal to the notional amount of the security-based swap multiplied by 15%.[193] The same approach would apply to a non-CDS security-based swap referencing a debt instrument. For example, Rule 15c3–1 prescribes a 7% standardized haircut for a corporate bond that has a maturity of five years and is not traded flat or in default as to principal or interest and is rated in one of the four highest rating categories by at least two NRSROs.[194] Under the proposal, a non-CDS security-based swap referencing such a bond would require a deduction equal to the contract's notional amount multiplied by 7%.[195] Linking the

[181] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*iii*)(*A*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*3*)(*i*) of proposed new Rule 18a–1.

[182] *Id.* For example, assume the nonbank SBSD is short protection on $10 million in notional CDS security-based swaps on XYZ Company with a 4.25-year (51-month) maturity that trades at a 290 basis point spread and long protection on $8 million in notional CDS security-based swaps on XYZ Company with a 5.25-year (63-month) maturity that trades at a 310 basis point spread. Rather than take the deductions on the short protection $10 million position and the long protection $8 million position individually, the nonbank SBSD would take a deduction on the excess short position of $2 million ($10 million short protection position minus the $8 million long protection position) of 5-year maturity CDS security-based swaps trading at a 290 basis point spread.

[183] *Id.*

[184] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*iii*)(*A*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*3*)(*i*) of proposed new Rule 18a–1. An example of an industry sector classification system is: consumer discretionary, consumer staples, energy, financials, health care, industrials, information technology, materials, telecommunication services, and utilities. *See* the Global Industry Classification Standard developed by MSCI and Standard & Poor's, available at *http://www.msci.com/resources/pdfs/MK-GICS-DIR-3-02.pdf.* Another example of an industry sector classification system is: basic materials, cyclical consumer, energy, financials, healthcare, industrials, non-cyclical consumer, technology, telecommunications, and utilities. *See* Thompson Reuters' business classifications, available at *http://thomsonreuters.com/products_services/financial/thomson_reuters_indices/trbc/sectors/.*

[185] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*iii*)(*B*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*3*)(*ii*) of proposed new Rule 18a–1.

[186] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*iii*)(*C*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*3*)(*iii*) of proposed new Rule 18a–1.

[187] *See Product Definitions Adopting Release,* 77 FR at 48207.

[188] *See id.* at 48264.

[189] *Id.*

[190] *Id.* The total return swap is designed to put the buyer in the position of having exposure to the reference security without actually owning it. Thus, the seller pays the buyer appreciation (*i.e.,* gains) and any interest or income on the security and the buyer pays the seller any depreciation (*i.e.,* loss) on the reference security plus a variable interest rate.

[191] *See* proposed new paragraph (c)(2)(vi)(O)(*2*) of Rule 15c3–1; paragraph (c)(1)(vi)(B) of proposed new Rule 18a–1.

[192] *See* 17 CFR 240.15c3–1(c)(2)(vi)(J).

[193] If the notional amount was $5 million, the standardized haircut would be $750,000 ($5 million × 0.15 = $750,000). The approach of multiplying the notional amount by the percentage deduction applicable to the reference security is consistent with the CFTC's proposed capital charges of equity swaps for nonbank swap dealers that are not using models and are FCMs. *See CFTC Capital Proposing Release,* 76 FR at 27812–27813.

[194] *See* 17 CFR 240.15c3–1(c)(2)(vi)(F)(*1*)(*v*).

[195] If the notional amount was $5 million, the standardized haircut would be $350,000 ($5 million × 0.07 = $350,000).

standardized deduction for the non-CDS security-based swap to the standardized deduction that would apply to the instrument referenced by the security-based swap is based on the rationale that changes in the market value of the instrument underlying the security-based swap will result in corresponding changes to the market value of the security-based swap. The proposal also is consistent with the treatment of equity security-based swaps under Rule 15c3–1.[196] Moreover, the potential volatility of the changes in the non-CDS security-based swap is expected to be similar to the potential volatility in the instrument underlying the security-based swap. For example, as discussed above, the standardized haircut for an exchange traded equity security is 15%,[197] whereas the standardized haircut is 7% for a corporate bond that has a maturity of five years and is not traded flat or in default as to principal or interest and is rated in one of the four highest rating categories by at least two NRSROs.[198] The equity security has a higher deduction amount because it is expected to have a greater amount of market risk.[199]

The examples above reflect the proposed standardized haircuts for a single non-CDS security-based swap treated in isolation. It is expected that nonbank SBSDs will maintain portfolios of multiple non-CDS security-based swaps with offsetting long and short positions to hedge their risk. Under the proposed standardized haircuts for non-CDS security-based swaps, nonbank SBSDs would be able to recognize the offsets currently permitted under Rule 15c3–1.[200] In particular, as discussed below, nonbank SBSDs would be permitted to treat a non-CDS security-based swap that references an equity security (''equity security-based swap'') under the provisions of Appendix A to Rule 15c3–1, which produces a single haircut for portfolios of equity options and related positions.[201] Similarly, nonbank SBSDs would be permitted to treat a non-CDS security-based swap that references a debt instrument (''debt security-based swap'') in the same manner as debt instruments are treated in the Rule 15c3–1 grids in terms of allowing offsets between long and short positions where the instruments are in the same maturity categories, subcategories, and in some cases, adjacent categories for the purposes of computing haircuts for debt security-based swaps.[202]

Appendix A to Rule 15c3–1 prescribes a standardized theoretical pricing model to determine a potential loss for a portfolio of equity positions involving the same equity security to establish a single haircut for the group of positions (''Appendix A methodology'').[203] Proposed amendments to Appendix A to Rule 15c3–1 would permit equity security-based swaps to be included in portfolios of equity positions for which the Appendix A methodology is used to compute a portfolio haircut.[204] Under these proposed amendments, broker-dealer SBSDs and broker-dealers that are not registered as SBSDs would be able to include equity security-based swaps in portfolios of equity positions for purposes of the Appendix A methodology. In addition, proposed new Rule 18a–1 would permit stand-alone SBSDs to use the Appendix A methodology as well.[205] By permitting equity security-based swaps to be included in portfolios of related equity positions, broker-dealer SBSDs and broker-dealers that are not registered as SBSDs would be able to employ a more sensitive measure of the risk when computing net capital than would be the case if the positions were treated in isolation.

Under the Appendix A methodology (as proposed to be amended), a nonbank SBSD could group equity security-based swaps, options, security futures, long securities positions, and short securities positions involving the same underlying security (*e.g.,* XYZ Company common stock) and stress the current market price for each position at ten equidistant points along a range of positive and negative potential future market movements, using an approved theoretical option pricing model that satisfies certain conditions specified in the rule.[206] For equity security-based swaps, the ten stress points for a portfolio of related positions would span a range from −15% to +15% (*i.e.,* −15%, −12%, −9%, −6%, −3%, +3%, +6%, +9%, +12%, +15%).[207] The gains and losses of each position (*e.g.,* a security-based swap, option, and a security future referencing XYZ Company and a long position and short position in XYZ Company stock) in the portfolio would be allowed to offset each other to yield a net gain or loss at each stress point.[208] The stress point

[196] *See Net Capital Rule,* 58 FR at 27490.

[197] *See* 17 CFR 240.15c3–1(c)(2)(vi)(J).

[198] *See* 17 CFR 240.15c3–1(c)(2)(vi)(F)(*1*).

[199] *See, e.g., Net Capital Rule,* Exchange Act Release No. 39456 (Dec. 17, 1997), 62 FR 68011 (Dec. 30, 1997) (''[A] broker-dealer's haircut for equity securities is equal to 15 percent of the market value of the greater of the long or short equity position plus 15 percent of the market value of the lesser position, but only to the extent this position exceeds 25 percent of the greater position. In contrast to the uniform haircut for equity securities, the haircuts for several types of interest rate sensitive securities, such as government securities, are directly related to the time remaining until the particular security matures.'').

[200] *See* proposed new paragraph (c)(2)(vi)(O)(*2)* of Rule 15c3–1; paragraph (c)(1)(vi)(B) of proposed new Rule 18a–1.

[201] *See* 17 CFR 240.15c3–1a; Appendix A to proposed new Rule 18a–1.

[202] *See* 17 CFR 240.15c3–1(c)(2)(vi).

[203] *See* 17 CFR 240.15c3–1a; Appendix A to proposed new Rule 18a–1.

[204] Specifically, Appendix A to Rule 15c3–1 would be amended to include equity security-based swaps within the definition of the term ''underlying instrument'' in paragraph (a)(4) of Appendix A. This would allow these positions to be included in portfolios of equity positions involving the same equity security for purposes of the Appendix A methodology. In addition, the proposals would include security futures on single stocks within the definition of the term ''underlying instrument,'' which would permit these positions to be included in portfolios of positions involving the same underlying security for purposes of the Appendix A methodology, subject to a minimum charge. This proposal is made in response to legislative and regulatory developments that have occurred since the Appendix A methodology was adopted in 1997. *See Net Capital Rule,* Exchange Act Release No. 38248 (Feb. 6, 1997), 62 FR 6474 (Feb. 12, 1997). When the Appendix A methodology was adopted, security futures trading was prohibited in the U.S. This prohibition was repealed by the Commodity Futures Modernization Act of 2000, which established a framework for the joint regulation of security futures products by the Commission and the CFTC. Public Law 106–554, 114 Stat. 2763 (2000). Because security futures contracts on individual stocks generally track the price of the underlying stock, and, at expiration, the price of the security futures contract equals the price of the underlying stock, the proposed amendments would treat a security future on an underlying stock as if it were the underlying stock. Appendix A to Rule 18a–1 similarly would include equity security-based swaps and security futures products in the definition of ''underlying instrument.'' *See* paragraph (a)(4) of proposed new Rule 18a–1a. *See also* letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, Commission, to Timothy H. Thompson, Senior Vice President and Chief Regulatory Officer, Chicago Board Options Exchange, Incorporated (''CBOE''), and Grace B. Vogel, Executive Vice President, Member Regulation, Risk Oversight and Operational Regulation, FINRA (May 4, 2012) (no-action letter permitting broker-dealers when calculating net capital using a theoretical pricing model pursuant to Appendix A to Rule 15c3–1 to group U.S.-listed security futures contracts on individual stocks with equity options on, and positions in, the same underlying instrument under paragraph (b)(1)(ii)(A) of Appendix A).

[205] *See* proposed new Rule 18a–1a.

[206] *See* 17 CFR 240.15c3–1a(b)(1); paragraph (b)(1) of proposed new Rule18a–1a. Presently, there is only one theoretical options pricing model that has been approved for this purpose.

[207] This range of price movements (±) 15% is consistent with the prescribed 15% haircut for most equity securities. *See* 17 CFR 240.15c3–1(c)(2)(vi)(J).

[208] For example, at the −6% stress point, XYZ Company stock long positions would experience a 6% loss, short positions would experience a 6% gain, and XYZ Company options would experience gains or losses depending on the features of the options. These gains and losses are added up resulting in a net gain or loss at that point.

that yields the largest potential net loss for the portfolio would be used to calculate the aggregate haircut for all the positions in the portfolio.[209] This method would permit a nonbank SBSD to compute deductions for a portfolio of equity security-based swaps in a more risk sensitive manner by accounting for the risk of the entire portfolio, rather than the risk of each position within the portfolio.

With respect to portfolios of debt security-based swaps, a nonbank SBSD could use the offsets permitted in the debt-maturity grids in Rule 15c3–1.[210] The debt-maturity grids permit the broker-dealer to reduce the amount of the deductions when long debt security positions are offset by short debt security positions. For example, as discussed above, the maturity grid for nonconvertible debt securities has nine maturity categories.[211] In each category, the broker-dealer is required to take the specified deduction on the greater of the long or short positions in the category.[212] Consequently, the broker-dealer need not take a deduction on the gross amount of these positions (*i.e.,* the broker-dealer need not take a deduction for the long *and* short positions). In addition, the rule permits the broker-dealer to exclude nonconvertible debt securities from the maturity categories if they are hedged by other similar nonconvertible debt securities or government securities or futures on government securities.[213] The excluded positions are subject to a separate maturity grid that imposes lower deductions.[214] The proposed amendments to Rule 15c3–1 and proposed new Rule 18a–1 would permit broker-dealer SBSDs and stand-alone SBSDs, respectively, to treat debt security-based swaps in the same manner as the debt instruments they reference are treated for the purposes of determining haircuts. Consequently, nonbank SBSDs could recognize the offsets and hedges that those provisions permit to reduce the deductions on portfolios of debt security-based swaps.

Request for Comment

The Commission generally requests comment on the proposed standardized haircuts for calculating deductions for security-based swaps. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed maturity/spread grid approach for CDS security-based swaps appropriate in terms of addressing the risk of these positions? If not, explain why not. How could the proposed maturity/spread grid approach be modified to better address the risk of these positions?

2. Do broker-dealers currently use the spread/maturity grid in FINRA Rule 4240 to determine capital charges for credit default swaps? If so, what has been the experience of broker-dealers in using the grid? If not, what potential practical issues does the maturity/spread grid raise? Are there ways these practical issues could be addressed through modifications to the proposed maturity/spread grid?

3. Is there an alternative maturity/spread grid approach that would be a preferable model for the standardized haircuts? If so, identify the model and explain why it would be preferable. For example, should the standardized haircut for a CDS security-based swap that references an obligation be based on the standardized haircut that would apply to the obligation under paragraph (c)(2)(vi) of Rule 15c3–1? If so, explain why. If not, explain why not. How could a CDS security-based swap that references an obligor as an entity be addressed under such a standardized haircut approach? For example, could the standardized haircut that would apply to obligations (*e.g.,* bonds) issued by the obligor be used as a proxy for the standardized haircut that would apply to the CDS security-based swap referencing the obligor? If so, explain why.

4. Are the proposed spread categories for the CDS security-based swap grid appropriate? If not, explain why not. For example, should there be more spread categories? If so, specify the total number of recommended spread categories and the basis point ranges that should be in each category, and explain why the recommended modifications would be preferable. Should there be fewer spread categories? If so, specify the total number of recommended spread categories and the basis point ranges that should be in each category, and explain why the recommended modifications would be preferable.

5. Would there always be an observable current offered basis point spread for purposes of determining the applicable spread category for a CDS security-based swap? If it could be the case that a CDS security-based swap does not have an observable current offered spread, how should the spread category be determined and how should the rule be modified to require the use of the determined spread category? For example, should the rule require that the nonbank SBSD apply the greatest percentage deduction applicable to the CDS security-based swap based on its maturity (*i.e.,* the deduction prescribed in ''700 or more'' basis points spread category) or another deduction amount?

6. Are the proposed maturity categories for the CDS security-based swap grid appropriate? If not, explain why not. For example, should there be more maturity categories? If so, specify the total number of recommended maturity categories and the time ranges that should be in each category, and explain why the recommended modifications would be preferable. Should there be fewer maturity categories? If so, specify the total number of recommended maturity categories and the time ranges that should be in each category, and explain why the recommended modifications would be preferable.

7. Are the proposed percentage deductions in the CDS security-based swap grid appropriate? If not, explain why not. For example, should the percentage deductions be greater? If so, specify the greater deductions and explain why they would be preferable. Should the percentage deductions be lesser? If so, specify the lesser deductions and explain why it would be preferable.

8. Is the proposed 50% reduced deduction for long CDS security-based swaps appropriate? If not, explain why not. For example, should the amount of the reduced deduction be greater? If so, specify the amount and explain why it would be preferable. Should the amount of the reduced deduction be lesser? If so, specify the lesser amount and explain why it would be preferable.

9. Is the proposed offset and corresponding reduced deduction for net long and short positions where the CDS security-based swaps reference the same obligor or obligation and are in the

[209] Because options are part of the portfolio, the greatest portfolio loss (or gain) would not necessarily occur at the largest potential market move stress points (±) 15%. This is because a portfolio that holds derivative positions that are far out of the money would potentially realize large gains at the greatest market move points as these positions come into the money. Thus, the greatest net loss for a portfolio conceivably could be at any market move stress point. In addition, the Appendix A methodology imposes a minimum charge based on the number of options contracts in a portfolio that applies if the minimum charge is greater than the largest stress point charge. *See* 17 CFR 240.15c3–1a(b)(1)(v)(C)(*2*); paragraph (b)(1)(iv)(C)(*2*) of proposed new Rule 18a–1a. This minimum charge is designed to address issues such as leverage and liquidity risk that may exist even if the market risk of the portfolio is very low as a result of closely-correlated hedging.

[210] *See* proposed new paragraph (c)(2)(vi)(O)(*2*) of Rule 15c3–1; paragraph (c)(1)(vi)(B) of proposed new Rule 18a–1 (incorporating by reference the standardized haircuts in Rule 15c3–1).

[211] *See* 17 CFR 240.15c3–1(c)(2)(vi)(F)(*1*).

[212] *Id.*

[213] *See* 17 CFR 240.15c3–1(c)(2)(vi)(F)(*2*).

[214] *See* 17 CFR 240.15c3–1(c)(2)(vi)(F)(*3*).

same maturity and spread categories appropriate? If not, explain why not.

10. Is the proposed offset and corresponding reduced deduction for net long and short positions where the CDS security-based swaps reference the same obligor or obligation, are in the same spread category, and are in an adjacent maturity category and have maturities within three months of the other maturity category appropriate? If not, explain why not.

11. Is the proposed offset and corresponding reduced deduction for long and short CDS security-based swap positions in the same maturity and spread categories and that reference obligors or obligations of obligors in the same industry sector appropriate? If not, explain why not.

12. Should the rule specify an industry sector classification system? If so, specify the recommended industry sector classification system and explain why it would be useful for the purposes of the standardized haircuts for CDS security-based swaps.

13. If a nonbank SBSD uses its own industry sector classification system, what factors would be relevant in evaluating whether the system is reasonable?

14. Should there be a concentration charge that would apply when the notional amount of the long and short CDS security-based swap positions in the same maturity and spread categories and that reference obligors or obligations of obligors in the same industry sector exceed a certain threshold to account for the potential that long and short positions may not directly offset each other? If so, explain why. If not, explain why not.

15. Is the proposed deduction for a position where a nonbank SBDS is long a bond and long a CDS security-based swap on the same underlying obligor appropriate? If not, explain why not. For example, is the proposed provision that the reduced deduction would apply only if the CDS security-based swap allowed the nonbank SBSD to deliver the bond to satisfy the firm's obligation on the swap appropriate? If not, explain why not. Additionally, is reducing the deduction applicable to the bond by 50% an appropriate reduction level? Should the reduction be less than 50% (*e.g.,* 25%) or greater than 50% (*e.g.,* 75%)?

16. Is the proposed reduced deduction for a position where a nonbank SBDS is short a bond and short a CDS security-based swap on the same underlying bond appropriate? If not, explain why not.

17. Should the Commission propose separate grids for CDS security-based swaps that reference a single obligor or obligation and CDS security-based swaps that reference a narrow based index? If so, how should the two grids differ?

18. Are the proposed standardized haircuts for non-CDS security-based swaps appropriate? If not, explain why not. For example, would the risk characteristics of non-CDS security-based swaps (*e.g.,* price volatility) be similar to the instruments they reference? If not, explain why not.

19. Are there practical issues with treating equity security-based swaps under the Appendix A methodology? If so, describe them. Are there modifications that could be made to the Appendix A methodology to address any practical issues identified? If so, describe the modifications.

20. Are there provisions in Appendix A to Rule 15c3–1 not included in Appendix A to Rule 18a–1 that should be incorporated into the latter rule? If so, identify the provisions and explain why they should be incorporated into Appendix A to Rule 18a–1. For example, should the strategy-based methodology in Appendix A to Rule 15c3–1 be applied to equity security-based swaps? If so, explain why.

21. Are there practical issues with treating debt security-based swaps under the debt maturity grids in Rule 15c3–1? If so, describe them. Are there modifications that could be made to address any practical issues identified? If so, describe the modifications.

iii. VaR Models

The proposed capital requirements for nonbank SBSDs would permit the use of internal VaR models to compute deductions for proprietary securities positions, including security-based swap positions, in lieu of the standardized haircuts. VaR models are used by financial institutions for internal risk management purposes.[215] In addition, VaR models are used to compute market risk charges in international bank capital standards[216] and are permitted by the Commission's rules for ANC broker-dealers and OTC derivatives dealers.[217] Furthermore, the prudential regulators and the CFTC have proposed permitting the use of VaR models in their capital requirements for bank SBSDs, bank swap dealers, and swap dealers.[218] The use of VaR models to calculate market risk charges for security-based swap positions would be subject to the conditions described below.

Broker-dealer SBSDs that are not already ANC broker-dealers would need to obtain approval to operate as ANC broker-dealers to use internal VaR models to compute net capital. Stand-alone SBSDs also would need to obtain Commission approval to use VaR models for this purpose. The requirements for a broker-dealer to apply for approval to operate as an ANC broker-dealer are contained in Appendix E to Rule 15c3–1.[219] Pursuant to these requirements, the applicant must provide the Commission with various types of information about the applicant.[220] A stand-alone SBSD applying for approval to use internal models to compute net capital would be required to provide similar information (though a stand-alone SBSD would not be required to provide certain information relating to its holding company or affiliates that is required of ANC broker-dealer applicants).[221]

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[215] *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428 (The option to use VaR models is ''intended to reduce regulatory costs for broker-dealers by allowing very highly capitalized firms that have developed robust internal risk management practices to use those risk management practices, such as mathematical risk measurement models, for regulatory purposes''); *Net Capital Rule,* Exchange Act Release No. 39456 (Dec. 17, 1997), 62 FR 68011 (Dec. 30, 1997) (''Given the increased use and acceptance of VAR as a risk management tool, the Commission believes that it warrants consideration as a method of computing net capital requirements for broker-dealers.'').

[216] *See, e.g., Amendment to the capital accord to incorporate market risks,* Basel Committee on Banking Supervision (Jan. 1996); 12 CFR part 3; 12 CFR parts 208 and 225; 12 CFR part 325.

[217] *See* 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f. *See also Alternative Net Capital Requirements Adopting Release,* 69 FR 34428; *OTC Derivatives Dealers,* 63 FR 59362.

[218] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564; *CFTC Capital Proposing Release,* 76 FR 27802.

[219] *See* 17 CFR 240.15c3–1e. The application covers both the use of internal VaR models to compute deductions for proprietary positions and internal credit risk models to compute charges for unsecured receivables relating to OTC derivatives. *Id.* Specifically, the broker-dealer may apply to the Commission for authorization to compute deductions pursuant to Appendix E to Rule 15c3–1 in lieu of computing deductions pursuant to paragraph (c)(2)(vi) (the standardized haircuts) and paragraph (c)(2)(vii) (the 100% deduction for securities with no ready market) of Rule 15c3–1 and to compute deductions for credit risk pursuant to Appendix E for unsecured receivables arising from transactions in OTC derivatives in lieu of computing deductions pursuant to paragraph (c)(2)(iv) of Rule 15c3–1 (the deductions for unsecured receivables). *See* 17 CFR 240.15c3–1e(a). The use of internal credit risk models is discussed below in section II.A.2.b.iv. of this release.

[220] *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34433.

[221] *See* paragraph (d)(1) of proposed new Rule 18a–1. Appendix E to Rule 15c3–1 requires a broker-dealer applying to become an ANC broker-dealer to provide information about the broker-dealer's ultimate holding company and affiliates. *See* 17 CFR 240.15c3–1e(a)(1)(viii)–(ix) and (a)(2). Consistent with the requirements for OTC derivatives dealers, the proposed application requirements for stand-alone SBSDs seeking

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A broker-dealer applying to become an ANC broker-dealer is required to provide the Commission with, among other things, the following information:

- An executive summary of the information provided to the Commission with its application and an identification of the ultimate holding company of the ANC broker-dealer; [222]
- A comprehensive description of the internal risk management control system of the broker-dealer and how that system satisfies the requirements set forth in Rule 15c3–4; [223]
- A list of the categories of positions that the ANC broker-dealer holds in its proprietary accounts and a brief description of the methods that the ANC broker-dealer will use to calculate deductions for market and credit risk on those categories of positions; [224]
- 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 ANC broker-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 model incorporates empirical correlations across risk categories, a description of the process for measuring correlations; a description of the backtesting procedures the ANC broker-dealer will use to backtest the mathematical model used to calculate maximum potential exposure; a description of how each mathematical model satisfies the applicable qualitative and quantitative requirements set forth in paragraph (d) of Appendix E to Rule 15c3–1; and a statement describing the extent to which each mathematical model used to compute deductions for market and credit risk will be used as part of the risk analyses and reports presented to senior management; [225]
- If the ANC broker-dealer is applying to the Commission for approval to use scenario analysis to calculate deductions for market risk for certain positions, a list of those types of positions, a description of how those deductions will be calculated using scenario analysis, and an explanation of why each scenario analysis is appropriate to calculate deductions for market risk on those types of positions; [226]
- A description of how the ANC broker-dealer will calculate current exposure; [227]
- A description of how the ANC broker-dealer will determine internal credit ratings of counterparties and internal credit risk weights of counterparties, if applicable; [228]
- For each instance in which a mathematical model used by the ANC broker-dealer to calculate a deduction for market risk or to calculate maximum potential exposure for a particular product or counterparty differs from the mathematical model used by the ultimate holding company of the ANC broker-dealer to calculate an allowance for market risk or to calculate maximum potential exposure for that same product or counterparty, a description of the difference(s) between the mathematical models; [229] and
- Sample risk reports that are provided to the persons at the ultimate holding company who are responsible for managing group-wide risk and that will be provided to the Commission pursuant to Rule 15c3–1g.[230]

The Commission may request that a broker-dealer applying to operate as an ANC broker-dealer supplement its application (''ANC application'') with other information relating to the internal risk management control system, mathematical models, and financial position of the broker-dealer.[231] A broker-dealer's ANC application and all submissions in connection with the ANC application are accorded confidential treatment, to the extent permitted by law.[232] If any information in an ANC application is found to be or becomes inaccurate before the Commission approves the application, the broker-dealer must notify the Commission promptly and provide the Commission with a description of the circumstances in which the information was inaccurate along with updated, accurate information.[233] The

approval to use internal models would not require the submission of the information about the firm's ultimate holding company and affiliates required in paragraphs (a)(1)(viii)–(ix) and (a)(2)(i)–(xi) of Appendix E to Rule 15c3–1. *Compare* 17 CFR 240.15c3–1e(a)(1) and (a)(2), *with* paragraph (d)(1) of proposed new Rule 18a–1 and 17 CFR 240.15c3–1f(a). This additional information may be more appropriate for a broker-dealer applying to operate as an ANC broker-dealer because of its ability to engage in wider ranges of activities than a stand-alone nonbank SBSD, such as engaging in a general securities business. The information about the ultimate holding company and affiliates is designed to help ensure the Commission can monitor activities of the holding company and affiliates that could negatively impact the financial well-being of the broker-dealer. *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34430.

[222] *See* 17 CFR 240.15c3–1e(a)(1)(i). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(A) of proposed new Rule 18a–1.

[223] *See* 17 CFR 240.15c3–1e(a)(1)(ii). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(B) of proposed new Rule 18a–1. As discussed below in section II.A.2.c. of this release, ANC broker-dealers are required to comply with Rule 15c3–4, and to provide this information in an application to use internal models. *See* 17 CFR 240.15c3–1e(a)(1)(ii), 17 CFR 240.15c3–1(a)(7)(iii) and 17 CFR 240.15c3–4. A nonbank SBSD that does not use internal models also would be required to comply with Rule 15c3–4, but would not have to provide information to the Commission unless it determined to apply to the Commission to use internal models. *See* paragraph (g) of proposed new Rule 18a–1 and section II.A.2.c. of this release discussing this requirement.

[224] *See* 17 CFR 240.15c3–1e(a)(1)(iii). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(C) of proposed new Rule 18a–1.

[225] *See* 17 CFR 240.15c3–1e(a)(1)(iv). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(D) of proposed new Rule 18a–1.

[226] *See* 17 CFR 240.15c3–1e(a)(1)(v). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(E) of proposed new Rule 18a–1. As discussed below, ANC broker-dealers can use scenario analysis in certain cases to determine deductions for some positions.

[227] *See* 17 CFR 240.15c3–1e(a)(1)(vi). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(F) of proposed new Rule 18a–1.

[228] *See* 17 CFR 240.15c3–1e(a)(1)(vii). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(G) of proposed new Rule 18a–1. As discussed below in section II.A.2.b.iv. of this release, internal credit ratings are used to compute the credit risk charge.

[229] *See* 17 CFR 240.15c3–1e(a)(2)(xi). A stand-alone SBSD also would be required to provide this information in an application to use internal models. *See* paragraph (d)(1)(i)(H) of proposed new Rule 18a–1.

[230] *See* 17 CFR 240.15c3–1e(a)(2)(xiii). A stand-alone SBSD would be required to provide similar information in an application to use internal models. *See* paragraph (d)(1)(i)(I) of proposed new Rule 18a–1. The proposed requirement for stand-alone SBSDs to provide this information refers to sample risk reports that are provided to ''management'' as opposed to the ''ultimate holding company.'' *Id.* As a practical matter, the two provisions would achieve the same result; namely, the submission of sample reports that are provided to senior levels of the firm. However, because the stand-alone SBSD application provisions do not require information about holding companies and affiliates, the proposed text of the rule refers to ''management.''

[231] *See* 17 CFR 240.15c3–1e(a)(4). A similar provision would apply to stand-alone SBSDs applying to use internal models. *See* paragraph (d)(2) of proposed new Rule 18a–1.

[232] *See* 17 CFR 240.15c3–1e(a)(5). *See also* 5 U.S.C. 552; *Alternative Net Capital Requirements Adopting Release,* 69 FR at 34433 (discussing confidential treatment of ANC applications). A similar provision would apply to information submitted by stand-alone SBSDs applying to use internal models. *See* paragraph (d)(3) of proposed new Rule 18a–1.

[233] *See* 17 CFR 240.15c3–1e(a)(6). A similar provision would apply to stand-alone SBSDs applying to use internal models. *See* paragraph (d)(4) of proposed new Rule 18a–1.

Commission may approve, in whole or in part, an ANC application or an amendment to the application, subject to any conditions or limitations the Commission may require if the Commission finds the approval to be necessary or appropriate in the public interest or for the protection of investors.[234]

As part of the ANC application approval process, the Commission staff reviews the operation of the broker-dealer's VaR model, including a review of associated risk management controls and the use of stress tests, scenario analyses, and back-testing.[235] As part of this process and on an ongoing basis, the broker-dealer applicant is required to demonstrate to the Commission that the VaR model reliably accounts for the risks that are specific to the types of positions the broker-dealer intends to include in the model computations. During the review, the Commission assesses the quality, rigor, and adequacy of the technical components of the VaR model and of related model governance processes. Stand-alone SBSDs applying for approval to use internal models to compute net capital would be subject to similar reviews of their VaR models as part of the application process.

After an ANC application is approved, an ANC broker-dealer is required to amend and submit to the Commission for approval its ANC application before materially changing its VaR model or its internal risk management control system.[236] Further, an ANC broker-dealer is required to notify the Commission 45 days before it ceases using a VaR model to compute net capital.[237] Finally, the Commission, by order, can revoke an ANC broker-dealer's ability to use a VaR model to compute net capital if the Commission finds that the ANC broker-dealer's use of the model is no longer necessary or appropriate in the public interest or for the protection of investors.[238] In this case, the broker-dealer would need to revert to using the standardized haircuts for all positions.

An ANC broker-dealer must comply with certain qualitative and quantitative requirements set forth in Appendix E to Rule 15c3–1.[239] A stand-alone SBSD approved to use a VaR model would be subject to the same qualitative and quantitative requirements.[240] In this regard, VaR models estimate the maximum potential loss a portfolio of securities and other instruments would be expected to incur over a fixed time period at a certain probability level. The model utilizes historical market data to generate potential values of a portfolio of positions taking into consideration the observed correlations between different types of assets.

The qualitative requirements in Appendix E to Rule 15c3–1 specify, among other things, that: (1) Each VaR model must be integrated into the ANC broker-dealer's daily internal risk management system;[241] (2) each VaR model must be reviewed periodically by the firm's internal audit staff, and annually by a registered public accounting firm, as that term is defined in section 2(a)(12) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 *et seq.*);[242] and (3) the VaR measure computed by the model must be multiplied by a factor of at least three but potentially a greater amount based on the number of exceptions to the measure resulting from quarterly back-testing exercises.[243]

The quantitative requirements specify that the VaR model of the ANC broker-dealer must, among other things: (1) Use a 99%, one-tailed confidence level with price changes equivalent to a ten-business-day movement in rates and prices;[244] (2) use an effective historical observation period of at least one year;[245] (3) use historical data sets that are updated at least monthly and are reassessed whenever market prices or volatilities change significantly;[246] and (4) take into account and incorporate all significant, identifiable market risk factors applicable to positions of the ANC broker-dealer, including risks arising from non-linear price characteristics, empirical correlations within and across risk factors, spread risk, and specific risk for individual positions.[247]

The deduction an ANC broker-dealer must take to tentative net capital in lieu of the standardized haircuts is an amount equal to the sum of four charges.[248] The first is a portfolio market risk charge for all positions that are included in the ANC broker-dealer's VaR models (*i.e.,* the amount measured by each VaR model multiplied by a factor of at least three).[249] The second charge is a *specific risk* charge for positions where specific risk was not captured in the VaR model.[250] The third

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[234] *See* 17 CFR 240.15c3–1e(a)(7). A similar provision would apply to applications of stand-alone SBSDs applying to use internal models. *See* paragraph (d)(5) of proposed new Rule 18a–1.

[235] The Commission also reviews the broker-dealer's credit risk model.

[236] *See* 17 CFR 240.15c3–1e(a)(8). This requirement also applies to material changes to the ANC broker-dealer's internal credit risk model. *Id.* A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(6) of proposed new Rule 18a–1.

[237] *See* 17 CFR 240.15c3–1(a)(10). This requirement also applies to the ANC broker-dealer's internal credit risk model. *Id.* A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(7) of proposed new Rule 18a–1.

[238] *See* 17 CFR 240.15c3–1e(a)(11). This requirement also applies to the ANC broker-dealer's internal credit risk model. *Id.* A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(8) of proposed new Rule 18a–1.

[239] *See* 17 CFR 15c3–1e(d).

[240] *Compare* 17 CFR 15c3–1e(d), *with* paragraph (d)(9) of proposed new Rule 18a–1.

[241] *See* 17 CFR 240.15c3–1e(d)(1)(i). A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(i)(A) of proposed new Rule 18a–1.

[242] *See* 17 CFR 240.15c3–1e(d)(1)(ii). The annual review must be conducted in accordance with procedures agreed upon by the broker-dealer and the registered public accounting firm conducting the review. A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(i)(B) of proposed new Rule 18a–1.

[243] *See* 17 CFR 240.15c3–1e(d)(1)(iii). A back-testing exception occurs when the ANC broker-dealer's actual one-day loss exceeds the amount estimated by its VaR model. *See, e.g., Supervisory framework for the use of ''backtesting'' in conjunction with the internal models approach to market risk capital requirements,* Basel Committee on Banking Supervision (Jan. 1996) (''The essence of all backtesting efforts is the comparison of actual trading results with model-generated risk measures. If this comparison is close enough, the backtest raises no issues regarding the quality of the risk measurement model. In some cases, however, the comparison uncovers sufficient differences that problems almost certainly must exist, either with the model or with the assumptions of the backtest. In between these two cases is a grey area where the test results are, on their own, inconclusive.''). Depending on the number of back-testing exceptions, the ANC broker-dealer may need to increase the market risk multiplier to 3.40, 3.50, 3.65, 3.75, 3.85, or 4.00. *Id.* Increasing the multiplier increases the deduction amount, which in turn is designed to account for a model that is producing less accurate measures. The same multiplier provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(i)(C) of proposed new Rule 18a–1.

[244] *See* 17 CFR 240.15c3–1e(d)(2)(i). This means the potential loss measure produced by the model is a loss that the portfolio could experience if it were held for ten trading days and that this potential loss amount would be exceeded only once every 100 trading days. A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(ii)(A) of proposed new Rule 18a–1.

[245] *See* 17 CFR 240.15c3–1e(d)(2)(iii). A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(ii)(C) of proposed new Rule 18a–1.

[246] *See* 17 CFR 240.15c3–1e(d)(2)(iii). A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(ii)(C) of proposed new Rule 18a–1.

[247] *See* 17 CFR 240.15c3–1e(d)(2)(iv). A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (d)(9)(ii)(D) of proposed new Rule 18a–1.

[248] *See* 17 CFR 240.15c3–1e(b). A similar provision would apply to stand-alone SBSDs approved to use internal models. *See* paragraph (e)(1) of proposed new Rule 18a–1.

[249] *See* 17 CFR 240.15c3–1e(b)(1). A similar charge would apply to stand-alone SBSDs in determining their deduction amount. *See* paragraph (e)(1)(i) of proposed new Rule 18a–1.

[250] *See* 17 CFR 240.15c3–1e(b)(2). *Specific risk* is the risk that a security price will change for reasons

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charge is for positions not included in the VaR model where the ANC broker-dealer is approved to determine a charge using scenario analysis.[251] The fourth charge is determined by applying the standardized haircuts for all other positions.[252]

Finally, ANC broker-dealers are subject to on-going supervision with respect to their internal risk management, including their use of VaR models.[253] In this regard, the Commission staff meets regularly with senior risk managers at each ANC broker-dealer to review the risk analytics prepared for the firm's senior management. These reviews focus on the performance of the risk measurement infrastructure, including statistical models, risk governance issues such as modifications to and breaches of risk limits, and the management of outsized risk exposures. In addition, Commission staff and personnel from an ANC broker-dealer hold regular meetings focused on financial results, the management of the firm's balance sheet, and, in particular, the liquidity of the balance sheet. The Commission staff also monitors the performance of the ANC broker-dealer's internal models through regular reports generated by the firms for their internal risk management purposes (backtesting, stress test, and other monthly risk reports) and discussions with firm personnel (scheduled and *ad hoc*).[254] Material changes to the internal models are also subject to review and approval.[255] Stand-alone SBSDs approved to use internal models to compute net capital would be subject to similar monitoring and reviews.

Request for Comment

The Commission generally requests comment on the proposed requirements for using VaR models to compute net capital. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Would VaR models appropriately account for the risks of security-based swaps? If not, explain why not. For example, do the characteristics of security-based swaps make it more difficult to measure their market risk using VaR models than it is to measure the market risk of other types of securities using VaR models? If so, explain why.

2. Are the application requirements in Appendix E to Rule 15c3–1 an appropriate model for the application requirements in proposed new Rule 18a–1? If not, explain why not.

3. Are there provisions in the application requirements in Appendix E to Rule 15c3–1 not incorporated into proposed new Rule 18a–1 that should be included in the proposed rule, such as information regarding the ultimate holding company of the nonbank SBSD? If so, identify the provisions and explain why they should be incorporated into the proposed rule.

4. Is the review process for ANC applications an appropriate model for the review process for stand-alone SBSDs seeking approval to use internal models to compute net capital? If not, explain why not.

5. Are there ways to facilitate the timely review of applications from nonbank SBSDs to use internal models if a large number of applications are filed at the same time? For example, could a more limited review process be used if a banking affiliate of a nonbank SBSD has been approved by a prudential regulator to use the same model the nonbank SBSD intends to use? If so, what conditions should attach to such approval? Are there other indicia of the reliability of such models that could be relied on?

6. Are the qualitative requirements in Appendix E to Rule 15c3–1 an appropriate model for the qualitative requirements in proposed new Rule 18a–1?

7. More generally, are the qualitative requirements in Appendix E to Rule 15c3–1 appropriate for VaR models that will include security-based swaps? If not, explain why not. For example, are there additional or alternative qualitative requirements that should be required to address the unique risk characteristics of security-based swaps? If so, describe them and explain why they would be appropriate qualitative requirements.

8. Are the quantitative requirements in Appendix E to Rule 15c3–1 an appropriate model for the quantitative requirements in proposed new Rule 18a–1? If not, explain why not.

9. More generally, are the quantitative requirements in Appendix E to Rule 15c3–1 appropriate for VaR models that will include security-based swaps? If not, explain why not. For example, are there additional or alternative quantitative requirements that should be required to address the unique risk characteristics of security-based swaps? If so, describe them and explain why they would be preferable.

10. Are the components of the deduction an ANC broker-dealer must take from tentative net capital under Appendix E to Rule 15c3–1 an appropriate model for the components of the deduction a stand-alone SBSD approved to use internal models would be required to take from tentative net capital under proposed new Rule 18a–1? If not, explain why not.

11. Should the Commission employ the same type of on-going monitoring process used for ANC broker-dealers to monitor stand-alone SBSDs using internal models? If not, explain why not.

iv. Credit Risk Charges

Obtaining collateral is one of the ways dealers in OTC derivatives manage their credit risk exposure to OTC derivatives counterparties.[256] Collateral may be provided to cover the amount of the

unrelated to broader market moves. The market risk charge is designed to address the risk that the value of a portfolio of trading book assets will decline as a result of a broad move in market prices or interest rates. For example, the potential that the S&P 500 index will increase or decrease on the next trading day creates market risk for a portfolio of equity securities positions (longs, shorts, options, and OTC derivatives) and the potential that interest rates will increase or decrease on the next trading day creates market risk for a portfolio of fixed-income positions (longs, shorts, options, and OTC derivatives). The specific risk charge is designed to address the risk that the value of an individual position would decline for reasons unrelated to a broad movement of market prices or interest rates. For example, specific risk includes the risk that the value of an equity security will decrease because the issuer announces poor earnings for the previous quarter or the value of a debt security will decrease because the issuer's credit rating is lowered. The Commission is proposing a similar charge that would apply to stand-alone SBSDs in determining their deduction amount. *See* paragraph (e)(1)(ii) of proposed new Rule 18a–1.

[251] *See* 17 CFR 240.15c3–1e(b)(3). A similar charge would apply to stand-alone SBSDs in determining their deduction amount. *See* paragraph (e)(1)(iii) of proposed new Rule 18a–1.

[252] *See* 17 CFR 240.15c3–1e(b)(4). A similar charge would apply to stand-alone SBSDs in determining their deduction amount. *See* paragraph (e)(1)(iv) of proposed new Rule 18a–1.

[253] More detailed descriptions of the Commission's ANC broker-dealer program are available on the Commission's Web site at *http://www.sec.gov/divisions/marketreg/bdriskoffice.htm* and *http://www.sec.gov/divisions/marketreg/bdaltnetcap.htm*. The ultimate holding companies of the ANC broker-dealers also are subject to monitoring by Commission staff.

[254] In addition to regularly scheduled meetings, communications with ANC broker-dealers may increase in frequency, dependent on existing market conditions, and at times, may involve daily, weekly or other *ad hoc* calls or meetings.

[255] *See* 17 CFR 240.15c3–1e(a)(8).

[256] *See, e.g.,* International Swaps and Derivatives Association, Inc. (''ISDA''), *Market Review of OTC Derivative Bilateral Collateralization Practices,* Release 2.0 (Mar. 1, 2010), available at *http://www.isda.org/c_and_a/pdf/Collateral-Market-Review.pdf* (''*Market Review of OTC Derivative Bilateral Collateralization Practices''*); Committee on Payment and Settlement Systems and the Euro-currency Standing Committee of the Central Banks of the Group of Ten countries, *OTC Derivatives: Settlement Procedures And Counterparty Risk Management,* (Sept. 1998), available at *http://www.bis.org/publ/ecsc08.pdf* (''*OTC Derivatives: Settlement Procedures And Counterparty Risk Management''*).

current exposure of the dealer to the counterparty.[257] In this case, the collateral is designed to protect the dealer from losing the positive market value of the OTC contract if the counterparty defaults.[258] Collateral also may be provided to cover an amount in excess of the current exposure (sometimes referred to as ''residual exposure'') of the dealer to the counterparty.[259] In this case, the collateral is designed to protect the dealer from potential future credit risk exposure to the counterparty (''potential future exposure'').[260] This risk, among other things, is that the current exposure may increase in the future and the counterparty will default on the obligation to provide additional collateral to cover the increase or an increase in the amount of current exposure will occur after the counterparty defaults and is no longer providing collateral.[261]

As discussed below in section II.B. of this release, the margin rule for non-cleared security-based swaps—proposed new Rule 18a–3—would require a nonbank SBSD to collect collateral from a counterparty to cover current and potential future exposure to the counterparty.[262] However, under the rule, a nonbank SBSD would not be required to collect collateral from a *commercial end user* to cover current and potential future exposure to the *commercial end user.*[263] This proposed exception to collecting collateral from *commercial end users* is intended to address concerns that have been expressed by these entities and others that the imposition of margin requirements on commercial companies that use derivatives to mitigate business risks could disrupt their ability to enter into hedging transactions by making it prohibitively expensive.[264] At the same time, because collecting collateral is an important means of mitigating risk, nonbank SBSDs would be required to take a 100% deduction from net worth if collateral is not collected from a *commercial end user* to cover the amount of the nonbank SBSD's uncollateralized current exposure.[265] In addition, as discussed below in section II.A.2.b.v. of this release, nonbank SBSDs would be required to take a capital charge equal to the amount that the potential future exposure to the *commercial end user*—as measured under proposed new Rule 18a–3—is uncollateralized.[266] As an alternative to taking these 100% capital charges for uncollateralized current and potential future exposure to a *commercial end user,* an ANC broker-dealer and a stand-alone SBSD using internal models could take a credit risk charge using a methodology in Appendix E to Rule 15c3–1.[267] This charge would be designed to balance the concern of *commercial end users* that delivering collateral to nonbank SBSDs could disrupt their ability to enter into hedging transactions with the need for nonbank SBSDs to account for their credit risk to *commercial end users.*

ANC broker-dealers currently are permitted to add back to net worth uncollateralized receivables from counterparties arising from OTC derivatives transactions (*i.e.,* they can add back the amount of the uncollateralized current exposure).[268] Instead of the 100% deduction that applies to most unsecured receivables under Rule 15c3–1, ANC broker-dealers are permitted to take a credit risk charge based on the uncollateralized credit exposure to the counterparty.[269] In most cases, the credit risk charge is significantly less than a 100% deduction, since it is a percentage of the amount of the receivable that otherwise would be deducted in full. ANC broker-dealers are permitted to use this approach because they are required to implement processes for analyzing credit risk to OTC derivative counterparties and to develop mathematical models for estimating credit exposures arising from OTC derivatives transactions and determining risk-based capital charges for those exposures.[270] Under the current requirements, this approach is used for uncollateralized OTC derivatives receivables from all types of counterparties.[271] For the reasons discussed below, this treatment would be narrowed under the proposed capital requirements for ANC broker-dealers and stand-alone SBSDs using internal models so that it would apply only to uncollateralized receivables from *commercial end users* arising from security-based swaps (*i.e.,* uncollateralized receivables from other types of counterparties would be subject to the 100% deduction from net worth).[272]

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[257] *See, e.g.,* ISDA, *Independent Amounts,* Release 2.0 (Mar. 1, 2010) (''*Independent Amounts*''). The current exposure is the amount that the counterparty would be obligated to pay the nonbank SBSD if all the OTC derivatives contracts with the counterparty were terminated (*i.e.,* the net positive value of the OTC contracts to the nonbank SBSD and the net negative value of the OTC contracts to the counterparty). The amount payable on the OTC derivatives contracts (the positive value) is determined by marking-to-market the OTC derivatives contracts and netting contracts with a positive value against contracts with a negative value. The market value of an OTC derivatives contract also is referred to as the *replacement value* of the contract as that is the amount the nonbank SBSD would need to pay to enter into an identical contract with a different counterparty.

[258] *Id.* at 2 (''The commercial reason for basing the collateral requirement around the Exposure is that this represents an approximation of the amount of credit default loss that would occur between the parties if one were to default.'').

[259] *Id.* at 4.

[260] *Id.* at 6 (''The underlying commercial reason behind Independent Amounts is the desire to create a ''cushion'' of additional collateral to protect against certain risk * * *'').

[261] *Id.*

[262] *See* proposed new Rule 18a–3.

[263] *See* paragraph (c)(1)(iii)(A) of proposed new Rule 18a–3. As discussed in section II.B. of this release, proposed new Rule 18a–3 would contain three other exceptions to the requirements in the rule to collect and hold collateral. *See* paragraphs (c)(1)(iii)(B), (C), and (D) of proposed new Rule 18a–3. The proposed alternative credit risk charge discussed in this section of the release would not apply to these other exceptions.

[264] *See, e.g.,* letter from the Honorable Debbie Stabenow, Chairman, Committee on Agriculture, Nutrition and Forestry, U.S. Senate, the Honorable Frank D. Lucas, Chairman, Committee on Agriculture, U.S. House of Representatives, the Honorable Tim Johnson, Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and the Honorable Spencer Bachus, Chairman, Committee on Financial Services, U.S. House of Representatives to Secretary Timothy Geithner, Department of Treasury, Chairman Gary Gensler, CFTC, Chairman Ben Bernanke, Federal Reserve Board, and Chairman Mary Schapiro, Commission (Apr. 6, 2011); letter from the Honorable Christopher Dodd, Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, and the Honorable Blanche Lincoln, Chairman, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, to the Honorable Barney Frank, Chairman, Financial Services Committee, U.S. House of Representatives, and the Honorable Collin Peterson, Chairman, Committee on Agriculture, U.S. House of Representatives (June 30, 2010); 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Lincoln). *See also* letter from Coalition for Derivatives End-Users to David A. Stawick, Secretary, CFTC (July 11, 2011); letter from Paul Cicio, President, Industrial Energy Users of America, to David A. Stawick, Secretary, CFTC (July 11, 2011); letter from Coalition for Derivatives End-Users to Elizabeth Murphy, Secretary, Commission and David A. Stawick, Secretary, CFTC (Sept. 10, 2010).

[265] *See* 17 CFR 240.15c3–1(c)(2)(iv)(B) (which requires a broker-dealer—and would require a broker-dealer SBSD—to deduct unsecured and partly secured receivables); paragraph (c)(1)(iii)(B) of proposed new Rule 18a–1 (which would contain an analogous provision for stand-alone SBSDs).

[266] *See* proposed new paragraph (c)(2)(xiv) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*1*) of proposed Rule 18a–1.

[267] *See* proposed amendments to paragraph (a)(7) of Rule 15c3–1; paragraph (a)(2) of proposed new Rule 18a–1.

[268] *See* 17 CFR 240.15c3–1e(c). OTC derivatives dealers are permitted to treat such uncollateralized receivables in a similar manner. *See* 17 CFR 240.15c3–1f.

[269] *See* 17 CFR 240.15c3–1e(c); 17 CFR 240.15c3–1(a)(7).

[270] *Id.*

[271] *Id.* While the requirements permit this treatment for unsecured receivables from all types of counterparties, the amount of the credit risk charge—as discussed below—depends on the creditworthiness of the counterparty. *Id.*

[272] *See* proposed amendments to paragraphs (a) and (c) of Rule 15c3–1e.

The current requirements for determining risk-based capital charges for credit exposures are prescribed in Appendix E to Rule 15c3–1. These requirements are based on a method of computing capital charges for credit risk exposures in the international capital standards for banking institutions. In general terms, credit risk is the risk of loss arising from a borrower or counterparty's failure to meet its obligations in accordance with agreed terms, including, for example, by failing to make a payment of cash or delivery of securities. The considerations that inform an entity's assessment of a counterparty's credit risk therefore are broadly similar across the various relationships that may arise between the dealer and the counterparty. Accordingly, the methodology in Appendix E to Rule 15c3–1 should be a reasonable model for determining risk-based capital charges for credit exposures whether the entity in question is an ANC broker-dealer or a stand-alone SBSD using models. Similarly, because credit risk arises regardless of the number or size of transactions, the methodology should apply in a consistent manner whether an entity deals exclusively in OTC derivatives, maintains a significant book of such derivatives, or only engages in one from time to time.

As discussed above in section II.A.2.b.i. of this release, the capital standard in Rule 15c3–1 is a net liquid assets test. The rule imposes this test by requiring a broker-dealer to deduct all illiquid assets, including most unsecured receivables.[273] The goal is to require the broker-dealer to hold more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities. The rule requires a 100% deduction for most types of unsecured receivables because these assets cannot be readily converted into cash to provide immediate liquidity to the broker-dealer.[274] FOCUS Report data and Commission staff experience with supervising the ANC broker-dealers indicates that ANC broker-dealers have not engaged in a large volume of OTC derivatives transactions since these rules were adopted in 2004. Therefore, they have not had significant amounts of unsecured receivables that could be subject to the credit risk charge provisions in Appendix E to Rule 15c3–1. However, when the Dodd-Frank Act's OTC derivatives reforms are implemented and become effective, ANC broker-dealers could significantly increase the amount of the receivables these firms have relating to OTC derivatives. This development could adversely impact the liquidity of the ANC broker-dealers to the extent exposures to OTC derivatives are not collateralized.

For these reasons, ANC broker-dealers (including broker-dealer SBSDs that are approved to use internal models) would be required to treat uncollateralized receivables from counterparties arising from security-based swaps like most other types of unsecured receivables (*i.e.,* subjecting them to a 100% deduction from net worth) *except* when the counterparty is a *commercial end user.* In the case of a *commercial end user,* the ANC broker-dealer would be permitted to continue to take a credit risk charge in lieu of the 100% deduction.[275] Stand-alone SBSDs that are approved to use internal models also would be permitted to take a credit risk charge for uncollateralized receivables arising from security-based swaps with (and only with) *commercial end users* in lieu of the 100% deduction.[276]

Under the proposed capital requirements for nonbank SBSDs, this credit risk charge for a *commercial end user* could serve as an alternative to the proposed capital charge in lieu of collecting collateral to cover potential future exposure.[277] The proposed capital charge in lieu of margin is designed to address situations where a nonbank SBSD does not collect sufficient (or any) collateral to cover potential future exposure relating to cleared and non-cleared security-based swaps.[278] This situation may arise with respect to counterparties to non-cleared security-based swaps that are *commercial end users* because proposed new Rule 18a–3 would not require nonbank SBSDs to collect collateral from them to cover either current or potential future exposure.[279]

The proposed method for calculating the credit risk charge for *commercial end users* would be the same method ANC broker-dealers currently are permitted to use for all OTC derivatives counterparties.[280] A stand-alone SBSD approved to use internal models would use the same method.[281] Under this method, the credit risk charge is the sum of three calculated amounts: (1) A counterparty exposure charge; (2) a concentration charge if the current exposure to a single counterparty exceeds certain thresholds; and (3) a portfolio concentration charge if aggregate current exposure to all counterparties exceeds certain thresholds.[282]

The first component of the credit risk charge is the counterparty exposure charge.[283] An ANC broker-dealer must determine an exposure charge for each OTC derivatives counterparty. The first component of the credit risk charge is the aggregate of the exposure charges across all counterparties. The exposure charge for a counterparty that is insolvent, in a bankruptcy proceeding, or in default of an obligation on its senior debt, is the net replacement value of the OTC derivatives contracts with the counterparty (*i.e.,* the net amount of the uncollateralized current exposure to the counterparty).[284] The counterparty exposure charge for all other counterparties is the *credit equivalent amount* of the ANC broker-dealer's exposure to the counterparty multiplied by an applicable credit risk weight factor and then multiplied by 8%.[285] The *credit equivalent amount* is the sum of the ANC broker-dealer's: (1) Maximum potential exposure (''MPE'') to the counterparty multiplied by a back-testing determined factor; and (2) current exposure to the counterparty.[286]

[273] *See* 17 CFR 240.15c3–1(c)(2)(iv).

[274] *See Interpretation Guide to Net Capital Computation for Brokers and Dealers,* 32 FR at 858.

[275] *See* proposed amendments to paragraphs (a) and (c) of Rule 15c3–1e.

[276] *See* paragraph (e)(2) of proposed new Rule 18a–1.

[277] *See* proposed new paragraph (c)(2)(xiv) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*1*) of proposed Rule 18a–1.

[278] *Id.*

[279] *See* paragraph (c)(1)(iii)(A) of proposed new Rule 18a–3.

[280] *See* 17 CFR 240.15c3–1e(c); paragraph (e)(2) of proposed new Rule 18a–1.

[281] *See* paragraph (e)(2) of proposed new Rule 18a–1. While this discussion focuses on the application of the method in the context of ANC broker-dealers, the same method would be used by stand-alone SBSDs for the reasons described above, in particular the fact that credit risk exposure should not vary materially depending on whether an entity is a broker-dealer SBSD or a stand-alone SBSD.

[282] 17 CFR 240.15c3–1e(c).

[283] 17 CFR 240.15c3–1e(c)(1). A stand-alone SBSD approved to use internal models would be required to take an identical credit risk charge for this type of counterparty. *See* paragraph (e)(2)(i) of proposed new Rule 18a–1.

[284] *See* 17 CFR 240.15c3–1e(c)(1)(i). In other words, the uncollateralized receivable is deducted in full. A stand-alone SBSD approved to use internal models would take an identical credit risk charge for this type of counterparty. *See* paragraph (e)(2)(i)(A) of proposed new Rule 18a–1.

[285] *See* 17 CFR 240.15c3–1e(c)(1)(ii). A stand-alone SBSD approved to use internal models would take an identical credit risk charge for this type of counterparty. *See* paragraph (e)(2)(i)(B) of proposed new Rule 18a–1. The 8% multiplier is consistent with the calculation of credit risk in the OTC derivatives dealers rules and with the Basel Standard, and is designed to dampen leverage to help ensure that the firm maintains a safe level of capital. *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34436, note 42.

[286] *See* 17 CFR 240.15c3–1e(c)(4)(i). The amount of the factor is based on backtesting exceptions. A stand-alone SBSD approved to use internal models

The MPE amount is a charge to address potential future exposure and is calculated using the ANC broker-dealer's VaR model as applied to the counterparty's positions after giving effect to a netting agreement with the counterparty, taking into account collateral received from the counterparty, and taking into account the current replacement value of the counterparty's positions.[287] The current exposure amount is the current replacement value of the counterparty's positions after giving effect to a netting agreement with the counterparty and taking into account collateral received from the counterparty.[288]

A collateral agreement gives the dealer the right of recourse to an asset or assets that can be sold or the value of which can be applied in the event the counterparty defaults on an obligation arising from an OTC derivatives contract between the dealer and the counterparty.[289] Collateral ''ideally'' is ''an asset of stable and predictable value, an asset that is not linked to the value of the transaction in any way and an asset that can be sold quickly and easily if the need arises.'' [290] Appendix E to Rule 15c3–1 sets forth requirements for taking account of collateral in determining the MPE and *current exposure* amounts.[291] These requirements are designed to require collateral that meets the characteristics noted above. The requirements, among other things, include that the collateral is: (1) Marked-to-market each day; (2) subject to a daily margin maintenance requirement;[292] (3) in the ANC broker-dealer's possession and control; (4) liquid and transferable; (5) capable of being liquidated promptly without intervention of any other party; (6) subject to a legally enforceable collateral agreement; (7) not comprised of securities issued by the counterparty or a party related to the ANC broker-dealer or the counterparty; (8) comprised of instruments that can be included in the ANC broker-dealer's VaR model; and (9) not used in determining the credit rating of the counterparty.[293]

Appendix E to Rule 15c3–1 sets forth certain minimum requirements for giving effect to netting agreements [294] when determining the MPE and current exposure amounts.[295] Specifically, an ANC broker-dealer may include the effect of a netting agreement that allows the netting of gross receivables from and gross payables to a counterparty upon default of the counterparty if:

- The netting agreement is legally enforceable in each relevant jurisdiction, including in insolvency proceedings;
- The gross receivables and gross payables that are subject to the netting agreement with a counterparty can be determined at any time; and
- For internal risk management purposes, the ANC broker-dealer monitors and controls its exposure to the counterparty on a net basis.[296]

These requirements are designed to ensure that the netting agreement between the ANC broker-dealer and the counterparty permits the ANC broker-dealer to reduce the receivables and payables between the two entities to a single net payment obligation.

The counterparty exposure charge is the sum of the MPE and current exposure amounts multiplied by an applicable credit risk weight factor and then multiplied by 8%.[297] Appendix E to Rule 15c3–1 prescribes three standardized credit risk weight factors (20%, 50%, and 150%) and, as an alternative, permits an ANC broker-dealer with Commission approval to use internal methodologies to determine appropriate credit risk weights to apply to counterparties.[298] A higher percentage credit risk weight factor results in a larger counterparty exposure charge amount. Moreover, because the counterparty exposure charge is designed to require the ANC broker-dealer to hold capital to address the firm's credit risk exposure to the counterparty, the selection of the appropriate risk weight factor to use for a given counterparty is based on an assessment of the creditworthiness of the counterparty. ANC broker-dealers are permitted to use internally derived credit ratings to select the appropriate risk weight factor.[299]

would determine the credit equivalent amount in the same manner. *See* paragraph (e)(2)(iv)(A) of proposed new Rule 18a–1.

[287] *See* 17 CFR 240.15c3–1e(c)(4)(ii). A stand-alone SBSD approved to use internal models would compute MPE in the same manner. *See* paragraph (e)(2)(iv)(B) of proposed new Rule 18a–1.

[288] *See* 17 CFR 240.15c3–1e(c)(4)(iii). A stand-alone SBSD approved to use internal models would compute *current exposure* in the same manner. *See* paragraph (e)(2)(iv)(C) of proposed new Rule 18a–1.

[289] *See Market Review of OTC Derivative Bilateral Collateralization Practices* at 5.

[290] *Id.*

[291] *See* 17 CFR 240.15c3–1e(c)(4)(v). A stand-alone SBSD approved to use internal models would be subject to the same requirements in order to be permitted to take into account collateral when determining the MPE and *current exposure* amounts. *See* paragraph (e)(2)(iv)(E) of proposed new Rule 18a–1.

[292] This refers to an internal maintenance margin requirement (*i.e.,* not one imposed by regulation).

[293] *See* 17 CFR 240.15c3–1e(c)(4)(v)(A)–(H). A stand-alone SBSD approved to use internal models would be subject to the same requirements. *See* paragraph (e)(2)(iv)(E)(*1*)–(*8*) of proposed new Rule 18a–1.

[294] Netting agreements are bilateral contracts between two counterparties that enter into OTC derivatives contracts with each other. In netting agreements, the two parties agree that if one counterparty defaults, the pending OTC derivatives contracts between the parties will be closed out and a single net payment obligation will be determined (as opposed to payment obligations for each separate OTC derivatives contract between the parties). The amount of the single net payment obligation is determined by offsetting OTC derivatives contracts that have a positive value to a counterparty with OTC derivatives contracts that have a negative value to the counterparty. After the offsets, one counterparty has an amount of positive value, which to the other counterparty is a negative value. This is the amount of the single net payment obligation. If the non-defaulting counterparty is owed the single net payment amount, it can liquidate collateral held to secure the obligations of the defaulting counterparty. However, if the non-defaulting party does not hold collateral, it becomes a general creditor of the defaulting counterparty with respect to the amount of the single net payment obligation.

[295] *See* 17 CFR 240.15c3–1e(c)(4)(iv). A stand-alone SBSD approved to use internal models would be subject to the same requirements in order to be permitted to take into account netting agreements when determining MPE and *current exposure* amounts. *See* paragraph (e)(2)(iv)(D) of proposed new Rule 18a–1.

[296] *See* 17 CFR 240.15c3–1e(c)(4)(iv)(A)–(C). A stand-alone SBSD approved to use internal models would be subject to the same requirements. *See* paragraphs (e)(2)(iv)(D)(*1*)–(*3*) of proposed new Rule 18a–1.

[297] *See* 17 CFR 240.15c3–1e(c)(1)(ii). As noted above, an 8% multiplier is consistent with the international bank capital standards and is designed to dampen leverage to help ensure that the ANC broker-dealer maintains a safe level of capital. *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34436.

[298] *See* 17 CFR 240.15c3–1e(c)(4)(vi). A stand-alone SBSD approved to use internal models would be subject to the same requirements. *See* paragraph (e)(2)(iv)(F) of proposed new Rule 18a–1. The credit risk weights in Appendix E to Rule 15c3–1 were based on the international bank capital standards. *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34436 (''These proposed credit risk weights were based on the formulas provided in the Foundation Internal Ratings-Based approach to credit risk proposed by the Basel Committee and were derived using a loss given default (the percent of the amount owed by the counterparty the firm expects to lose if the counterparty defaults) of 75%.'') (citations omitted).

[299] *See* 17 CFR 240.15c3–1e(c)(4)(vi)(D). There is a basic method for ANC broker-dealers to determine the applicable risk weight factor using external credit ratings of NRSROs. *See* 17 CFR 240.15c3–1e(c)(4)(vi)(A)–(C). Currently, all six ANC broker-dealers are approved to use internally derived credit ratings. *See Reference Removal Release,* 76 FR at 26555. Pursuant to section 939A of the Dodd-Frank Act, the Commission has proposed eliminating the basic method of using NRSRO credit ratings and, consequently, if the proposals are adopted, an ANC broker-dealer would be required to use internally derived credit ratings. *See* Public Law 111–203 § 939A and *Reference Removal Release,* 76 FR at 26555–26556. Consistent with section 939A of the Dodd-Frank Act, there would not be a basic method for stand-alone SBSDs approved to use internal models. *See* paragraph (e)(2)(iv)(F) of proposed new Rule 18a–1. Consequently, these nonbank SBSDs would be required to use internally derived credit ratings to determine the appropriate risk weight factor to apply to a counterparty. This does not mean that an ANC broker-dealer or stand-alone SBSD could

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The second component of an ANC broker-dealer's credit risk charge is a counterparty concentration charge.[300] This charge accounts for the additional risk resulting from a relatively large exposure to a single counterparty.[301] This charge is triggered if the current exposure of the ANC broker-dealer to a counterparty exceeds 5% of the tentative net capital of the ANC broker-dealer.[302] In this case, the ANC broker-dealer must take a counterparty concentration charge equal to: (1) 5% of the amount by which the current exposure exceeds 5% of tentative net capital for a counterparty with a risk weight factor of 20% or less; (2) 20% of the amount by which the current exposure exceeds 5% of tentative net capital for a counterparty with a risk weight factor of greater than 20% and less than 50%; and (3) 50% of the amount by which the current exposure exceeds 5% of tentative net capital for a counterparty with a risk weight factor of 50% or more.[303]

The third—and final—component of the credit risk charge is a portfolio concentration charge.[304] The portfolio concentration charge is designed to address the risk of having a relatively large amount of unsecured receivables relative to the size of the firm. This charge is triggered when the aggregate current exposure of the ANC broker-dealer to all counterparties exceeds 50% of the firm's tentative net capital.[305] In this case, the portfolio concentration charge is equal to 100% of the amount by which the aggregate current exposure exceeds 50% of the ANC broker-dealer's tentative net capital.[306]

Request for Comment

The Commission generally requests comment on the proposed credit risk charges. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Should ANC broker-dealers and stand-alone SBSDs using internal models be required to deduct in full unsecured receivables from *commercial end users,* rather than being permitted to use the proposed credit risk charge? If so, explain why. If not, explain why not. For example, would ANC broker-dealers and stand-alone SBSDs using internal models have substantial amounts of receivables from *commercial end users* that, if not collateralized, could adversely impact the liquidity of these firms? If so, what measures in addition to the proposed credit risk charge could be implemented to address the risk of uncollateralized credit risk exposure to *commercial end users* in the absence of a required 100% deduction? Commenters should provide data to support their responses to these questions.

2. Should ANC broker-dealers and stand-alone SBSDs using internal models be required to take a capital charge in lieu of margin for non-cleared security-based swaps with *commercial end users*? If so, explain why. If not, explain why not. For example, would ANC broker-dealers and stand-alone SBSDs using internal models enter into substantial amounts of non-cleared security-based swaps with *commercial end users* that could adversely impact the risk profiles of these firms, if collateral was not collected to cover potential future exposure? If so, what measures in addition to the proposed credit risk charge could be implemented to address this risk in the absence of a required 100% deduction? Commenters should provide data to support their responses to these questions.

3. Is the credit risk charge an appropriate measure to address the risk to nonbank SBSDs of having uncollateralized current and potential future exposure to *commercial end users*? If so, explain why. If not, explain why not. Are there other measures that could be implemented as an alternative or in addition to the credit risk charge to address the risk of this uncollateralized exposure? If so, identify the measures and explain why they would be appropriate alternatives or supplements to the credit risk charge.

4. What will be the economic impact of the credit risk charge? For example, will the additional capital that a nonbank SBSD would be required to maintain because of the credit risk charge result in costs that will be passed through to end users? Please explain.

5. Should the application of the credit risk charge be expanded to unsecured receivables from other types of counterparties? If so, explain why. If not, explain why not. How would such an expansion impact the liquidity of nonbank SBSDs?

6. Should the application of the credit risk charge be expanded to the other exceptions to the margin collateral requirements in proposed new Rule 18a–3? If so, explain why. If not, explain why not. How would such an expansion impact the risk profile of nonbank SBSDs?

7. The ability to take a credit risk charge in lieu of a 100% deduction for an unsecured receivable would apply only to unsecured receivables from *commercial end users* arising from security-based swap transactions. Consequently, an ANC broker-dealer and a nonbank SBSD would need to take a 100% deduction for unsecured receivables from *commercial end users* arising from swap transactions. Should the application of the credit risk charge be expanded to include unsecured receivables from *commercial end users* arising from swap transactions? If so, explain why. If not, explain why not. How would such an expansion impact the liquidity of nonbank SBSDs?

8. Is the overall method of computing the credit risk charge appropriate for nonbank SBSDs? If not, explain why not. For example, are there differences between ANC broker-dealers and nonbank SBSDs that would make the method of computing the credit risk charge appropriate for the former but not appropriate for the latter? If so, identify the differences and explain why they would make the credit risk charge not appropriate for nonbank SBSDs. What modifications should be made to the method of computing the credit risk charge for nonbank SBSDs?

9. Are the steps required to compute the credit risk charge understandable? If not, identify the steps that require further explanation.

10. Is the method of computing the first component of the credit risk charge—the counterparty exposure charge—appropriate for nonbank SBSDs? If not, explain why not. For example, is the calculation of the *credit equivalent amount* for a counterparty

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not include external credit ratings as part of its internal credit rating methodology. *See Reference Removal Release,* 76 FR at 26552–26553 (identifying external credit ratings as one of several factors a broker-dealer could consider when assessing credit risk under the Commission's proposals to substitute NRSRO credit ratings in the broker-dealer rules with a different standard of creditworthiness).

[300] *See* 17 CFR 240.15c3–1e(c)(2). A stand-alone SBSD approved to use internal models would be subject to the same counterparty concentration charge. *See* paragraph (e)(2)(ii) of proposed new Rule 18a–1.

[301] Concentration charges are intended to provide a liquidity cushion if a lack of diversification of positions exposes the firm to additional risk.

[302] *See* 17 CFR 240.15c3–1e(c)(2)(i)–(iii). A stand-alone SBSD approved to use internal models would be subject to the same threshold in determining the counterparty concentration charge. *See* paragraphs (e)(2)(ii)(A)–(C) of proposed new Rule 18a–1.

[303] *See* 17 CFR 240.15c3–1e(c)(1)(i)–(iii). A stand-alone SBSD approved to use internal models would be subject to the same charges. *See* paragraphs (e)(2)(ii)(A)–(C) of proposed new Rule 18a–1.

[304] *See* 17 CFR 240.15c3–1e(c)(3). A stand-alone SBSD approved to use internal models would be subject to the same portfolio concentration charge. *See* paragraph (e)(2)(iii) of proposed new Rule 18a–1.

[305] 17 CFR 240.15c3–1e(c)(3).

[306] *See* 17 CFR 240.15c3–1e(c)(3). A stand-alone SBSD approved to use internal models would be subject to the same charge. *See* paragraph (e)(2)(iii) of proposed new Rule 18a–1.

(*i.e.,* the sum of the MPE and the current exposure to the counterparty) a workable requirement for nonbank SBSDs? If not, explain why not.

11. Are the conditions for taking collateral into account when calculating the *credit equivalent amount* appropriate for nonbank SBSDs? If not, explain why not.

12. Are the conditions for taking netting agreements into account when calculating the *credit equivalent amount* appropriate for nonbank SBSDs? If not, explain why not.

13. Are the standardized risk weight factors (20%, 50%, and 150%) proposed for calculating the *credit equivalent amount* appropriate for nonbank SBSDs? If not, explain why not.

14. Is the method of computing the second component of the credit risk charge—the counterparty concentration charge—appropriate for nonbank SBSDs? If not, explain why not.

15. Is the method of computing the third component of the credit risk charge—portfolio concentration charge—appropriate for nonbank SBSDs? If not, explain why not.

v. Capital Charge In Lieu of Margin Collateral

As discussed above in section II.B. of this release, collateral is one of the ways dealers in OTC derivatives manage their credit risk exposure to OTC derivatives counterparties.[307] Collateral may be provided to cover the amount of the current exposure of the dealer to the counterparty.[308] Collateral also may be provided to cover the potential future exposure of the dealer to the counterparty, *i.e.,* margin collateral.[309] Clearing agencies will impose margin collateral requirements on their clearing members, including nonbank SBSDs, for cleared security-based swaps.[310] In addition, as discussed below in section II.B. of this release, proposed new Rule 18a–3 would establish margin collateral requirements for nonbank SBSDs with respect to non-cleared security-based swaps.[311] Furthermore, FINRA also prescribes margin requirements for security-based swaps.[312]

Rule 15c3–1 currently requires a broker-dealer to take a deduction from net worth for under-margined accounts.[313] Specifically, the broker-dealer is required to deduct from net worth the amount of cash required in each customer's and noncustomer's account to meet a maintenance margin requirement of the firm's designated examining authority after application of calls for margin, marks to the market, or other required deposits which are outstanding five business days or less.[314] These deductions serve the same purpose as the deductions a broker-dealer is required to take on proprietary securities positions in that they account for risk of the positions in the customer's account, which the broker-dealer may need to liquidate if the customer defaults on obligations to the broker-dealer.

In order to prescribe a similar requirement for security-based swap positions, Rule 15c3–1 would be amended to require broker-dealer SBSDs to take a deduction from net worth for the amount of cash required in the account of each security-based swap customer to meet the margin requirements of a clearing agency, self-regulatory organization (''SRO''), or the Commission, after application of calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.[315] An analogous provision would be included in new Rule 18a–1, though it would not refer to margin requirements of SROs because stand-alone SBSDs will not be members of SROs.[316] These provisions would require broker-dealer SBSDs to take capital charges when their security-based swap customers do not meet margin collateral requirements of clearing agencies, SROs, or the Commission after one business day from the date the margin collateral requirement arises. The capital charge would be designed to address the risk to nonbank SBSDs that arises from not collecting the margin collateral.[317]

As discussed below in section II.B. of this release, proposed new Rule 18a–3 would require nonbank SBSDs to collect collateral to meet account *equity* requirements by noon of the next business day from the day the account *equity* requirement arises.[318] Consequently, to be consistent with the proposed requirement to collect collateral within one day, the under-margined capital charge for security-based swap accounts would be triggered within one day of the margin requirement arising, as opposed to the five-day trigger in Rule 15c3–1.

In addition to the deductions for under-margined security-based swap accounts, the proposed rules would impose capital charges designed to address situations where the account of a security-based swap customer is meeting all applicable margin requirements but the margin collateral requirement results in the collection of an amount of collateral that is insufficient to address the risk because, for example, the requirement for cleared security-based swaps established by a clearing agency does not result in sufficient margin collateral to cover the nonbank SBSD's exposure or because an exception to collecting margin collateral for non-cleared security-based swaps exists.[319] These proposed capital charges would not apply in the circumstance, discussed in the preceding section, involving unsecured receivables from *commercial end users,* which would be separately addressed by proposed new Rule 18a–1 and proposed amendments to Rule 15c3–1.[320] The proposed capital charges relating to margin collateral would be required deductions from the nonbank SBSD's net worth when computing net capital.[321] The proposals are intended to require a nonbank SBSD to set aside net capital to address the risks of potential future exposure that are mitigated through the collection of margin collateral. The set aside net capital would serve as an alternative to obtaining margin collateral for this purpose.

With respect to cleared security-based swaps, for which margin requirements will not be established by the Commission, the rules would impose a capital charge that would apply if a nonbank SBSD collects margin collateral from a counterparty in an amount that is less than the deduction that would apply to the security-based swap if it was a proprietary position of

[307] *See Market Review of OTC Derivative Bilateral Collateralization Practices.*

[308] *See Independent Amounts.*

[309] *Id.* at 4.

[310] *See* discussion below in section II.B. of this release.

[311] *See* proposed new Rule 18a–3.

[312] *See* FINRA Rule 4240.

[313] *See* 17 CFR 240.15c3–1(c)(2)(xii).

[314] *Id.*

[315] *See* proposed new paragraph (c)(2)(xii)(B) of Rule 15c3–1.

[316] *See* paragraph (c)(1)(ix) of proposed new Rule 18a–1.

[317] *See* section II.B.1. of this release for a discussion of the purpose of margin collateral.

[318] *See* paragraph (c)(1)(ii) of proposed new Rule 18a–3.

[319] *See* proposed new paragraph (c)(2)(xiv) of Rule 15c3–1; paragraph (c)(1)(viii) of proposed new Rule 18a–1. The exceptions to the proposed margin rule are discussed below.

[320] As discussed above in section II.A.2.b.v. of this release, nonbank SBSDs would be required to take a 100% deduction to net worth when calculating net capital equal to their uncollateralized current exposure to a counterparty arising from a security-based swap except that an ANC broker-dealer and a stand-alone SBSD approved to use internal models could take a credit risk charge as an alternative to the 100% deduction if the counterparty was a *commercial end user. See* 17 CFR 240.15c3–1(c)(2)(iv)(B) (which requires a broker-dealer—and would require a broker-dealer SBSD—to deduct unsecured and partly secured receivables); paragraph (c)(1)(iii)(B) of proposed new Rule 18a–1 (which would contain an analogous provision for stand-alone SBSDs).

[321] *Id.*

the nonbank SBSD (*i.e.,* less than an amount determined by using the standardized haircuts in Commission Rule 15c3–1, as proposed to be amended, and in proposed new Rule 18a–1 or a VaR model, as applicable).[322] This aspect of the proposal is intended to adequately account for the risk of the counterparty defaulting by requiring the nonbank SBSD to maintain capital in the place of margin collateral in an amount that is no less than would be required for a proprietary position.[323] This requirement also is intended to ensure that there is a standard minimum coverage for exposure to cleared security-based swap counterparties apart from the individual clearing agency margin requirements, which could vary among clearing agencies and over time. If the counterparty defaults, the nonbank SBSD would need to liquidate the counterparty's cleared security-based swaps and other positions in the account to cover the counterparty's obligation to the nonbank SBSD. Thus, the nonbank SBSD will become subject to the market risk of these positions in the event of the counterparty's default. If the positions decrease in value, the nonbank SBSD may not be able to cover the defaulted counterparty's obligations to the nonbank SBSD through the liquidation of the positions because the cash proceeds from the liquidation may yield less than the obligation.

Margin collateral is designed to mitigate this risk by serving as a buffer to account for a decrease in the market value of the counterparty's positions between the time of the default and the liquidation. If the amount of the margin collateral is insufficient to make up the difference, the nonbank SBSD will incur losses. This proposed capital charge is designed to require the nonbank SBSD to hold sufficient net capital, as an alternative to margin, to enable it to withstand such losses.

With respect to non-cleared security-based swaps, the rules would impose capital charges to address three exceptions in proposed new Rule 18a–3 (the nonbank SBSD margin rule).[324] Under these three exceptions, a nonbank SBSD would not be required to collect (or, in one case, hold) margin collateral. As discussed below in section II.B.2.b. of this release, proposed Rule 18a–3 would require a nonbank SBSD to perform a daily calculation of a *margin* amount for the account of each counterparty to a non-cleared security-based swap transaction.[325] Proposed new Rule 18a–3 also would require a nonbank SBSD to collect and hold margin collateral (in the form of cash, securities, and/or money market instruments) from each counterparty in an amount at least equal to the calculated margin amount to the extent that amount is greater than the amount of *positive equity* in the account.[326] The rule would, however, provide exceptions in certain cases.[327]

Consequently, the three proposed capital charges discussed below are designed to serve as an alternative to margin collateral by requiring the nonbank SBSD to hold sufficient net capital to enable it to withstand losses if the counterparty defaults.

The first proposed capital charge would apply when a nonbank SBSD not approved to use internal models does not collect sufficient margin collateral from a counterparty to a non-cleared security-based swap because the counterparty is a *commercial end user.*[328] As discussed below in section II.B.2.c.i. of this release, a nonbank SBSD would not be required to collect margin collateral from *commercial end users* for non-cleared security-based swaps.[329] The nonbank SBSD would be required to take a capital charge equal to the margin amount less any *positive equity* in the account of the *commercial end user* if the nonbank SBSD did not collect margin collateral from the *commercial end user* pursuant to this exception.[330] As discussed above in section II.A.2.b.iv. of this release, as an alternative to this deduction, an ANC broker-dealer and a stand-alone SBSD approved to use internal models could incur a credit risk charge.

The second proposed capital charge would apply when the nonbank SBSD does not hold the margin collateral because the counterparty to the non-cleared security-based swap is requiring the margin collateral to be segregated pursuant to section 3E(f) of the Exchange Act.[331] Section 3E(f) of the Exchange Act, among other things, provides that the segregated account authorized by that provision must be carried by an independent third-party custodian and be designated as a segregated account for and on behalf of the counterparty.[332] Collateral held in this manner would not be in the

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[322] *See* proposed paragraph (c)(2)(xiv)(A) of Rule 15c3–1; paragraph (c)(1)(viii)(A) of proposed Rule 18a–1.

[323] As discussed in section II.B.2. of this release, the margin requirements for non-cleared security-based swaps would be the same as the deductions to net capital that a nonbank SBSD would take on the positions under Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1.

[324] *See* paragraphs (c)(1)(iii)(A), (C), and (D) of proposed new Rule 18a–3. There is a fourth exception in proposed new Rule 18a–3 under which a nonbank SBSD would not be required to collect margin collateral to cover potential future exposure to another SBSD. *See* paragraph (c)(1)(iii)(B)—Alternative A of proposed new Rule 18a–3. There would not be a capital charge in lieu of collecting margin collateral from another SBSD because capital charges could impact the firm's liquidity, and each SBSD would be subject to regulatory capital requirements. A second alternative (Alternative B) being proposed in new Rule 18a–3 would require a nonbank SBSD to have margin collateral posted to an account at a third-party custodian in an amount sufficient to cover the nonbank SBSD's potential future exposure to the other SBSD. *See* paragraph (c)(1)(iii)(B)—Alternative B—of proposed new Rule 18a–3. These two alternatives are discussed in more detail in section II.B.2. of this release.

[325] *See* paragraph (c)(1)(i)(B) of proposed new Rule 18a–3. The term *margin* in proposed new Rule 18a–3 would be defined to mean the amount of *positive equity* in an account of a counterparty. *See* paragraph (b)(5) of proposed new Rule 18a–3.

[326] *See* paragraph (c)(1)(ii) of proposed new Rule 18a–3. *See also* paragraph (c)(4) of proposed new Rule 18a–3 (requiring among other things that collateral be in the physical possession or control of the nonbank SBSD and that the collateral must be capable of being liquidated promptly by the nonbank SBSD). As discussed in section II.B.2. of this release, the term *equity* in proposed new Rule 18a–3 would be defined to mean the total current fair market value of securities positions in an account of a counterparty (excluding the time value of an over-the-counter option), plus any credit balance and less any debit balance in the account after applying a qualifying netting agreement with respect to gross derivatives payables and receivables. *See* paragraph (b)(4) of proposed new Rule 18a–3. The term *negative equity* in proposed new Rule 18a–3 would be defined to mean *equity* of less than $0. *See* paragraph (b)(6) of proposed new Rule 18a–3. The term *positive equity* in proposed new Rule 18a–3 would be defined to mean *equity* of greater than $0. *See* paragraph (b)(7) of proposed new Rule 18a–3.

[327] *See* paragraphs (c)(1)(iii)(A), (C), and (D) of proposed new Rule 18a–3. As noted above and discussed in more detail in section II.B.2. of this release, one alternative being considered is to establish a fourth exception in proposed new Rule 18a–3 under which a nonbank SBSD would not be required to collect margin collateral to cover potential future exposure to another SBSD. *See* paragraph (c)(1)(iii)(B) of proposed new Rule 18a–3. Under this alternative, there would not be a capital charge in lieu of collecting margin collateral from the other SBSD because capital charges could impact the firm's liquidity, and each SBSD would be subject to regulatory capital requirements. The other alternative would require nonbank SBSDs to have margin collateral posted to an account at a third-party custodian in an amount sufficient to cover the nonbank SBSD's potential future exposure to the other SBSD.

[328] *See* proposed paragraph (c)(2)(xiv)(B)(*1*) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*1*) of proposed new Rule 18a–1.

[329] *See* paragraph (c)(1)(iii)(A) of proposed new Rule 18a–3.

[330] *See* proposed new paragraph (c)(2)(xiv)(B)(*1*) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*1*) of proposed new Rule 18a–1. If collateral is not collected from a *commercial end user,* the nonbank SBSD would be required to take a 100% deduction for the amount of the uncollateralized current exposure. As discussed above in section II.A.2.b.iv. of this release, as alternative to this deduction, an ANC broker-dealer and a stand-alone SBSD approved to use internal models could take a credit risk charge.

[331] *See* proposed new paragraph (c)(2)(xiv)(B)(*2*) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*2*) of proposed new Rule 18a–1.

[332] *See* 15 U.S.C. 78c–5(f)(3).

physical possession or control of the nonbank SBSD, nor would it would be capable of being liquidated promptly by the nonbank SBSD without the intervention of another party. Consequently, it would not meet collateral requirements in proposed new Rule 18a–3.[333] Because collateral segregated under section 3E(f) of the Exchange Act would not be under the control of the nonbank SBSD, consistent with the existing capital requirements that apply to broker-dealers, the Commission is proposing to require the nonbank SBSD to take a capital charge equal to the margin amount less any *positive equity* in the account of the counterparty.[334]

The third proposed capital charge would apply when a nonbank SBSD does not collect sufficient margin collateral from a counterparty to a non-cleared security-based swap because the transaction was entered into prior to the effective date of proposed new Rule 18a–3 (a ''legacy non-cleared security-based swap'').[335] The nonbank SBSD would not be required to collect margin collateral for accounts holding legacy non-cleared security-based swaps.[336] This proposal is designed to avoid the difficulties of requiring a nonbank SBSD to renegotiate security-based swap contracts in order to come into compliance with new margin collateral requirements, which would be a complex task.[337] In lieu of collecting the margin collateral, the nonbank SBSD would be required to take a capital charge equal to the margin amount less any *positive equity* in the account.[338]

Request for Comment

The Commission generally requests comment on the proposed capital in lieu of margin requirements. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Would the proposed deductions for under-margined accounts be appropriate for cleared security-based swap margin requirements, which would be established by clearing agencies and SROs? If not, explain why not. For example, is the requirement to take the deduction after one business day workable in the context of cleared security-based swaps? If not, explain why not. In addition, should the margin requirements of clearing agencies be included in the deduction for under-margined accounts?

2. Would the proposed deductions for under-margined accounts be appropriate for non-cleared security-based swap margin requirements, which would be established by proposed new Rule 18a–3 and, potentially, by SROs? If not, explain why not. For example, is the requirement to take the deduction after one business day workable in the context of non-cleared security-based swaps? If not, explain why not.

3. Should there be a deduction for under-margined swap accounts? If so, explain why. If not, explain why not.

4. Would the proposed capital charges in lieu of collecting margin collateral appropriately address the potential future exposure risk of nonbank SBSDs arising from security-based swaps? If not, explain why not. Are there alternative means of addressing this risk? If so, identify and explain them.

5. Is the proposed capital charge in lieu of margin for cleared security-based swaps appropriate? If not, explain why not. In particular, if the amount of margin collateral required to be collected for cleared security-based swaps is less than the capital deduction that would apply to the positions, would the margin collateral nonetheless be sufficient? If so, explain why. In addition, should SBSDs approved to use internal models be permitted to use their VaR models (as opposed to the standardized haircuts) for purposes of determining whether this capital charge applies? If so, explain why.

6. Is the proposed capital charge in lieu of margin for non-cleared security-based swaps with counterparties that are *commercial end users* appropriate? If not, explain why not.

7. Should there be an exception for broker-dealer SBSDs and stand-alone SBSDs not using internal models from the requirement to take a capital charge in lieu of collecting margin collateral from *commercial end users*? If so, explain why such an exception would not negatively impact the risk profiles of these nonbank SBSDs and suggest alternative measures that could be implemented to address the risk of uncollateralized potential future exposure to *commercial end users.*

8. Should there be a capital charge in lieu of margin for non-cleared swaps with counterparties that are *commercial end users*? If so, explain why. If not, explain why not.

9. Is it appropriate to apply the proposed capital charge in lieu of margin for non-cleared security-based swaps with counterparties that require segregation pursuant to section 3E(f) of the Exchange Act? If not, explain why not.

10. Should there be an exception for counterparties that require segregation pursuant to section 3E(f) of the Exchange Act from the requirement to take a capital charge in lieu of margin collateral? If so, explain why such an exception would not negatively impact the risk profiles of nonbank SBSDs and suggest alternative measures that could be implemented to address the risk of not holding collateral to cover the potential future exposure.

11. Should there be a capital charge in lieu of margin for non-cleared swaps with counterparties that require margin

[333] *See* paragraphs (c)(4)(i) and (iii) of proposed new Rule 18a–3.

[334] *See* proposed new paragraph (c)(2)(xiv)(B)(*2*) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*2*) of proposed new Rule 18a–1.

[335] *See* proposed new paragraph (c)(2)(xiv)(B)(*3*) of Rule 15c3–1; paragraph (c)(1)(viii)(B)(*3*) of proposed new Rule 18a–1.

[336] *See* paragraph (c)(1)(iii)(D) of proposed new Rule 18a–3. A nonbank SBSD would need to take a 100% deduction for the amount of the uncollateralized current exposure arising from a legacy non-cleared security-based swap because (as discussed above) this amount would be an unsecured receivable from the counterparty and subject to a 100% deduction in the computation of net capital under Rule 15c3–1 and proposed new Rule 18a–1.

[337] The CFTC has proposed a similar exception for legacy swap transactions. *See CFTC Margin Proposing Release,* 76 FR at 23734 (''The Commission believes that the pricing of existing swaps reflects the credit arrangements under which they were executed and that it would be unfair to the parties and disruptive to the markets to require that the new margin rules apply to those positions.''). The prudential regulators proposed to permit a covered swap entity to exclude pre-effective swaps from initial margin calculations, while requiring these entities to collect variation margin, consistent with industry practice. *Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27569.

[338] The prudential regulators and CFTC have not proposed new capital charges for legacy swaps and legacy security-based swaps; nor have they proposed specific margin collateral requirements for such positions. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564; *CFTC Capital Proposing Release,* 76 FR 27802; *CFTC Margin Proposing Release,* 76 FR 23732. With respect to banks, the credit risk of holding legacy security-based swap positions is already taken into account by existing capital requirements for banks. The proposed capital charge in lieu of margin for nonbank SBSDs is based on a concern that, after SBSD registration requirements take effect, financial institutions may transfer large volumes of legacy non-cleared security-based swaps from unregulated affiliates to newly registered nonbank SBSDs, including broker-dealer SBSDs. As noted above, the Commission understands that registered broker-dealers currently do not engage in a high volume of security-based swap transactions. An influx of legacy non-cleared security-based swaps into a newly registered nonbank SBSD could create substantial risks to the entity. Under the proposed rule, nonbank SBSDs would be required to hold sufficient collateral to cover the current exposure and potential future exposure that arise from these transactions or, alternatively, to take appropriate capital charges to address these risks. Entities holding legacy non-cleared security-based swaps could either obtain additional capital in order to register as nonbank SBSDs or legacy non-cleared security-based swaps could be held and ''wound down'' in one entity while a separate entity is used to conduct new business.

collateral with respect to the swaps to be segregated and held by an independent third party custodian? If so, explain why. If not, explain why not.

12. Is the proposed capital charge in lieu of margin for non-cleared security-based swaps in accounts that hold legacy security-based swaps appropriate, or should there be an exception from the capital charge for legacy security-based swaps? Is there an alternate measure that could be implemented to address the risk of uncollateralized potential future exposure resulting from legacy security-based swaps? If the proposed capital charge applies to legacy security-based swaps, explain how the proposed capital charge in lieu of margin collateral would change the economics of the transactions previously entered into. How would any such change(s) be reflected in the cost of maintaining those, or initiating, new positions? Would there be any other impacts of the change in treatment of the legacy positions?

13. If there is an exception from the capital charge for legacy security-based swaps, how would such an exception impact the risk profiles of nonbank SBSDs?

14. After the SBSD registration requirements take effect, would substantial amounts of legacy security-based swaps with uncollateralized potential future exposure be transferred to broker-dealer SBSDs? Would entities with substantial amounts of legacy security-based swaps with uncollateralized potential future exposure register as stand-alone SBSDs?

15. Would it be practical for financial institutions to wind down legacy security-based swaps in existing entities rather than transferring them to nonbank SBSDs? What legal and operational issues would this approach raise?

16. Should there be a capital charge in lieu of margin for non-cleared swap accounts that hold legacy swaps? If so, explain why. If not, explain why not.

17. What should be deemed a legacy security-based swap? For example, if a nonbank SBSD dealer holds an existing legacy security-based swap that is subsequently modified for risk mitigation purposes, should this be deemed a new security-based swap transaction or should it continue to be treated as a legacy security-based swap?

vi. Treatment of Swaps

CFTC Rule 1.17 prescribes minimum capital requirements for FCMs.[339] The rule imposes a net liquid assets test capital standard.[340] Broker-dealers that are registered as FCMs are subject to Rule 15c3–1 and CFTC Rule 1.17.[341] CFTC Rule 1.17 provides that an FCM registered as a broker-dealer must maintain a minimum amount of adjusted net capital equal to the greater of, among other amounts, the minimum amount of net capital required by Rule 15c3–1.[342] CFTC Rule 1.17 also prescribes standardized haircuts for securities positions by incorporating by reference the standardized haircuts in Rule 15c3–1.[343] Similarly, Rule 15c3–1, through Appendix B, prescribes capital deductions for commodities positions of a broker-dealer by incorporating by reference deductions in CFTC Rule 1.17 to the extent Rule 15c3–1 does not otherwise prescribe a deduction for the type of commodity position.[344]

Broker-dealer SBSDs (as broker-dealers) would be subject to Appendix B to Rule 15c3–1.[345] Appendix B to proposed new Rule 18a–1 would prescribe capital deductions for commodities positions of stand-alone SBSDs and would be modeled on Appendix B to Rule 15c3–1.[346] Consequently, under the provisions of Rule 15c3–1 and proposed new Rule 18a–1, nonbank SBSDs would be required to take deductions for commodity positions when computing net capital.[347]

In addition, nonbank SBSDs and broker-dealers may have proprietary positions in swaps. Consequently, Appendix B to Rule 15c3–1 would be amended to establish standardized haircuts for proprietary swap positions and analogous provisions would be included in Appendix B to proposed new Rule 18a–1.[348] This would make the standardized swap haircuts applicable to nonbank SBSDs and broker-dealers.[349] An ANC broker-dealer and a stand-alone SBSD could apply to include different types of swaps in their VaR models. If approved, the firm would not need to apply the standardized haircuts for the type of swaps covered by the approved models.

The proposed standardized haircuts for swaps are similar to the proposed standardized haircuts for security-based swaps. Specifically, swaps that are credit default swaps referencing a broad based securities index (''Index CDS swaps'') would be subject to a maturity grid similar to the proposed maturity grid for CDS security-based swaps.[350] All other swaps would be subject to a standardized haircut determined by multiplying the notional amount of the swap by the percentage deduction that would apply to the type of asset or event referenced by the swap.

Index CDS Swaps

The standardized haircuts proposed for Index CDS swaps would use the maturity grid approach proposed for CDS security-based swaps discussed above in section II.A.2.b.ii. of this release. This would provide for a consistent standardized haircut approach for Index CDS swaps and CDS security-based swaps though, as discussed below, the haircuts would be lower for the Index CDS security-based swaps. As with CDS security-based swaps, the proposed maturity grid for Index CDS swaps prescribes the applicable deduction based on two variables: the length of time to maturity of the swap and the amount of the current offered spread on the swap.[351] The vertical axis of the proposed grid would contain nine maturity categories ranging from 12 months or less (the smallest deduction) to 121 months and longer (the largest deduction).[352] The horizontal axis would contain six spread categories ranging from 100 basis points or less (the smallest deduction) to

[339] *See* 17 CFR 1.17.

[340] *Id.*

[341] *See* 17 CFR 240.15c3–1; 17 CFR 1.17.

[342] *See* 17 CFR 1.17(a)(1)(i)(D).

[343] *See* 17 CFR 1.17(c)(5)(v)–(vii).

[344] *See* 17 CFR 240.15c3–1b(a)(1).

[345] 17 CFR 240.15c3.–1b.

[346] *Compare* 17 CFR 240.15c3–1b, *with* Appendix B to proposed new Rule 18a–1. As discussed above in section II.A.2.b.ii. of this release, a broker-dealer's minimum net capital requirement is the greater of a fixed-dollar amount specified in Rule 15c3–1 and an amount determined by applying one of two financial ratios: the 15-to-1 aggregate indebtedness to net capital ratio or the 2% of customer debit items ratio. The minimum net capital requirement for a stand-alone SBSD under proposed Rule 18a–1, however, would not use either of these financial ratios; rather, its minimum net capital requirement would be determined by calculating the 8% margin factor. Appendix B to Rule 15c3–1 contains provisions that factor into a broker-dealer's calculation of the aggregate indebtedness financial ratio. *See* 17 CFR 240.15c3–1b(a)(1) and (a)(2). Those provisions are not included in Appendix B to proposed new Rule 18a–1 because stand-alone SBSDs would not use the aggregate indebtedness financial ratio to determine their minimum net capital requirement.

[347] *See* 17 CFR 240.15c3–1b; Appendix B to proposed new Rule 18a–1.

[348] *See* proposed new paragraph (b) of Rule 15c3–1b; paragraph (b) of proposed new Rule 18a–1b.

[349] A nonbank SBSD that is registered as a swap dealer with the CFTC also would be required to comply with the CFTC's capital requirements applicable to swap dealers as would a broker-dealer that is registered as a swap dealer (just as a broker-dealer registered as an FCM must comply with Rule 15c3–1 and CFTC Rule 1.17).

[350] *See* proposed new paragraph (b)(1)(i) of Rule 15c3–1b; paragraph (b)(1)(i) of proposed new Rule 18a–1b.

[351] *See* proposed new paragraph (b)(1)(i)(A) of Rule 15c3–1b; paragraph (b)(1)(i)(A) of proposed new Rule 18a–1b.

[352] *Id.*

700 basis points and above (the largest deduction).[353]

The haircut percentages in the proposed maturity grid for Index CDS swaps would be one-third less than the haircut percentages in the maturity grid for CDS security-based swaps to account for the diversification benefits of an index.[354] For example, the proposed haircut for an Index CDS swap with a maturity of 12 months or less and a spread of 100 basis points or less would be 0.67% as opposed to a 1% haircut for a CDS security-based swap in the same maturity and spread categories. This one-third reduction in the haircut percentages is consistent with how broad-based equity security-indices are treated in the Appendix A methodology as compared with single name equity securities and narrow-based equity index securities. Specifically, as discussed above in section II.A.2.b.ii. of this release, the Appendix A methodology requires portfolios of single name equity securities and narrow-based equity index securities to be stressed at 10 equidistant valuation points within a range consisting of a (+/−) 15% market move. Portfolios of broad-based equity index securities are stressed at 10 equidistant valuation points within a range consisting of a (+/−) 10% market move, which is two-thirds of the market move range applicable to single name equity securities and narrow-based equity index securities.

Consistent with the maturity grid approach for CDS security-based swaps, the proposed deduction for an un-hedged long position in an Index CDS swap would be 50% of the applicable haircut in the grid.[355] The proposed deduction requirements for Index CDS swaps would permit a nonbank SBSD to net long and short positions where the credit default swaps reference the same index, are in the same spread categories, are in the same maturity categories or in adjacent maturity categories, and have maturities within three months of each other.[356] In this case, the nonbank SBSD would need to take the specified haircut only on the notional amount of the excess long or short position.[357]

Reduced deductions also would apply for strategies where the firm is long a basket of securities consisting of the components of an index and long (buyer of protection on) an Index CDS swap on the index.[358] The reduced deduction for this strategy would apply only if the credit default swap allowed the nonbank SBSD to deliver a security in the basket to satisfy the firm's obligation on the swap.[359] In this case, the nonbank SBSD would be required to take 50% of the deduction required on the securities in the basket (*i.e.,* no deduction would be required with respect to the Index CDS swap and a lesser deduction would apply to the securities).[360] If the nonbank SBSD is short (seller of protection) a basket of securities consisting of the components of an index and short a credit default swap that references the index, the nonbank SBSD would be required only to take the deduction required on the securities in the basket (*i.e.,* no deduction would be required with respect to the Index CDS swap).[361]

Interest Rate Swaps

For interest rate swaps, Appendix B to both Rule 15c3–1 and proposed new Rule 18a–1 would prescribe a standardized haircut equal to a percentage of the notional amount of the swap that is generally based on the standardized haircuts in Rule 15c3–1 for U.S. government securities.[362] An interest rate swap typically involves the exchange of specified or determinable cash flows at specified times based upon a notional amount.[363] The notional amount is not exchanged but is used to calculate the fixed or floating rate interest payments under the swap.

Under the proposed rule, each side of the interest rate swap would be converted into a synthetic bond position based on the notional amount of the swap and the interest rates against which payments are calculated. These synthetic bonds would then be placed into the standardized haircut grid in Rule 15c3–1 for U.S. government securities. Any obligation to receive payments under the swap would be categorized as a long position; any obligation to make payments under the swap would be categorized as a short position. A position receiving or paying based on a floating interest rate generally would be treated as having a maturity equal to the period until the next interest reset date; a position receiving or paying based on a fixed rate would be treated as having a maturity equal to the residual maturity of the swap. Synthetic bond equivalents derived from interest rate swaps, when offset against one another, would be subject to a one percent charge based on the swap's notional amount. Any synthetic bond equivalent that would be subject to a standardized haircut of less than one percent under the approach described above would be subject to a minimum deduction equal to a one percent charge against the notional value of the swap.[364] This minimum haircut of one percent is designed to account for potential differences between the movement of interest rates on U.S. government securities and interest rates upon which swap payments are based.

All Other Swaps

In the case of a swap that is not an Index CDS swap or an interest rate swap, the applicable haircut would be the amount calculated by multiplying the notional value of the swap and the percentage specified in either Rule 15c3–1 or CFTC Rule 1.17 for the asset, obligation, or event referenced by the swap.[365] For example, a swap referencing a commodity that is not covered by an open futures contract or commodity option would be subject to a capital deduction applicable to the commodity as if it were a long or short inventory position with a market value equal to the notional value of the swap. This would typically result in a deduction equal to 20% of the notional value of the swap.[366] The deduction for un-hedged currency swaps referencing certain major foreign currencies, including the euro, British pounds, Canadian dollars, Japanese yen, or Swiss francs, would be 6%.[367] This

[353] *Id.*

[354] *Id.*

[355] *See* proposed new paragraph (b)(1)(i)(B) of Rule 15c3–1b; paragraph (b)(1)(i)(B) of proposed new Rule 18a–1b.

[356] *See* proposed new paragraph (b)(1)(i)(C)(*1*) of Rule 15c3–1b; paragraph (b)(1)(i)(C)(*1*) of proposed new Rule 18a–1b.

[357] *Id.*

[358] *See* proposed new paragraph (b)(1)(i)(C)(*2*) of Rule 15c3–1b; paragraph (b)(1)(i)(C)(*2*) of proposed new Rule 18a–1b.

[359] *Id.*

[360] *Id.*

[361] *See* proposed new paragraph (b)(1)(i)(C)(*3*) of Rule 15c3–1b; paragraph (b)(1)(i)(C)(*3*) of proposed new Rule 18a–1b.

[362] *See* 17 CFR 240.15c3–1(c)(2)(vi)(A).

[363] *See Net Capital Rule,* Exchange Act Release No. 39455 (Dec. 17, 1997), 62 FR 67996 (Dec. 30, 1997).

[364] Under Rule 15c3–1, U.S. government securities with a maturity of less than nine months are subject to net capital deductions ranging from three-quarters of 1% to 0%. *See* 17 CFR 240.15c3–1(c)(2)(vi)(A)(*1*)(*i*)–(*iii*).

[365] *See* proposed new paragraph (b)(2) of Rule 15c3–1b; paragraph (b)(2) of proposed new Rule 18a–1b.

[366] *See* 17 CFR 240.15c3–1b(a)(3)(ix)(C); paragraph (a)(2)(ix)(C) of proposed new Rule 18a–1b.

[367] *See* CFTC Rule 1.17(c)(5)(ii)(E) (imposing a 6% haircut). 17 CFR 1.17(c)(5)(ii)(E). Currency swaps may involve exchanges of fixed amounts of currencies. If a nonbank SBSD has a currency swap in which it receives one foreign currency and pays out another foreign currency, the broker-dealer would treat the currency swap as a long position in a forward of the one foreign currency and an unrelated short position in the other foreign currency for capital purposes. *See, e.g., Net Capital Rule,* Exchange Act Release No. 32256 (May 4, 1993), 58 FR 27486, 27490 (May 10, 1993).

deduction could be reduced by an amount equal to any reduction recognized for a comparable long or short position in the referenced instrument, obligation, or event under Appendix B to Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1, or CFTC Rule 1.17. For example, a commodity swap referencing an agricultural product that is covered by an open futures contract or commodity option in that product would be subject to a 5% deduction from the notional value of the swap, rather than the 20% deduction specified above.[368] Finally, swaps referencing an equity index could be treated under Appendix A to Rule 15c3–1 and proposed new Rule 18a–1.

Request for Comment

The Commission generally requests comment on the proposed standardized haircuts swaps. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Which types of swap activities would nonbank SBSDs engage in? How would nonbank SBSDs use swaps?

2. Which types of swap activities would broker-dealers engage in? How would broker-dealers use swaps?

3. Do the proposed standardized haircuts for swaps provide a reasonable and workable solution for determining capital charges? Explain why or why not. Are there preferable alternatives? If so, describe those alternatives.

4. Are there additional categories of swaps, other than commodity swaps, currency swaps, and interest rate swaps, that the Commission should address in Rule 15c3–1 and/or proposed Rule 18a–1? If so, describe them.

5. Are the proposed standardized haircuts for swaps too high or too low? If so, please explain why and provide data to support the explanation.

6. Are there capital charges that should be applied to swaps? If so, describe them.

7. Do the proposed standardized haircuts for swaps adequately recognize offsets in establishing capital deductions? If not, what offsets should be recognized, for what type of swap, and why? Provide data, if applicable, and identify why that offset would be appropriate.

8. Do the proposed standardized haircuts for swaps provide any incentives or disincentives to effect swap transactions in a particular type of legal entity (*e.g.,* in a stand-alone SBSD versus a broker-dealer SBSD)? Describe the incentives and/or disincentives.

9. Do the proposed standardized haircuts for swaps provide any competitive advantages or disadvantages for a particular type of legal entity? Describe the advantages and/or disadvantages.

10. How closely do the movements of interest rates on U.S. government securities track the movements of interest rates upon which interest rate swap payments are based? Is the proposed 1% minimum percentage deduction for interest rate swaps appropriate given that U.S. government securities with a maturity of less than nine months have a haircut ranging from three-quarters of 1% to 0%?

c. Risk Management

Prudent financial institutions establish and maintain integrated risk management systems that seek to have in place management policies and procedures designed to help ensure an awareness of, and accountability for, the risks taken throughout the firm and to develop tools to address those risks.[369] A key objective of a risk management system is to ensure that the firm does not ignore any material source of risk.[370] Elements of an integrated risk management system include a dedicated risk management function, which seeks to promote integrated and systematic approaches to risk management and to develop and encourage the use of a common set of metrics for risk throughout the firm.[371] This function generally includes establishing common firm-wide definitions of risk and requiring that different business segments of the firm apply such definitions consistently for risk reporting purposes.[372] The risk management function in a financial institution also typically prepares background material and data analysis (risk reports) for senior managers to review and use to discuss firm-wide risks.[373]

Nonbank SBSDs would be required to comply with Rule 15c3–4, which requires the establishment of a risk management control system.[374] Rule 15c3–4 was adopted in 1998 as part of the OTC derivatives dealer oversight program.[375] The rule requires an OTC derivatives dealer to establish, document, and maintain a system of internal risk management controls to assist in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.[376] It also requires OTC derivatives dealers to establish, document, and maintain procedures designed to prevent the firm from engaging in securities activities that are not permitted of OTC derivatives dealers pursuant to Rule 15a–1.[377] Rule 15c3–4 identifies a number of elements that must be part of an OTC derivatives dealer's internal risk management control system.[378] These include, for example, that the system have:

- A risk control unit that reports directly to senior management and is independent from business trading units; [379]
- Separation of duties between personnel responsible for entering into a transaction and those responsible for recording the transaction in the books and records of the OTC derivatives dealer; [380]
- Periodic reviews (which may be performed by internal audit staff) and annual reviews (which must be conducted by independent certified public accountants) of the OTC derivatives dealer's risk management systems; [381] and
- Definitions of risk, risk monitoring, and risk management.[382]

Rule 15c3–4 further provides that the elements of the internal risk management control system must include written guidelines, approved by the OTC derivatives dealer's governing body, that cover various topics, including, for example:

- Quantitative guidelines for managing the OTC derivatives dealer's overall risk exposure; [383]
- The type, scope, and frequency of reporting by management on risk exposures; [384]
- The procedures for and the timing of the governing body's periodic review of the risk monitoring and risk

[368] *See* 17 CFR 240.15c3–1b(a)(3)(ix)(B); paragraph (a)(2)(ix)(B) of proposed new Rule 18a–1b.

[369] *See Trends in Risk Integration and Aggregation,* Joint Forum, Bank of International Settlements (Aug. 2003), available at *http://www.bis.org/publ/joint07.pdf.*

[370] *Id.*

[371] *Id.*

[372] *Id.*

[373] *Id.*

[374] *See* proposed new paragraph (a)(10)(ii) of Rule 15c3–1 (17 CFR 240.15c3–1); paragraph (g) of proposed new Rule 18a–1. *See also* 17 CFR 240.15c3–4.

[375] *See* 17 CFR 240.15c3–4; *OTC Derivatives Dealers,* 63 FR 59362.

[376] *See* 17 CFR 240.15c3–4.

[377] *See* 17 CFR 240.15c3–4; 17 CFR 240.15a-1.

[378] *See* 17 CFR 240.15c3–4(c).

[379] *See* 17 CFR 240.15c3–4(c)(1).

[380] *See* 17 CFR 240.15c3–4(c)(2).

[381] *See* 17 CFR 240.15c3–4(c)(3). The annual review must be conducted in accordance with procedures agreed to by the firm and the independent certified public accountant conducting the review.

[382] *See* 17 CFR 240.15c3–4(c)(4).

[383] *See* 17 CFR 240.15c3–4(c)(5)(iii).

[384] *See* 17 CFR 240.15c3–4(c)(5)(iv).

management written guidelines, systems, and processes; [385]

- The process for monitoring risk independent of the business or trading units whose activities create the risks being monitored; [386]
- The performance of the risk management function by persons independent from or senior to the business or trading units whose activities create the risks; [387]
- The authority and resources of the groups or persons performing the risk monitoring and risk management functions; [388]
- The appropriate response by management when internal risk management guidelines have been exceeded; [389]
- The procedures to monitor and address the risk that an OTC derivatives transaction contract will be unenforceable; [390]
- The procedures requiring the documentation of the principal terms of OTC derivatives transactions and other relevant information regarding such transactions; [391] and
- The procedures authorizing specified employees to commit the OTC derivatives dealer to particular types of transactions.[392]

Rule 15c3–4 also requires management to periodically review, in accordance with the written procedures, the business activities of the OTC derivatives dealer for consistency with risk management guidelines.[393]

In 2004, when adopting the ANC broker-dealer oversight program, the Commission included a requirement that an ANC broker-dealer must comply with Rule 15c3–4.[394] The Commission explained this requirement:

> Participants in the securities markets are exposed to various risks, including market, credit, funding, legal, and operational risk. These risks result, in part, from the diverse range of financial instruments that broker-dealers now trade. Risk management controls within a broker-dealer promote the stability of the firm and, consequently, the stability of the marketplace. A firm that adopts and follows appropriate risk management controls reduces its risk of significant loss, which also reduces the risk of spreading the losses to other market participants or throughout the financial markets as a whole.[395]

The Commission is proposing to require that nonbank SBSDs comply with Rule 15c3–4 because their activities will involve risk management concerns similar to those faced by other firms subject to the rule.[396] In particular, dealing in OTC derivatives, including security-based swaps, creates various types of risk that need to be carefully managed.[397] These risks are due, in part, to the characteristics of OTC derivative products and the way OTC derivative markets have evolved in comparison to the markets for exchange-traded securities.[398] For example, individually negotiated OTC derivative products, including security-based swaps, generally are less liquid than exchange-traded instruments and involve a high degree of leverage. Furthermore, market participants face risks associated with the financial and legal ability of counterparties to perform under the terms of specific transactions. Consequently, a firm that is active in dealing in these types of instruments should have an internal risk management control system that helps the firm identify and mitigate the risks it is facing. Rule 15c3–4 is designed to require an OTC derivatives dealer and ANC broker-dealer to take prudent measures to protect the firm from losses that can result from failing to account for and control risk. Requiring nonbank SBSDs to comply with Rule 15c3–4 is designed to promote the establishment of effective risk management control systems by these firms.[399] Moreover, based on Commission staff experience, it is expected that many nonbank SBSDs will be affiliates of firms already subject to these requirements.

Request for Comment

The Commission generally requests comment on the proposed risk management requirements. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the types of management controls required by Rule 15c3–4 appropriate for addressing the risks associated with engaging in a security-based swap business? If not, explain why not.

2. Are there types of risk management controls not identified in Rule 15c3–4 that would be appropriate to prescribe for nonbank SBSDs? If so, identify the controls and explain why they would be appropriate for nonbank SBSDs.

3. Are the factors listed in paragraph (b) of Rule 15c3–4 appropriate for nonbank SBSDs? If not, explain why not.

4. Are there any additional factors that a nonbank SBSD should consider when adopting its internal control system guidelines, policies, and procedures, in addition to the factors listed in paragraph (b) of Rule 15c3–4? If so, identify the factors and explain why they should be included.

5. Are the elements prescribed in paragraph (c) of Rule 15c3–4 appropriate for nonbank SBSDs? If not, explain why not.

6. Are there any additional elements that a nonbank SBSD should include in its internal risk management system in addition to the applicable elements prescribed in paragraph (c) of Rule 15c3–4? If so, identify the elements and explain why they should be included.

7. Are there any elements in paragraph (c) of Rule 15c3–4 that should not be applicable to nonbank SBSDs other than elements in paragraphs (c)(xiii) and (xiv)? If so, identify the elements and explain why they should not be applicable.

8. Are the factors management would need to consider in its periodic review of the nonbank SBSD's business activities for consistency with the risk management guidelines appropriate for nonbank SBSDs? If not, explain why not.

9. Should management consider any additional factors in its periodic review of the nonbank SBSD's business activities for consistency with the risk management guidelines other than those listed in paragraph (d) of Rule 15c3–4? If so, identify the factors and explain why they should be included.

10. Are there any factors in paragraph (d) of Rule 15c3–4 that management should not consider other than the factors in paragraphs (d)(8) and (9)? If so, identify the factors and explain why they should not be considered.

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[385] *See* 17 CFR 240.15c3–4(c)(5)(v).

[386] *See* 17 CFR 240.15c3–4(c)(5)(vi).

[387] *See* 17 CFR 240.15c3–4(c)(5)(vii).

[388] *See* 17 CFR 240.15c3–4(c)(5)(viii).

[389] *See* 17 CFR 240.15c3–4(c)(5)(ix).

[390] *See* 17 CFR 240.15c3–4(c)(5)(x).

[391] *See* 17 CFR 240.15c3–4(c)(5)(xi).

[392] *See* 17 CFR 240.15c3–4(c)(5)(xii).

[393] *See* 17 CFR 240.15c3–4(d).

[394] *See* 17 CFR 240.15c3–1(a)(7)(iii); *Alternative Net Capital Requirements Adopting Release,* 69 FR 34428. ANC broker-dealers—because they are not subject to Rule 15a–1—do not need to comply with the provisions of Rule 15c3–4 relating to Rule 15a–1. *See* 17 CFR 240.15c3–1(a)(7)(iii); 17 CFR 240.15c3–4; 17 CFR 240.15a–1.

[395] *Alternative Net Capital Requirements Adopting Release,* 69 FR at 34449.

[396] Like ANC broker-dealers, nonbank SBSDs would not need to comply paragraphs (c)(5)(xiii), (c)(5)(xiv), (d)(8), and (d)(9) of Rule 15c3–4. These are the provisions that specifically reference Rule 15a–1. *See* 17 CFR 240.15c3–4.

[397] *See OTC Derivatives: Settlement Procedures And Counterparty Risk Management* at 11–15.

[398] *See OTC Derivatives Dealers,* Exchange Act Release No. 39454 (Dec. 17, 1997), 62 FR 67940 (Dec. 30, 1997).

[399] *See* paragraph (g) of proposed new Rule 18a–1 (which would apply Rule 15c3–4 to stand-alone SBSDs); proposed new paragraph (a)(10)(ii) of Rule 15c3–1 (which would apply Rule 15c3–4 to broker-dealer SBSDs); 17 CFR 240.15c3–1(a)(7)(iii) (which applies Rule 15c3–4 to ANC broker-dealers); 17 CFR 240.15c3–4.

d. Funding Liquidity Stress Test Requirement

The Commission is proposing that ANC broker-dealers and nonbank SBSDs approved to use internal models be subject to liquidity risk management requirements. Funding liquidity risk has been defined as the risk that a firm will not be able to efficiently meet both expected and unexpected current and future cash flow and collateral needs without adversely impacting either the daily operations or the financial condition of the firm.[400] The consequences of liquidity funding strains for financial institutions active in a securities business include the inability to continue to issue unsecured long-term debt to finance illiquid assets and requirements to deliver additional collateral to continue to finance liquid assets on a secured basis.[401] The causes of funding liquidity strain for a financial institution include firm-specific events such as credit rating downgrades and other negative news leading to a loss of market confidence in the firm.[402] Funding liquidity also can come under stress such as occurred during the financial crisis.[403] Traditionally, financial institutions have used liquidity funding stress tests as a means to measure liquidity risk.[404] For institutions active in securities trading, liquidity funding stress tests generally estimate cash and collateral needs over a period of time and assume that sources to meet those needs (*e.g.,* issuance of long and short unsecured term debt, secured funding lines, and lines of credit) will become impaired or be unavailable.[405] To manage funding liquidity risk, these firms maintain pools of liquid unencumbered assets that can be used to raise funds during a liquidity stress event to meet cash needs.[406] The size of the liquidity pool is based on the firm's estimation of how much funding will be lost from external sources during a stress event and the duration of the event.[407]

The financial crisis demonstrated that the funding liquidity risk management practices of certain individual financial institutions were not sufficient to handle a liquidity stress event of that magnitude.[408] In particular, it has been observed that the stress tests utilized by financial institutions had weaknesses [409] and the amount of contingent liquidity they maintained to replace external sources of funding was insufficient to cover the institutions' liquidity needs.[410]

As discussed above in section II.A.2.c. of this release, nonbank SBSDs approved to use internal models would be subject to Rule 15c3–4, which currently applies to ANC broker-dealers and OTC derivatives dealers.[411] Rule 15c3–4 requires each firm subject to the rule to ''establish, document, and maintain a system of internal risk management controls to assist it in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.'' [412] The Commission's supervision of ANC broker-dealers consists of regular meetings with firm personnel to review each firm's financial results, the management of the firm's balance sheet, and, in particular, the liquidity of the firm's balance sheet.[413] Emphasis is placed on funding and liquidity risk management plans and liquidity stress scenarios.[414] The Commission staff also meets regularly with the firm's financial controllers to review and discuss price verification results and other financial controls, particularly concerning illiquid or hard-to-value assets or large asset concentrations.[415]

Given the large size of ANC broker-dealers and the potentially substantial role that stand-alone SBSDs approved to use internal models may play in the security-based swap markets, these firms would be required to take steps to manage funding liquidity risk.[416] Specifically, these firms would be required to perform a liquidity stress test at least monthly and, based on the results of that test, maintain liquidity reserves to address potential funding needs during a stress event.[417]

Under the proposal, an ANC broker-dealer and stand-alone SBSD using internal models would need to perform a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days.[418] The results of the liquidity stress test would need to be provided within ten business days of the month end to senior management that has responsibility to oversee risk management at the firm. In addition, the assumptions underlying the liquidity stress test would need to be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the firm and at least annually by senior management of the firm. These provisions are designed to

[400] *See* Joint Forum, Bank of International Settlements, *The management of liquidity risk in financial groups,* (May 2006), at 1, note 1 (''*The management of liquidity risk in financial groups''*). *See also* Basel Committee on Banking Supervision, *Principles for Sound Liquidity Risk Management and Supervision* (Sept. 2008), at 1, note 2 (''Funding liquidity risk is the risk that the firm will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition of the firm. Market liquidity risk is the risk that a firm cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption.''); *Amendments to Financial Responsibility Rules for Broker-Dealers,* Exchange Act Release No. 55432 (Mar. 9, 2007), 72 FR 12862, 12870, note 72 (Mar. 19, 2007) (''Liquidity risk includes the risk that a firm will not be able to unwind or hedge a position or meet cash demands as they become due.''); *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,* Federal Reserve, 77 FR 594 (Jan. 5, 2012) (proposing a rule to require certain large financial institutions to conduct liquidity stress testing at least monthly).

[401] *See The management of liquidity risk in financial groups* at 10.

[402] *See id.* at 6–8.

[403] *See Risk Management Lessons from the Global Bank Crisis of 2008,* Senior Supervisors Group (SSG) (Oct. 21, 2009) (''*Risk Management Lessons from the Global Bank Crisis of 2008''*).

[404] *The management of liquidity risk in financial groups* at 8–12.

[405] *Id.* at 10–11.

[406] *Id.*

[407] *Id.*

[408] *See Risk Management Lessons from the Global Bank Crisis of 2008.*

[409] *Id.* at 14 (''Market conditions and the deteriorating financial state of firms exposed weaknesses in firms' approaches to liquidity stress testing, particularly with respect to secured borrowing and contingent funding needs. These deteriorating conditions underscored the need for greater consideration of the overlap between systemic and firm-specific events and longer time horizons, and the connection between stress tests and business-as-usual liquidity management.'').

[410] *Id.* at 15 (''Interviewed firms typically calculated and maintained a measurable funding cushion, such as 'months of coverage,' which is conceptually similar to rating agencies' twelve-month liquidity alternatives analyses. Some institutions were required to maintain a liquidity cushion that could withstand the loss of *unsecured* funding for one year. Many institutions found that this metric did not capture important elements of stress that the organizations faced, such as the loss of secured funding and demands for collateral to support clearing and settlement activity and to mitigate the risks of accepting novations.'') (emphasis in the original).

[411] *See* 17 CFR 240.15c3–4.

[412] 17 CFR 240.15c3–4.

[413] A more detailed description of the Commission's ANC broker-dealer program is available on the Commission's Web site at *http://www.sec.gov/divisions/marketreg/bdaltnetcap.htm.*

[414] *Id.*

[415] *Id.*

[416] *See* proposed new paragraph (f) to Rule 15c3–1; paragraph (f) of proposed new Rule 18a–1.

[417] *Id.* The requirement to conduct the liquidity stress test on at least a monthly basis is designed to ensure that the test is conducted at sufficiently regular intervals to account for material changes that could impact the firm's liquidity profile. In this regard, the ANC broker-dealers are required to prepare and file monthly financial reports, which are designed to allow securities regulators to monitor their financial condition. *See* 17 CFR 240.17a–5; *compare Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,* 77 FR 594 (Jan. 5, 2012) (Federal Reserve's proposed rule to require a ''covered company'' to conduct liquidity stress testing at least monthly).

[418] Based on the Commission staff's experience, ANC broker-dealers currently perform regular liquidity stress tests.

promote the engagement of senior level risk managers and managers of the firm in the implementation of the liquidity stress test and senior level risk managers in monitoring the results of the liquidity stress test.

These required assumed conditions are designed to be consistent with the liquidity stress tests performed by the ANC broker-dealers (based on Commission staff experience supervising the firms) and to address the types of liquidity outflows experienced by ANC broker-dealers and other broker-dealers in times of stress. The required assumed conditions would be:

- A stress event that includes a decline in creditworthiness of the firm severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;
- The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding, including intercompany advances and unfunded committed lines of credit;
- The potential for a material net loss of secured funding;
- The loss of the ability to procure repurchase agreement financing for less liquid assets;
- The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;
- A material increase in collateral required to be maintained at registered clearing agencies of which the firm is a member; and
- The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the firm, including those related to customer businesses of the firm.[419]

These proposed minimum elements are designed to ensure that ANC broker-dealers and stand-alone SBSDs using internal models employ a stress test that is severe enough to produce an estimate of a potential funding loss of a magnitude that might be expected in a severely stressed market. As discussed below, the results of the stress test would be used by the firm to determine the amount of contingent liquidity to be maintained. The proposals would require that the ANC broker-dealer and stand-alone SBSD itself must maintain at all times liquidity reserves based on the results of the liquidity stress test.[420] The liquidity reserves would need to be comprised of unencumbered cash or U.S. government securities.[421] This limitation with respect to the assets that can be used for the liquidity reserves requirement is designed to ensure that only the most liquid instruments are held in the reserves, given that the market for less liquid instruments is generally disproportionately volatile during a time of market stress.

The results of stress tests play a key role in shaping an entity's liquidity risk contingency planning.[422] Thus, stress testing and contingency planning are closely intertwined.[423] Under the proposals, the ANC broker-dealer and a stand-alone SBSD using internal models would be required to establish a written contingency funding plan.[424] The plan would need to clearly set out the strategies for addressing liquidity shortfalls in emergency situations,[425] and would need to address the policies, roles, and responsibilities for meeting the liquidity needs of the firm and communicating with the public and other market participants during a liquidity stress event.[426]

Request for Comment

The Commission generally requests comment on the proposed liquidity stress test requirement. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the proposed funding liquidity requirements appropriate for ANC broker-dealers and nonbank SBSDs that use internal models? If not, explain why not. Are there modifications that would improve the funding liquidity provisions? If so, explain them.

2. Should the proposed funding liquidity requirements apply to a broader group of broker-dealers (*e.g.,* all broker-dealers that hold customer securities and cash or all broker-dealer with total assets in excess of minimum threshold)? Explain why or why not.

3. Should the proposed funding liquidity requirements apply to all nonbank SBSDs? If so, explain why. If not, explain why not.

4. Is monthly an appropriate frequency for the liquidity stress test? For example, would it be preferable to require the liquidity stress test on a more frequent basis such as weekly, or, alternatively, on a less frequent basis such as quarterly? If so, explain why.

5. Is the requirement to provide the results of the liquidity stress test within ten business days to senior management that has responsibility to oversee risk management at the firm appropriate? If not, explain why not. Should results be provided in a shorter or longer timeframe than ten business days? For example, is ten business days sufficient time to run the stress tests, generate the results, and provide them to senior management? If the time-frame should be longer or shorter, identify the different timeframe and explain why it would be more appropriate than ten business days.

6. Is the requirement that the assumptions underlying the liquidity stress test be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the firm and at least annually by senior management of firm appropriate? If not, explain why not. Should the reviews be more or less frequent? If so, identify the frequency and explain why it would be more appropriate than quarterly and annually.

7. Are the required assumptions of the funding liquidity stress test appropriate? If not, explain why not.

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[419] *See* proposed new paragraph (f)(1) to Rule 15c3–1; paragraph (f)(1) of proposed new Rule 18a–1.

[420] *See* proposed new paragraph (f)(3) of Rule 15c3–1; paragraph (f)(3) of proposed new Rule 18a–1.

[421] *See* proposed new paragraph (f)(3) of Rule 15c3–1; paragraph (f)(3) of proposed new Rule 18a–1.

[422] *See, e.g.,* Federal Reserve, FDIC, OCC, OTS, and NCUA, *Interagency Policy Statement on Funding and Liquidity Risk Management* 7, SR 10–6 (Mar. 17, 2010).

[423] *Id.*

[424] Based on staff experience supervising the ANC broker-dealers, all of the ANC broker-dealers that are part of a holding company generally have a written contingency funding plan, generally at the holding company level. This proposed rule would require that each ANC broker-dealer and stand-alone SBSD using internal models maintain a written contingency funding plan at the entity level (in addition to any holding company plan). *See also Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,* 77 FR at 604. The Federal Reserve stated that the objectives of the contingency funding plan are to provide a plan for responding to a liquidity crisis, to identify alternate liquidity sources that a covered company can access during liquidity stress events, and to describe steps that should be taken to ensure that the covered company's sources of liquidity are sufficient to fund its operating costs and meet its commitments while minimizing additional costs and disruptions. *Id.* at 610.

[425] *See* proposed new paragraph (f)(4) of Rule 15c3–1; paragraph (f)(4) of proposed new Rule 18a–1.

[426] *See* proposed new paragraph (f)(4) of Rule 15c3–1; paragraph (f)(4) of proposed new Rule 18a–1. To promote the flow of necessary information during a liquidity stress, the Federal Reserve's proposed rule would require the event management process to include a mechanism that ensures effective reporting and communication within the covered company and with outside parties, including the Federal Reserve and other relevant supervisors, counterparties, and other stakeholders. *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,* 77 FR at 611.

8. Are there additional or alternative assumptions that should be required in the funding liquidity stress test? If so, identify the additional or alternative assumptions and explain why they should be included.

9. Are the required assumptions of the funding liquidity stress test understandable? If not, identify the elements that require further explanation.

10. Should other types of securities in addition to U.S. government securities be permitted for the liquidity pool? If so, identify the types of securities and explain why they should be permitted.

11. Are the requirements for the written contingency funding plan appropriate? If not, explain why not.

12. Should additional or alternative requirements for the written contingency funding plan be required? If so, identify the additional or alternative requirements and explain why they should be required.

e. Other Rule 15c3–1 Provisions Incorporated into Rule 18a–1

Rule 15c3–1 has four other sets of provisions that are proposed to be included in new Rule 18a–1: (1) Debt-equity ratio requirements;[427] (2) capital withdrawal notice requirements;[428] (3) subsidiary consolidation requirements (Appendix C);[429] and (4) subordinated loan agreement requirements (Appendix D).[430]

i. Debt-Equity Ratio Requirements

Rule 15c3–1 sets limits on the amount of a broker-dealer's outstanding subordinated loans.[431] The limits are prescribed in terms of debt-to-equity amounts.[432] The debt-to-equity limits are designed to ensure that a broker-dealer has a base of permanent capital in addition to any subordinated loans, which—as discussed above—are permitted to be added back to net worth when computing net capital.[433] Proposed new Rule 18a–1 would contain the same debt-to-equity limits.[434] The objective of this parallel provision in Rule 18a–1 is to require nonbank SBSDs to maintain a base of permanent capital.

Request for Comment

The Commission generally requests comment on the proposal to incorporate the debt-equity ratio provisions of Rule 15c3–1 into proposed new Rule 18a–1. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following question:

1. Are the debt-equity ratio requirements in Rule 15c3–1 appropriate standards for stand-alone SBSDs? If not, explain why not and suggest an alternative standard.

ii. Capital Withdrawal Requirements

Rule 15c3–1 requires that a broker-dealer provide notice when it seeks to withdraw capital in an amount that exceeds certain thresholds.[435] For example, a broker-dealer must give the Commission a two-day notice before a withdrawal that would exceed 30% of the firm's excess net capital and a notice within two days after a withdrawal that exceeded 20% of that measure.[436] The notice provisions are designed to alert the Commission and the firm's designated examining authority that capital is being withdrawn to assist in the monitoring of the financial condition of the broker-dealer. Rule 15c3–1 also restricts capital withdrawals that could have certain financial impacts on the firm, including withdrawals that reduce net capital below certain numerical levels.[437] These restrictions are designed to ensure that the broker-dealer maintains a buffer of net capital above its minimum required amount. Finally, under the rule, the Commission may issue an order temporarily restricting a broker-dealer from withdrawing capital or making loans or advances to stockholders, insiders, and affiliates under certain circumstances.[438] This provision and several of the notice and restriction provisions were put in place after the failure of the investment bank Drexel Burnham Lambert, Inc. (''Drexel'').[439] Drexel, prior to its bankruptcy, transferred significant funds from its broker-dealer subsidiary to the holding company without notice to the Commission or Drexel's designated examining authority.[440]

Stand-alone SBSDs would be subject to the same provisions, with one difference.[441] In 2007, the Commission proposed amendments to Rule 15c3–1 to eliminate certain of the conditions required in an order restricting the withdrawals or the making of loans or advances to stockholders, insiders, and affiliates.[442] More specifically, under Rule 15c3–1, the Commission can, by order, restrict a broker-dealer for a period up to 20 business days from making capital withdrawals, loans, and advances only to the extent the withdrawal, loan, or advance would exceed 30% of the broker-dealer's excess net capital when aggregated with other such transactions over a 30-day period.[443] The current requirement raises a concern, based on Commission staff experience, that to the extent the books and records of a broker-dealer that is in financial distress are incomplete or inaccurate it can be difficult for regulators to determine the firm's actual net capital and excess net capital amounts.[444] An order that limits withdrawals to a percentage of excess net capital may be difficult to enforce as it may not always be clear when that threshold had been reached.[445] Given these concerns and consistent with the proposed amendment to Rule 15c3–1, the Commission is proposing that its ability to restrict withdrawals of capital, loans or advances by stand-alone SBSDs not be limited based on the amount of the withdrawal, loan or advance in relation to the amount of the firms' excess net capital.[446]

[427] *See* 17 CFR 240.15c3–1(d).

[428] *See* 17 CFR 240.15c3–1(e).

[429] *See* 17 CFR 240.15c3–1c.

[430] *See* 17 CFR 240.15c3–1d.

[431] *See* 17 CFR 240.15c3–1(d).

[432] *Id.*

[433] *See Net Capital Rule,* Exchange Act Release No. 9891 (Dec. 5, 1972), 38 FR 56, 59 (Jan. 3, 1973) (''The Commission has discovered a large number of instances in which broker-dealers were able to comply with the net capital although the firms [*sic*] net worth been entirely depleted. Compliance with the rule was possible only because subordinated debt is a permissible form of capital. Such conditions rendered the firm technically insolvent since its liabilities exceeded its assets.'').

[434] *See* paragraph (h) of proposed new Rule 18a–1.

[435] *See* 17 CFR 240.15c3–1(e)(1).

[436] See 17 CFR 240.15c3–1(e)(1).

[437] *See* 17 CFR 240.15c3–1(e)(2).

[438] *See* 17 CFR 240.15c3–1(e)(3).

[439] *See Net Capital Rule,* Exchange Act Release No. 28927 (Feb. 28, 1991), 56 FR 9124 (Mar. 5, 1991).

[440] *Id.* at 9125.

[441] *See* paragraph (i) of proposed new Rule 18a–1.

[442] *Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR 12862.

[443] *See* 17 CFR 240.15c3–1(e)(3)(i). To issue an order, the Commission must, based on the facts and information available, conclude that the withdrawal, advance or loan may be detrimental to the financial integrity of the broker-dealer, or may unduly jeopardize the broker-dealer's ability to repay its customer claims or other liabilities which may cause a significant impact on the markets or expose the customers or creditors of the broker-dealer to loss without taking into account the application of the Securities Investor Protection Act of 1970 (''SIPA''). *See* 17 CFR 240.15c3–1(e)(3)(i)(B). Furthermore, the rule provides that an order temporarily prohibiting the withdrawal of capital shall be rescinded if the Commission determines that the restriction on capital withdrawal should not remain in effect and that the hearing will be held within two business days from the date of the request in writing by the broker-dealer. *See* 17 CFR 240.15c3–1(e)(3)(ii).

[444] *See Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR at 12873.

[445] *Id.*

[446] *See* paragraph (i) of proposed new Rule 18a–1; *Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR at 12873.

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Request for Comment

The Commission generally requests comment on the proposal to incorporate the capital withdrawal provisions of Rule 15c3–1 into proposed new Rule 18a–1. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the capital withdrawal requirements in Rule 15c3–1 appropriate standards for stand-alone SBSDs? If not, explain why and suggest an alternative standard.

2. Under Rule 15c3–1, a broker-dealer must give the Commission notice two days before a withdrawal that would exceed 30% of the firm's excess net capital and two days after a withdrawal that exceeded 20% of that measure. Are these thresholds appropriate for stand-alone SBSDs? If not, explain why not and suggest alternative thresholds.

3. Rule 15c3–1 also restricts capital withdrawals that would have certain financial impacts on a broker-dealer such as lowering net capital below certain levels. Are these same requirements appropriate standards for stand-alone SBSDs?

4. Under the proposed amendments, the 30% of excess net capital limitation currently contained in Rule 15c3–1 with respect to Commission orders restricting withdrawals would be eliminated. However, under the proposed amendments, the Commission in issuing an order restricting withdrawals could impose such terms and conditions as the Commission deems necessary or appropriate in the public interest or consistent with the protection of investors. Please identify terms and conditions that the Commission should consider to be included in such orders. For example, under certain circumstances, would it be appropriate for the current limitation in Rule 15c3–1 to be included in the order? Alternatively, should the 30% of excess net capital limitation currently contained in Rule 15c3–1 be retained in proposed new Rule 18a–1? If so, please explain why.

iii. Appendix C

Appendix C to Rule 15c3–1 requires a broker-dealer in computing its net capital and aggregate indebtedness to consolidate in a single computation assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses or assumes directly or indirectly obligations or liabilities.[447] The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the broker-dealer may also be consolidated.[448] By including the assets and liabilities of a subsidiary in its net capital computation, a firm may receive flow-through net capital benefits because the consolidation may serve to increase the firm's net capital and thereby assist it in meeting the minimum requirements of Rule 15c3–1. Appendix C sets forth the requirements that must be met to consolidate in a single net capital computation the assets and liabilities of subsidiaries and affiliates in order to obtain flow-through capital benefits for a parent broker-dealer.[449] Specifically, the broker-dealer must possess majority ownership and control over the consolidated subsidiary or affiliate and obtain an opinion of counsel essentially stating that at least the portion of the subsidiary's or affiliate's net asset value related to the broker-dealer's ownership interest therein may be distributed to the broker-dealer (or a trustee in a SIPA liquidation) within thirty days, at the request of the distributee.[450] In addition, subordinated obligations of the subsidiary or affiliate may not serve to increase the net worth of the broker-dealer unless the obligations also are subordinated to the claims of present and future creditors of the broker-dealer.[451] Appendix C also requires that liabilities and obligations of a subsidiary or affiliate of the broker-dealer that are guaranteed, endorsed, or assumed either directly or indirectly by the broker-dealer must be reflected in the firm's net capital computation.[452]

Based on Commission staff experience and information from an SRO, very few broker-dealers consolidate subsidiaries or affiliates to obtain the flow-through capital benefits under Appendix C to Rule 15c3–1. The review and information from the SRO indicate that the limited use results from the difficulty in obtaining the required opinion of counsel. Consequently, Appendix C to proposed new Rule 18a–1 would contain only the requirement that a stand-alone SBSD include in its net capital computation all liabilities or obligations of a subsidiary or affiliate of the stand-alone SBSD that the SBSD guarantees, endorses, or assumes either directly or indirectly. Thus, stand-alone SBSDs would not be able to claim flow-through capital benefits for consolidated subsidiaries or affiliates. The Commission does not expect that this difference in approach between Rule 15c3–1 and proposed new Rule 18a–1 would create any competitive disadvantage for stand-alone SBSDs vis-à-vis broker-dealer SBSDs, given the limited use of the flow-through benefits provision under the current rule.

Request for Comment

The Commission generally requests comment on Appendix C of both Rule 15c3–1 and proposed Rule 18a–1. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Should the flow-through capital benefit provisions of Appendix C to Rule 15c3–1 be eliminated? If so, explain why. Alternatively, should the flow-through capital benefit provisions in Appendix C to Rule 15c3–1 be incorporated into proposed Rule 18a–1? If so, explain why.

2. Would stand-alone SBSDs be subject to a competitive disadvantage vis-à-vis broker-dealer SBSDs as a result of the differences between proposed Appendix C of Rule 18a–1 and Appendix C of Rule 15c3–1? Would these differences provide an incentive for an entity to register a nonbank SBSD as a broker-dealer SBSD? Please explain.

iv. Appendix D

Appendix D to Rule 15c3–1 sets forth the minimum and non-exclusive requirements for satisfactory subordination agreements.[453] A subordination agreement is a contract between a broker-dealer and a third party pursuant to which the third party lends money or provides a collateralized note to the broker-dealer. Generally, broker-dealers use subordination agreements to borrow from third parties (typically affiliates) to increase the broker-dealer's net capital.[454] Nonbank SBSDs also are expected to use subordinated debt to obtain financing for their activities and the proposals discussed below would prescribe when

[447] *See* 17 CFR 240.15c3–1c.

[448] *Id.*

[449] *See* 17 CFR 240.15c3–1c.

[450] *See* 17 CFR 240.15c3–1c(b). FINRA Rule 4150(a) requires that prior written notice be given to FINRA whenever a FINRA member guarantees, endorses or assumes, directly or indirectly, the obligations or liabilities of another person. Paragraph (b) of the rule requires that prior written approval must be obtained from FINRA whenever any member seeks to receive flow-through capital benefits in accordance with Appendix C to Rule 15c3–1. This makes compliance with the rule more stringent because FINRA must pre-approve the subordinated debt for FINRA member firms who wish to take advantage of the capital benefits available under Appendix C of Rule 15c3–1. As of June 1, 2012, of the 4,711 broker-dealers registered with the Commission, 4,437 were FINRA member firms.

[451] *See* 17 CFR 240.15c3–1c(c)(2).

[452] *See* 17 CFR 240.15c3–1c(d).

[453] 17 CFR 240.15c3–1d.

[454] *See* 17 CFR 240.15c3–1(c)(2)(ii).

such loans would receive favorable capital treatment.

In order to receive beneficial regulatory capital treatment under Rule 15c3–1, the obligation to the third party must be subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined under Appendix D.[455] Among other things, a satisfactory subordination agreement must prohibit, except under strictly defined limitations, prepayments or any payment of an obligation before the expiration of at least one year from the effective date of the subordination agreement.[456] This provision was designed to ensure the adequacy as well as the permanence of capital in the industry.[457]

There are two types of subordination agreements under Appendix D to Rule 15c3–1: (1) a subordinated loan agreement, which is used when a third party lends cash to a broker-dealer; [458] and (2) a secured demand note agreement, which is a promissory note in which a third party agrees to give cash to a broker-dealer on demand during the term of the note and provides cash or securities to the broker-dealer as collateral.[459]

A broker-dealer SBSD would be subject to the provisions of Appendix D to Rule 15c3–1 through parallel provisions in Appendix D to proposed new Rule 18a–1.[460] However, only the subordinated loan agreement provisions would be included in Appendix D to proposed new Rule 18a–1. Thus, stand-alone SBSDs would not be able to use secured demand note agreements to obtain beneficial regulatory capital treatment under proposed Appendix D to Rule 18a–1. Based on Commission staff experience, broker-dealers infrequently utilize secured demand notes as a source of capital, and the amounts of these notes are relatively small in size. Therefore, this form of regulatory capital is not being proposed for stand-alone SBSDs. Accordingly, Appendix D to proposed new Rule 18a–1 would refer solely to ''subordinated loan agreements'' in the provisions where Appendix D to Rule 15c3–1 refers more broadly to ''subordination agreements.'' [461]

Subordination agreements under Appendix D to Rule 15c3–1 are approved by a broker-dealer's designated examining authority.[462] A broker-dealer also is required to notify its designated examining authority upon the occurrence of certain events under Appendix D to Rule 15c3–1.[463] Because the term ''designated examining authority'' applies only to registered broker-dealers (*i.e.,* stand-alone SBSDs would not have a designated examining authority), the provisions of Appendix D to Rule 18a–1 refer to the ''Commission'' instead of the ''designated examining authority.'' Specifically, under paragraph (c)(5) of Appendix D to proposed Rule 18a–1, a stand-alone SBSD would be required to file two copies of any proposed subordinated loan agreement (including nonconforming subordinated loan agreements) at least 30 days prior to the proposed execution date of the agreement with the Commission.[464] The rule would also require an SBSD to file with the Commission a statement setting forth the name and address of the lender, the business relationship of the lender to the SBSD, and whether the SBSD carried an account for the lender effecting transactions in security-based swaps at or about the time the proposed agreement was filed.[465]

Request for Comment

The Commission generally requests comment on Appendix D to both Rule 15c3–1 and proposed new Rule 18a–1. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Should the secured demand note provisions of Appendix D to Rule 15c3–1 be eliminated? Alternatively, should the secured demand note provisions be incorporated into Appendix D to proposed new Rule 18a–1? If so, explain why.

2. Would stand-alone SBSDs be disadvantaged vis-à-vis broker-dealer SBSDs as a result of the differences between proposed Appendix D to proposed new Rule 18a–1 and Appendix D to Rule 15c3–1? Would these differences provide an incentive for an entity to register a nonbank SBSD as a broker-dealer SBSD? Please explain.

3. Proposed Capital Rules for Nonbank MSBSPs

Proposed new Rule 18a–2 would establish capital requirements for nonbank MSBSPs. In particular, a nonbank MSBSP would be required at all times to have and maintain positive tangible net worth.[466] A tangible net worth standard is being proposed for nonbank MSBSPs, rather than the net liquid assets test in Rule 15c3–1, because the entities that may need to register as nonbank MSBSPs may engage in a diverse range of business activities different from, and broader than, the securities activities conducted by broker-dealers or SBSDs (otherwise they would be required to register as an SBSD and/or broker-dealer). For example, these entities may engage in commercial activities that require them to have substantial fixed assets to support manufacturing and/or result in them having significant assets comprised of unsecured receivables. Requiring them to adhere to a net liquid assets test could result in their having to obtain significant additional capital or engage in costly restructurings.

The term *tangible net worth* would be defined to mean the nonbank MSBSP's net worth as determined in accordance with generally accepted accounting principles in the United States, excluding goodwill and other intangible assets.[467] In determining net worth, all long and short positions in security-based swaps, swaps, and related positions would need to be marked to

[455] *Id.*

[456] *See* 17 CFR 240.15c3–1d(b)(1).

[457] *See Net Capital Requirements for Broker-Dealers; Amended Rules,* Exchange Act Release No. 18417 (Jan. 13, 1982), 47 FR 3512, 3516 (Jan. 25, 1982).

[458] *See* 17 CFR 240.15c3–1d(a)(2)(ii).

[459] *See* 17 CFR 240.15c3–1d(a)(2)(v)(A). Under a secured demand note agreement, the third party cannot sell or otherwise use the collateral unless the third party substitutes securities of equal value for the deposited securities. *See* 17 CFR 240.15c3–1d(a)(2)(v)(D).

[460] Appendix D to Rule 15c3–1d has provisions that apply if an action (*e.g.,* repayment of the subordinated loan) would cause the broker-dealer's net capital to fall below certain thresholds (*e.g.,* 120% of the broker-dealer's minimum net capital requirement) and a provision that applies if the broker-dealer's net capital has fallen below its minimum net capital requirement. *See* paragraphs (b)(7), (b)(8)(i), (b)(10)(ii)(B), (c)(2), and (c)(5)(i)(B) of 17 CFR 240.15c3–1d. Proposed new Rule 18a–1 would contain analogous provisions that would be based on the proposed minimum net capital and tentative net capital requirements for stand-alone SBSDs. *See* paragraphs (b)(6), (b)(7), (b)(9)(ii)(A), (c)(2), and (c)(4)(i) of proposed new Rule 18a–1d. In addition, in order to reflect the minimum net capital requirements that would apply to broker-dealer SBSDs, conforming amendments are being proposed for Rule 15c3–1d. *See* proposed amendments to paragraphs (b)(7), (b)(8)(i), (b)(10)(ii)(B), (c)(2), and (c)(5)(i)(B) of 17 CFR 240.15c3–1d.

[461] The term ''subordination agreements'' as used in Appendix D to Rule 15c3–1 references both subordinated loan agreements and secured demand note agreements.

[462] *See* 17 CFR 240.15c3–1d(c)(6)(i). *See also* FINRA Rule 4110(e)(1), which provides that subordinated loans and secured demand notes must be approved by FINRA in order to receive beneficial regulatory capital treatment.

[463] *See, e.g.,* 17 CFR 240.15c3–1d(b)(6).

[464] *See* paragraph (c)(5) of proposed new Rule 18a–1d.

[465] *Id.*

[466] *See* paragraph (a) of proposed new Rule 18a–2. If a broker-dealer is required to register as a nonbank MSBSP, it would need to continue to comply with Rule 15c3–1 in addition to proposed new Rule 18a–2.

[467] *See* paragraph (b) of proposed new Rule 18a–2.

their market value.[468] Further, a nonbank MSBSP would be required to include in its computation of tangible net worth all liabilities or obligations of a subsidiary or affiliate that the participant guarantees, endorses, or assumes, either directly or indirectly.[469] The proposed definition of *tangible net worth* would allow nonbank MSBSPs to include as regulatory capital assets that would be deducted from net worth under Rule 15c3–1, such as property, plant, equipment, and unsecured receivables. At the same time, it would require the deduction of goodwill and other intangible assets.[470]

Because nonbank MSBSPs, by definition, will be entities that engage in a substantial security-based swap business, they would be required to comply with Rule 15c3–4 with respect to their security-based swap and swap activities.[471] As discussed above in section II.A.2.c. of this release, Rule 15c3–4 requires OTC derivatives dealers and ANC broker-dealers to establish, document, and maintain a system of internal risk management controls to assist in managing the risks associated with their business activities, including market, credit, leverage, liquidity, legal, and operational risks.[472] The proposal that nonbank MSBSPs be subject to Rule 15c3–4 is designed to promote sound risk management practices with respect to the risks associated with OTC derivatives.

Finally, the risk that the failure of a nonbank MSBSP could have a destabilizing market impact is being addressed in part by the account *equity* requirements in proposed new Rule 18a–3—as discussed below in section II.B.2.c.ii. of this release—that would require a nonbank MSBSP to deliver collateral to counterparties to cover the counterparty's current exposure to the nonbank MSBSP. The proposed requirement that nonbank MSBSPs deliver collateral to counterparties is designed to address a risk that arose during the 2008 credit crisis (*i.e.,* the existence of large uncollateralized exposures of market participants to a single entity). The proposed requirements in proposed new Rule 18a–2 that a nonbank MSBSP maintain positive tangible net worth and establish risk management controls are designed to serve as an extra measure of protection but be flexible enough to account for the potential range of business activities of these entities.

Request for Comment

The Commission generally requests comment on the proposed capital requirements for nonbank MSBSPs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is a tangible net worth test an appropriate standard for a nonbank MSBSP? Would a net liquid assets test capital standard be more appropriate? If so, describe the rationale for such an approach.

2. Should nonbank MSBSPs be permitted to calculate their tangible net worth using generally accepted accounting principles in jurisdictions other than U.S., such as where the nonbank MSBSP is incorporated, organized, or has its principal office? If so, explain why.

3. Can the risks to market stability presented by nonbank MSBSPs be largely addressed through margin requirements?

4. Should proposed new Rule 18a–2 require that a nonbank MSBSP maintain a minimum fixed-dollar amount of tangible net equity, for example, equal to $20,000,000 or some greater or lesser amount? If so, explain the merits of imposing a fixed-dollar amount and identify the recommended fixed-dollar amount.

5. Should proposed new Rule 18a–2 require that a nonbank MSBSP compute capital charges for market risk and credit risk? For example, should such a requirement be modeled on the CFTC's proposed market and credit risk charges for nonbank swap dealers and nonbank major swap participants that are not using internal models and are not FCMs?[473] If nonbank SBSDs should be required to take market and credit risk charges, explain why. If not, explain why not.

6. Should nonbank MSBSPs be subject to a leverage test and if so, how should it be designed? Explain the rationale for such a test.

7. Should a nonbank MSBSP be subject to a minimum tangible net worth requirement that is proportional to the amount of risk incurred by the MSBSP through its outstanding security-based swap transactions? More specifically, should an MSBSP calculate an ''adjusted tangible net worth'' by subtracting market risk deductions for their security-based swaps (either based on the standardized haircuts or on approved models) from their tangible net worth and be required to maintain sufficient capital such that this adjusted tangible net worth figure is positive?

B. Margin

1. Introduction

As discussed above in section II.A.2.b.iv. of this release, dealers in OTC derivatives manage credit risk to their OTC derivatives counterparties through collateral and netting agreements.[474] The two types of credit exposure arising from OTC derivatives are current exposure and potential future exposure. The current exposure is the amount that the counterparty would be obligated to pay the dealer if all the OTC derivatives contracts with the counterparty were terminated (*i.e.,* it is the amount of the current receivable from the counterparty). This form of credit risk arises from the potential that the counterparty may default on the obligation to pay the current receivable. The potential future exposure is the amount that the current exposure may increase in favor of the dealer in the future. This form of credit risk arises from the potential that the counterparty may default before providing the dealer with additional collateral to cover the incremental increase in the current exposure or that the current exposure will increase after a default when the counterparty has ceased to provide additional collateral to cover such increases and before the dealer can liquidate the position.

Dealers may require counterparties to provide collateral to cover their current and potential future exposures to the counterparty.[475] On the other hand, they may not require collateral for these purposes because, for example, the counterparty is deemed to be of low

[468] *Id.* This provision is modeled on paragraph (c)(2)(vi)(B)(*1*) of Rule 15c3–1. *See* 17 CFR 240.15c3–1(c)(2)(vi)(B)(*1*). *See also* paragraph (c)(1)(i)(B)(*1*) of proposed new Rule 18a–1.

[469] *See* paragraph (b) of proposed new Rule 18a–2.

[470] The proposed definition of *tangible net worth* is consistent with the CFTC's proposed definition of *tangible net equity. See CFTC Capital Proposing Release,* 76 FR at 27828 (defining *tangible net equity* as ''equity as determined under U.S. generally accepted accounting principles, and excludes goodwill and other intangible assets.'').

[471] *See* paragraph (c) of proposed new Rule 18a–2.

[472] *See* 17 CFR 240.15c3–4.

[473] *See CFTC Capital Proposing Release,* 76 FR at 27809–27812.

[474] *See Market Review of OTC Derivative Bilateral Collateralization Practices; OTC Derivatives: Settlement Procedures and Counterparty Risk Management.*

[475] In the Dodd-Frank Act, collateral collected to cover current exposure is referred to as *variation margin* and collateral collected to cover potential future exposure is referred to as *initial margin. See, e.g.,* section 15F(e)(2)(B)(i)–(ii) of the Exchange Act (15 U.S.C. 78o–10(e)(2)(B)(i)–(ii)) and section 4s(e)(1)(A)–(B) of the CEA (7 U.S.C. 6s(e)(1)(A)–(B)), added by the Dodd-Frank Act. In this release, collateral collected to cover potential future exposure is referred to as *margin collateral.*

credit risk.[476] Alternatively, agreements between a dealer and its counterparties could require the counterparties to begin delivering collateral during the pendency of the transaction if certain ''trigger events,'' *e.g.,* a downgrade of the counterparty's credit rating, occur. Prior to the financial crisis, the ability to enter into OTC derivatives transactions without having to deliver collateral allowed counterparties to enter into OTC derivatives transactions without the necessity of using capital to support the transactions.[477] So, when ''trigger events'' occurred during the financial crisis, counterparties faced significant liquidity strains in seeking to meet the requirements to deliver collateral.[478] As a result, some dealers experienced large uncollateralized exposures to counterparties experiencing financial difficulty, which, in turn, risked exacerbating the already severe market dislocation.[479]

The Dodd-Frank Act seeks to address the risk of uncollateralized credit risk exposure arising from OTC derivatives by, among other things, mandating margin requirements for non-cleared security-based swaps and swaps. In particular, section 764 of the Dodd-Frank Act added new section 15F to the Exchange Act.[480] Section 15F(e)(2)(B) of the Exchange Act provides that the Commission shall adopt rules for nonbank SBSDs and nonbank MSBSPs imposing ''both initial and variation margin requirements on all security-based swaps that are not cleared by a registered clearing agency.'' [481] Section 15F(e)(2)(A) of the Exchange Act provides that the prudential regulators shall prescribe initial and variation margin requirements for non-cleared security-based swap transactions applicable to bank SBSDs and bank MSBSPs.[482] Section 15F(e)(3)(A) also provides that ''[t]o offset the greater risk to the security-based swap dealer or major security-based swap participant and the financial system arising from the use of security-based swaps that are not cleared,'' the margin requirements proposed by the Commission and prudential regulators shall ''help ensure the safety and soundness'' of the SBSDs and the MSBSPs, and ''be appropriate for the risk associated with non-cleared security-based swaps held'' by an SBSD or MSBSP.[483]

Similarly, sections 4s(e)(1)(A) and (B) of the CEA provide that the prudential regulators and the CFTC shall prescribe margin requirements for, respectively, bank swap dealers and bank major swap participants, and nonbank swap dealers and nonbank major swap participants.[484] Further, section 4s(e)(3)(A) of the CEA provides, among other things, that ''[t]o offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared,'' the margin requirements adopted by the prudential regulators and the CFTC shall ''help ensure the safety and soundness'' of swap dealers and major swap participants, and ''be appropriate for the risk associated with non-cleared swaps held'' by these entities.[485]

The margin requirements that must be established with respect to non-cleared security-based swaps and non-cleared swaps will operate in tandem with provisions in the Dodd-Frank Act requiring that security-based swaps and swaps must be cleared through a registered clearing agency or registered DCO, respectively, unless an exception to mandatory clearing exists.[486] More specifically, section 3C of the Exchange Act,[487] as added by section 763(a) of the Dodd-Frank Act, creates, among other things, a clearing requirement with respect to certain security-based swaps. Specifically, this section provides that ''[i]t shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency that is registered under this Act or a clearing agency that is exempt from registration under this Act if the security-based swap is required to be cleared.'' [488]

Clearing agencies and DCOs that operate as central counterparties (''CCPs'') manage credit and other risks through a range of controls and methods, including prescribed margin rules for their members.[489] Thus, the

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[476] *See, e.g.,* Orice M. Williams, Director, Financial Markets and Community Investment, General Accountability Office (''GAO''), *Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps,* GAO–09–397T (Mar. 2009), available at *http://www.gao.gov/new.items/d09397t.pdf* (testimony before the U.S. House Financial Services Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises).

[477] *Id.* at 13.

[478] *Id. See also* GAO, *Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc.,* GAO–11–616 (Sept. 2011), available at *http://www.gao.gov/assets/590/585560.pdf* (''*Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc.''*).

[479] *See Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc.* at 5–6.

[480] *See* Public Law 111–203 § 764.

[481] 15 U.S.C. 78o–10(e)(2)(B).

[482] *See* 15 U.S.C. 78o–10(e)(2)(A). The prudential regulators have proposed margin rules with respect to non-cleared swaps and security-based swaps that would apply to bank swap dealers, bank major swap participants, bank SBSDs, and bank MSBSPs. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564. The prudential regulators refer to collateral to cover current exposure as *variation margin* and collateral to cover potential future exposure as *initial margin. Id.*

[483] 15 U.S.C. 78o–10(e)(3)(A).

[484] *See* 7 U.S.C. 6s(e)(1)(A) and (B). The CFTC has proposed margin requirements with respect to non-cleared swaps that would apply to nonbank swap dealers and nonbank major swap participants. *See CFTC Margin Proposing Release,* 76 FR 23732. The CFTC refers to collateral to cover current exposure as *variation margin* and collateral to cover potential future exposure as *initial margin. Id.*

[485] 7 U.S.C. 6s(e)(3)(A).

[486] *See* Public Law 111–203 § 763 (adding section 3C(a)(1) of the Exchange Act (15 U.S.C. 78c–3(a)(1) (mandatory clearing of security-based swaps)) and Public Law 111–203 § 723 (adding section 2(h) of the CEA (7 U.S.C. 2(h) (mandatory clearing of swaps)). The mandatory clearing provisions in the Exchange Act and CEA contain exceptions from the mandatory clearing requirement for certain types of entities, security-based swaps, and swaps. *See Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b–4 and Form 19b–4 Applicable to All Self-Regulatory Organizations,* Exchange Act Release No. 67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (explaining exceptions to mandatory clearing for security-based swaps) (''*Process for Submissions of Security-Based Swaps''*); *Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available To Trade,* 76 FR 77728 (Dec. 30, 2010) (explaining exceptions to mandatory clearing for swaps). Security-based swaps and swaps that are not required to be cleared would be non-cleared security-based swaps and swaps.

[487] 15 U.S.C. 78c–3 *et seq.*

[488] 15 U.S.C. 78c–3(a)(1) (as added by section 763(a) of the Dodd-Frank Act). The requirement that a security-based swap must be cleared will stem from the determination to be made by the Commission. Such determination may be made in connection with the review of a clearing agency's submission regarding a security-based swap, or any group, category, type or class of security-based swap, the clearing agency plans to accept for clearing. *See* 15 U.S.C. 78c–3(b)(2)(C)(ii) (as added by section 763(a) of the Dodd-Frank Act) (''[t]he Commission shall * * * review each submission made under subparagraphs (A) and (B), and determine whether the security-based swap, or group, category, type, or class of security-based swaps, described in the submission is required to be cleared''.). In addition, section 3C(b)(1) of the Exchange Act provides that ''[t]he Commission on an ongoing basis shall review each security-based swap, or any group, category, type, or class of security-based swaps to make a determination that such security-based swap, or group, category, type, or class of security-based swaps should be required to be cleared.''

[489] *See Clearing Agency Standards for Operation and Governance,* Exchange Act Release No. 64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011) (''*Clearing Agency Standards for Operation and Governance''*). A CCP interposes itself between two counterparties to a transaction. *See Process for Submissions of Security-Based Swaps,* 77 FR at 41603. For example, when an OTC derivatives contract between two counterparties that are members of a CCP is executed and submitted for clearing, it is typically replaced by two new contracts—separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties are no longer counterparties to each other. Instead, each acquires the CCP as its counterparty, and the CCP assumes the counterparty credit risk of each of the original counterparties that are members of the CCP. To address the credit risk of acting as a CCP, clearing

mandatory clearing requirements established by the Dodd-Frank Act for security-based swaps and swaps, in effect, will establish margin requirements for cleared security-based swaps and cleared swaps and, thereby, complement the margin requirements for non-cleared security-based swaps and non-cleared swaps established by the Commission, the prudential regulators, and the CFTC.[490]

Pursuant to section 15F(e) of the Exchange Act, the Commission is proposing new Rule 18a–3 to establish margin requirements for nonbank SBSDs and nonbank MSBSPs with respect to non-cleared security-based swaps. The provisions of proposed Rule 18a–3 are based on the margin rules applicable to broker-dealers (the ''broker-dealer margin rules'').[491] The goal of modeling proposed new Rule 18a–3 on the broker-dealer margin rules is to promote consistency with existing rules and to facilitate the portfolio margining of security-based swaps with other types of securities. In the securities markets, margin rules have been set by relevant regulatory authorities (the Federal Reserve and the SROs) since the 1930s.[492] The requirement that an SRO file proposed margin rules with the Commission has promoted the establishment of consistent margin levels across the SROs, which mitigates the risk that SROs (as well as their member firms) will compete by implementing lower margin levels and also helps ensure that margin levels are set at sufficiently prudent levels to reduce systemic risk.[493] Basing proposed Rule 18a–3 on the broker-dealer margin rules is intended to achieve these same objectives in the market for security-based swaps.

Under the broker-dealer margin rules, an accountholder is required to maintain a specified level of *equity* in a securities account at a broker-dealer (*i.e.,* the market value of the assets in the account must exceed the amount of the accountholder's obligations to the broker-dealer by a prescribed amount).[494] This equity serves as a buffer in the event the accountholder fails to meet an obligation to the broker-dealer and the broker-dealer must liquidate the assets in the account to satisfy the obligation.[495] The equity also provides liquidity to the broker-dealer with which to fund the credit extended to the accountholder. The amount of the equity required to be maintained in the account depends on the securities transactions being facilitated through the resources of the broker-dealer because the equity requirement increases as the risk of the securities purchased with borrowed funds or sold short with borrowed securities increases.

Proposed new Rule 18a–3 is based on these same principles and is intended to form part of an integrated program of financial responsibility requirements, along with the proposed capital and segregation standards. For example, proposed new Rule 18a–1 would impose a capital charge in certain cases for uncollateralized exposures arising from security-based swaps. The segregation requirements are intended to ensure that initial margin collected by SBSDs is protected from their proprietary business risks.[496]

Request for Comment

The Commission generally requests comment on the proposal to model the nonbank SBSD margin rule for non-cleared security-based swaps on the broker-dealer margin rules. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are there other margin standards that would more appropriately address the risks of non-cleared security-based swaps and/or be more practical margining programs for non-cleared security-based swaps? If so, identify them and explain how they would be more appropriate and/or practical.

2. What are the current margining practices of dealers in OTC derivatives with respect to contracts that likely would be security-based swaps subject to proposed new Rule 18a–3? How do those margining practices differ from the proposed requirements in proposed new Rule 18a–3?

3. As a practical matter, would the structure of proposed new Rule 18a–3 accommodate portfolio margining of security-based swaps and swaps? If so, explain why. If not, explain why not.

2. Proposed Margin Requirements for Nonbank SBSDs and Nonbank MSBSPs

a. Scope of Rule 18a–3

Proposed new Rule 18a–3 would apply to nonbank SBSDs and nonbank MSBSPs.[497] As discussed in more detail below, the proposed rule would require nonbank SBSDs to collect collateral from their counterparties to non-cleared security-based swaps to cover both current exposure and potential future exposure to the counterparty (*i.e.,* the rule would require the account to have prescribed minimum levels of *equity*); however, there would be exceptions to

agencies and DCOs require their clearing members to post collateral for proprietary and customer positions of the member cleared by the clearing agency or DCO. They also may require their clearing members to collect collateral from their customers. In addition, as discussed below, the Federal Reserve and the broker-dealer SROs prescribe margin rules requiring broker-dealers to collect margin collateral from their customers for financed securities transactions and facilitated short sales of securities. *Id.*

[490] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27567 (''In the derivatives clearing process, central counterparties (CCPs) manage the credit risk through a range of controls and methods, including a margining regime that imposes both initial margin and variation margin requirements on parties to cleared transactions. Thus, the mandatory clearing requirement established by the Dodd-Frank Act for swaps and security-based swaps will effectively require any party to any transaction subject to the clearing mandate to post initial and variation margin to the CCP in connection with that transaction.'') (footnote omitted). *See also Clearing Agency Standards for Operation and Governance,* 76 FR at 14482 (proposing a requirement that clearing agencies acting as CCPs must establish, implement, maintain, and enforce written policies and procedures reasonably designed to use margin requirements to limit credit exposures to members in normal market conditions, use risk-based models and parameters to set margin requirements, and review the models and parameters at least monthly).

[491] Broker-dealers are subject to margin requirements in rules promulgated by the Federal Reserve (12 CFR 220.1, *et seq.*), SROs (*see, e.g.,* FINRA Rules 4210–4240), and, with respect to security futures, jointly by the Commission and the CFTC (17 CFR 242.400–406).

[492] The Federal Reserve originally adopted Regulation T pursuant to section 7 of the Exchange Act shortly after the enactment of the Exchange Act. *See* 1934 Fed. Res. Bull. 675. The purposes of the Federal Reserve's margin rules include: (1) Regulation of the amount of credit directed into securities speculation and away from other uses; (2) protection of the securities markets from price fluctuations and disruptions caused by excessive margin credit; (3) protection of investors against losses arising from undue leverage in securities transactions; and (4) protection of broker-dealers from the financial exposure involved in excessive margin lending to customers. *See* Charles F. Rechlin, *Securities Credit Regulation* § 1:3 (2d ed. 2008).

[493] Pursuant to section 19(b)(1) of the Exchange Act, each SRO must file with the Commission any proposed change in, addition to, or deletion from the rules of the exchange electronically on a Form 19b–4 through the Electronic Form 19b–4 Filing System, which is a secure Web site operated by the Commission. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b–4.

[494] *See, e.g.,* 12 CFR 220.2; FINRA Rule 4210(a)(5); 17 CFR 242.401(a)(8). Accountholder obligations to the broker-dealer generally arise from the accountholder borrowing funds from the broker-dealer to finance securities purchases and the accountholder relying on the broker-dealer to borrow securities or use its own securities to make delivery on short sales of securities by the accountholder.

[495] The account *equity* requirement, in effect, mandates that the account contain sufficient collateral to cover the broker-dealer's current exposure to the accountholder plus a buffer to address potential future exposure.

[496] *See* proposed new Rules 18a–1, 18a–3, and 18a–4.

[497] *See* paragraph (a) of proposed new Rule 18a–3.

these requirements for certain types of counterparties and for certain types of transactions. The collateral collected to address the potential future exposure (the margin collateral) would need to be sufficient to meet the level of account *equity* required by the proposed rule. The required level of account *equity* would be based on the risk of the positions in the account.

Proposed new Rule 18a–3 would require a nonbank MSBSP to collect collateral from counterparties to which the nonbank MSBSP has current exposure and deliver collateral to counterparties that have current exposure to the nonbank MSBSP; however, there would be exceptions to these requirements for certain types of counterparties. These requirements would apply only to current exposure (*i.e.,* nonbank MSBSPs and their counterparties would not be required to exchange collateral to cover potential future exposure to each other).

The proposed rule would not identify the types of instruments that must be delivered as collateral (*e.g.,* U.S. government securities). However, it would place limitations on the collateral that could be collected by nonbank SBSDs. First, the rule would require the nonbank SBSD to take haircuts on the collateral equal to the amounts of the deductions required under Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1, as applicable to the nonbank SBSD. Second, the rule would prescribe conditions with respect to the collateral modeled on the conditions in Appendix E to Rule 15c3–1, discussed above in section II.A.2.b.iv. of this release, that determine when collateral can be taken into account for purposes of determining a potential credit risk charge for exposure to certain counterparties.[498]

Finally, the provisions in proposed new Rule 18a–3 are intended to establish *minimum* margin requirements for non-cleared security-based swaps. A nonbank SBSD and a nonbank MSBSP could establish ''house'' margin requirements that are more conservative than those specified in the proposed new rule.[499] For example, a nonbank SBSD could require that a minimum level of *equity* must be maintained in the accounts of counterparties that exceed the level of *equity* required to be maintained pursuant to the proposed new rule. In addition, a nonbank SBSD and a nonbank MSBSP could specifically identify and thereby limit the types of instruments they will accept as collateral.

b. Daily Calculations

i. Nonbank SBSDs

Proposed new Rule 18a–3 would require nonbank SBSDs to collect collateral from their counterparties to non-cleared security-based swaps to cover both current exposure and potential future exposure, subject to certain exceptions discussed below.[500] Consequently, proposed new Rule 18a–3 would require a nonbank SBSD to perform two calculations as of the close of each business day with respect to each account carried by the firm for a counterparty to a non-cleared security-based swap transaction.[501] A nonbank SBSD would be required to increase the frequency of the calculations (*i.e.,* perform intra-day calculations) during periods of extreme volatility and for accounts with concentrated positions.[502] These more frequent calculations would be designed to monitor the nonbank SBSD's counterparty risk exposure in situations where a default by a counterparty or multiple counterparties would have a more significant adverse impact on the financial condition of the nonbank SBSD than under more normal circumstances.[503] One consequence of the more frequent calculations could be that the nonbank SBSD requests that a counterparty deliver collateral during the day pursuant to a ''house'' margin requirement to account for changes in the value of the securities and money market instruments held in the account.

As discussed below in section II.B.2.c.i. of this release, the daily calculations would form the basis for the nonbank SBSD to determine the amount of collateral the counterparty would need to deliver to cover any current exposure and potential future exposure the nonbank SBSD has to the counterparty. The proposed rule would except certain counterparties from this requirement. Even if the counterparty is not required to deliver collateral, the calculations—by measuring the current and potential future exposure to the counterparty—would assist the nonbank SBSD in managing its credit risk and understanding the extent of its uncollateralized credit exposure to the counterparty and across all counterparties. In addition, as discussed above in section II.A.2.a. of this release, the calculations would be used for determining the *risk margin amount* for purposes of calculating the 8% margin factor to determine the nonbank SBSD's minimum net capital requirement.[504]

The first calculation would be to determine the amount of *equity* in the account.[505] For purposes of the rule, the term *equity* would mean the total current fair market value of securities positions in an account of a counterparty (excluding the time value of an over-the-counter option), plus any credit balance and less any debit balance in the account after applying a qualifying netting agreement with respect to gross derivatives payables and receivables.[506] Consequently, the first step in calculating the *equity* would be to mark-to-market all of the securities positions in the account, including non-cleared security-based swap positions. The second step would be to add to that amount any credit balance in the account or subtract from that amount any debit balance in the account. Credit balances would include payables the nonbank SBSD owed to the counterparty. Payables could relate to cash deposited into the account, the proceeds of the sales of securities held in the account, and/or interest and dividends earned from securities held in the account. In addition, payables could relate to derivatives in the account, including non-cleared security-based swaps with a net replacement value in the favor of the counterparty. Debit balances would be receivables to the nonbank SBSD owed by the

[498] *See* 17 CFR 240.15c3–1e(c)(4)(v)(A)–(H).

[499] Under broker-dealer margin rules, broker-dealers also can establish ''house'' margin requirements as long as they are at least as restrictive as the Federal Reserve and SRO margin rules. *See, e.g.,* FINRA Rule 4210(d).

[500] *See* paragraphs (c)(1)(ii) and (iii) of proposed new Rule 18a–3.

[501] *See* paragraphs (c)(1)(i)(A) and (B) of proposed new Rule 18a–3. For purposes of proposed new Rule 18a–3, the term *account* would mean an account carried by a nonbank SBSD or nonbank MSBSP for a counterparty that holds non-cleared security-based swaps. *See* paragraph (b)(1) of proposed new Rule 18a–3. In addition, the term *counterparty* would mean a person with whom the nonbank SBSD or nonbank MSBSP has entered into a non-cleared security-based swap transaction. *See* paragraph (b)(3) of proposed new Rule 18a–3.

[502] *See* paragraph (c)(7) of proposed new Rule 18a–3.

[503] *Compare* FINRA Rule 4210(d) which states that procedures shall be established by members to: ''(1) review limits and types of credit extended to all customers; (2) formulate their own margin requirements; and (3) review the need for instituting higher margin requirements, mark-to-markets and collateral deposits than are required by this [margin rule] for individual securities or customer accounts.''

[504] *See* proposed new paragraph (c)(16) of Rule 15c3–1; paragraph (c)(6) of proposed new Rule 18a–1.

[505] *See* paragraph (c)(1)(i)(A) of proposed new Rule 18a–3.

[506] *See* paragraph (b)(4) of proposed new Rule 18a–3. The time value of an OTC option is the amount that the current market value of the option exceeds the in-the-money amount of the option. *See also, generally,* FINRA Rule 4210(a)(5) (defining *equity* to mean the customer's ownership interest in the account, computed by adding the current market value of all securities ''long'' and the amount of any credit balance and subtracting the current market value of all securities ''short'' and the amount of any debit balance).

counterparty, including any net replacement values in favor of the nonbank SBSD arising from derivatives positions and any other amounts owed to the nonbank SBSD by the counterparty.

As indicated by the proposed definition of *equity,* the nonbank SBSD could offset payables and receivables relating to derivatives in the account by applying a qualifying netting agreement with the counterparty. To qualify for this treatment, a netting agreement would need to meet the minimum requirements prescribed in Appendix E to Rule 15c3–1 to qualify for purposes of the credit risk charge discussed above in section II.A.2.b.iv. of this release.[507] These requirements are designed to ensure that the netting agreement between the nonbank SBSD and the counterparty permits the nonbank SBSD to reduce the receivables and payables relating to derivatives between the two entities to a single net payment obligation.

The *equity* is the amount that results after marking-to-market the securities positions and adding the credit balance or subtracting the debit balance (including giving effect to qualifying netting agreements). If the value of the securities positions in the account exceeds the amount of any debit balance, the account would have a *positive equity*.[508] On the other hand, if the amount of the debit balance is greater, the account would have a *negative equity.*[509] The *negative equity* in an account would be equal to the nonbank SBSD's current exposure to the counterparty.

The second calculation would be to determine a *margin* amount for the account to address potential future exposure.[510] The proposed rule would prescribe a standardized method and a model-based method for calculating the *margin* amount.[511] The method for determining the *margin* amount would be similar to the approach a nonbank SBSD would need to use to determine haircuts on proprietary security-based swap positions when computing net capital.[512] This approach would maintain consistency between the proposed margin and capital rules. Specifically, paragraph (d) of proposed new Rule 18a–3 would divide security-based swaps into two classes: CDS security-based swaps and all other security-based swaps. Paragraph (d) would define the standardized methodology for determining the *margin* amount for each class of security-based swap by reference to the standardized haircuts that would apply to the class in proposed new Rule 18a–1 (if a stand-alone SBSD) or Rule 15c3–1, as proposed to be amended (if a broker-dealer SBSD).[513] Paragraph (d) would provide further that, if the nonbank SBSD was approved to use internal models to compute net capital, the firm could use its internal VaR model to determine the margin amount for security-based swaps for which the firm had been approved to use the model, except that the margin amount for equity security-based swaps would need to be determined exclusively using the standardized haircuts.[514] Consequently, for debt security-based swaps, a nonbank SBSD approved to use internal models could calculate the margin amount using the firm's VaR model to the extent the firm is approved to include these types of positions in the model for the purposes of computing net capital. For all other positions, a nonbank SBSD would need to use the standardized haircut approach. Nonbank SBSDs that are not approved to use internal models to compute net capital would need to use the standardized haircuts for all positions to calculate the margin amount.

As noted above, a nonbank SBSD (regardless of whether it is approved to use internal models to compute net capital) would be required to calculate the *margin* amount for equity security-based swaps using the standardized haircuts, which includes the ability to use the methodology in Appendix A to Rule 15c3–1. This proposal is designed to establish a margin requirement for equity security-based swaps that is consistent with SRO portfolio margin rules for equity securities, which are based on the Appendix A methodology.[515] This provision would

[507] *See* paragraph (c)(5) of proposed new Rule 18a–3; 17 CFR 240.15c3–1e(c)(4)(iv).

[508] The proposed rule would define the term *positive equity* to mean *equity* of greater than $0. *See* paragraph (b)(7) of proposed new Rule 18a–3.

[509] The proposed rule would define the term *negative equity* to mean *equity* of less than $0. *See* paragraph (b)(6) of proposed new Rule 18a–3.

[510] *See* paragraph (c)(1)(i)(B) of proposed new Rule 18a–3.

[511] *See* paragraph (d) of proposed new Rule 18a–3. Similarly, the prudential regulators have proposed that bank SBSDs and bank swap dealers have the option of using internal models to calculate initial margin requirements for non-cleared security-based swaps. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27567–27568 (''With respect to initial margin, the proposed rule permits a covered swap entity to select from two alternatives to calculate its initial margin requirements. A covered swap entity may calculate its initial margin requirements using a standardized 'lookup' table that specifies the minimum initial margin that must be collected, expressed as a percentage of the notional amount of the swap or security-based swap. These percentages depend on the broad asset class of the swap or security-based swap. Alternatively, a covered swap entity may calculate its minimum initial margin requirements using an internal margin model that meets certain criteria and that has been approved by the relevant prudential regulator.'') (footnotes omitted). On the other hand, the CFTC, because of concerns about the resources necessary to approve the use of internal models for margining purposes and the fact that nonbank swap dealers may not have internal models, proposed that nonbank swap dealers must use either external models or a standardized approach to determine initial margin (though the CFTC did propose a provision under which the CFTC could approve the use of an internal model should the CFTC obtain sufficient resources). *See CFTC Margin Proposing Release,* 76 FR at 23737. The external models proposed by the CFTC are: (1) a model currently in use for margining cleared swaps at a DCO; (2) a model currently in use for modeling non-cleared swaps by an entity subject to regular assessment by a prudential regulator; or (3) a model available for licensing to any market participant by a vendor. *Id.* The use of external models is not being proposed for nonbank SBSDs because the basis for permitting firms to use VaR models to compute net capital is to align their internally developed (*i.e.,* not vender-developed) risk management processes with the process for computing net capital. *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34428 (the option to use VaR models is ''intended to reduce regulatory costs for broker-dealers by allowing very highly capitalized firms that have developed robust internal risk management practices to use those risk management practices, such as mathematical risk measurement models, for regulatory purposes'').

[512] *See* paragraph (d) of proposed new Rule 18a–3; proposed new paragraph (c)(2)(vi)(O) of Rule 15c3–1; paragraph (c)(1)(vi) of proposed new Rule 18a–1.

[513] *See* paragraphs (d)(1)(i) and (ii) of proposed new Rule 18a–3. As discussed in section II.A.2.b.ii. of this release, proposed new Rule 18a–1 and Rule 15c3–1, as proposed to be amended, would prescribe standardized haircuts for security-based swaps. *See* proposed new paragraph (c)(2)(vi)(O) of Rule 15c3–1; paragraph (c)(1)(vi) of proposed new Rule 18a–1. Consequently, for CDS security-based swaps, the nonbank SBSD would use the proposed maturity/spread grid in proposed new paragraph (c)(2)(vi)(O)(*1*) of Rule 15c3–1 and paragraph (c)(1)(vi)(A) of proposed new Rule 18a–1 to determine the margin amount. *See* paragraph (d)(1)(i) of proposed new Rule 18a–3. While the required standardized haircuts would be the same in Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1, the nonbank SBSD would refer to Rule 15c3–1 if it is a broker-dealer SBSD and proposed new Rule 18a–1 if it is a stand-alone SBSD. For all equity security-based swaps and debt security-based swaps (other than CDS security-based swaps), the nonbank SBSD would use the method of multiplying the notional amount of the position by the standardized haircut that would apply to the underlying security as specified in proposed new paragraph (c)(2)(vi)(O)(*2*) of Rule 15c3–1 and paragraph (c)(1)(vi)(B) of proposed new Rule 18a–1. *See* paragraph (d)(ii) of proposed new Rule 18a–3. For equity security-based swaps, this would include being able to use the methodology in Appendix A to Rule 15c3–1, as proposed to be amended, and in Appendix A to proposed new Rule 18a–1, as applicable to the nonbank SBSD. For debt security-based swaps, this would include being able to use the offsets that are permitted in the debt maturity grids in paragraph (c)(2)(vi) of Rule 15c3–1. *See* 17 CFR 240.15c3–1(c)(2)(vi).

[514] *See* paragraph (d)(2) of proposed new Rule 18a–3.

[515] *See* FINRA Rule 4210(g); CBOE Rule 12.4. *See also* FINRA, Portfolio Margin Frequently Asked Questions, available at *www.finra.org.* As discussed in section II.A.2.b.ii. of this release, Appendix A to Rule 15c3–1 permits a broker-dealer to group

Continued

allow broker-dealer SBSDs to include equity security-based swaps in the portfolios of equity securities positions for which they calculate margin requirements using the SRO portfolio margin rules.[516] The proposal also would ensure a consistent portfolio margin approach for equity security products across nonbank SBSDs and broker-dealers that are not SBSDs, and thereby reduce opportunity for regulatory arbitrage.

Request for Comment

The Commission generally requests comment on the proposed daily calculation requirements for nonbank SBSDs in proposed new Rule 18a–3. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the proposed definition of *equity* appropriate? For example, would the proposed definition be practical in terms of determining the net *equity* in an account holding non-cleared security-based swaps? If the proposed definition is not appropriate, explain why and provide suggested alternative definitions.

2. Should the definition of *equity* include the time value of an over-the-counter option? If so, explain why.

3. Should the terms *current market value, credit balance,* and *debit balance* be defined for the purpose of proposed new Rule 18a–3? For example, would defining these terms provide greater clarity to the definition of *equity* in the proposed rule? If these terms should be defined, explain why and provide suggested definitions.

4. Are the proposed requirements for netting agreements to qualify for purposes of determining the amount of *equity* in an account appropriate? If not, explain why not. Are there additional or alternative provisions that should be contained in the netting agreement requirements? If so, identify and explain them.

5. Is the proposed method for calculating the *margin* amount appropriate? If not, explain why not. For example, is it appropriate to use the techniques in Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1 to determine the *margin* amount? If not, explain why not. Are there alternative methods for calculating the *margin* amount that would be preferable? If so, identify them and explain why they would be preferable.

6. Should proposed new Rule 18a-3 allow an alternative method of calculating the *margin* amount that would permit a nonbank SBSD to determine the *margin* amount for a non-cleared security-based swap based on the margin required by a registered clearing agency for a cleared security-based swap whose terms and conditions closely resemble the terms and conditions of the non-cleared security-based swap (similar to the CFTC's proposal)? Would there be sufficient similarity between certain cleared and non-cleared security-based swaps to make this approach workable? In addition, if this alternative approach was permitted, how could the potential differences in margin requirements across clearing agencies be addressed?

7. In addition to internal models, should external models be permitted such as: (1) a model currently in use for margining cleared security-based swaps at a clearing agency; (2) a model currently in use for modeling non-cleared swaps by an entity subject to regular assessment by a prudential regulator; or (3) a model available for licensing to any market participant by a vendor? What would be the advantages and disadvantages of permitting external models?

8. How would the proposed standardized approaches to determining the *margin* amount differ from the standardized approaches the prudential regulators proposed for determining the initial margin amount?

9. The provisions for using VaR models to compute net capital require that the model use a 99%, one-tailed confidence level with price changes equivalent to a ten-business-day movement in rates and prices. This means the VaR model used for the purpose of determining a counterparty's *margin* amount also would need to use a 99%, one-tailed confidence level with price changes equivalent to a ten-business-day movement in rates and prices. The ten-business-day requirement is designed to account for market movements that occur over a period of time as opposed to a single day. This is designed to ensure that the VaR model uses potential market moves that are large enough to capture multi-day moves in rates and prices. Given this purpose, should the VaR model be required to use a longer period of time (*e.g.,* 15, 20, 25, or 30 business days) to establish a potentially greater margin collateral requirement for customers given that they may not be subject to capital and other prudential requirements? Would the 3-times multiplication factor proposed to be required for VaR models used by nonbank SBSDs (which, under the proposal, would need to be increased in response to back-testing exceptions) be necessary if the time period were longer than 10 business days? If not, explain why not.

ii. Nonbank MSBSPs

Proposed new Rule 18a–3 would require nonbank MSBSPs to collect collateral from counterparties to which the nonbank MSBSP has current exposure and provide collateral to counterparties that have current exposure to the nonbank MSBSP.[517] Consequently, a nonbank MSBSP would be required to calculate as of the close of business each day the amount of *equity* in each account of a counterparty.[518] Consistent with the proposal for nonbank SBSDs, a nonbank MSBSP would be required to increase the frequency of its calculations (*i.e.,* perform intra-day calculations) during periods of extreme volatility and for accounts with concentrated positions.[519]

options, futures, long securities positions, and short securities positions involving the same underlying security and stress the current market price for each position at ten equidistant points along a range of positive and negative potential future market movements, using an approved theoretical options pricing model that satisfies certain conditions specified in the rule. *See* 17 CFR 240.15c3–1a. The gains and losses of each position in the portfolio offset each other to yield a net gain or loss at each stress point. The stress point that yields the largest potential net loss for the portfolio would be used to calculate the aggregate haircut for all the positions in the portfolio. *Id.*

[516] *See, e.g.,* FINRA Rule 4210(g)(2)(G) (defining the term ''unlisted derivative'' for purposes of inclusion in the Appendix A methodology as used in the rule to calculate a portfolio margin requirement to mean ''any equity-based or equity index-based unlisted option, forward contract, or *security-based swap* that can be valued by a theoretical pricing model approved by the [Commission].'') (emphasis added).

[517] *See* paragraph (c)(2)(ii) of proposed new Rule 18a-3.

[518] *See* paragraph (c)(2)(i) of proposed new Rule 18a–3. A nonbank MSBSP would apply the definitions in paragraph (b) of proposed new Rule 18a–3 for the purposes of complying with the requirements in the rule. *See* paragraph (b) of proposed new Rule 18a–3. The term *equity* would be defined to mean the total current fair market value of securities positions in an account of a counterparty (excluding the time value of an over-the-counter option), plus any credit balance and less any debit balance in the account after applying a qualifying netting agreement with respect to gross derivatives payables and receivables. *See* paragraph (b)(4) of proposed new Rule 18a–3. The time value of an OTC option is the amount that the current market value of the option exceeds the in-the-money amount of the option. In addition, the term *account* is proposed to be defined to mean an account carried by a nonbank SBSD or nonbank MSBSP for a counterparty that holds non-cleared security-based swaps. *See* paragraph (b)(1) of proposed new Rule 18a-3. Furthermore, the term *counterparty* is proposed to mean a person with whom the nonbank SBSD or nonbank MSBSP has entered into a non-cleared security-based swap transaction. *See* paragraph (b)(3) of proposed new Rule 18a–3.

[519] *See* paragraph (c)(7) of proposed new Rule 18a–3. These more frequent calculations would be designed to monitor the nonbank MSBSP's

As would be the case for a nonbank SBSD, the first step for a nonbank MSBSP in calculating the *equity* in an account would be to mark-to-market all of the securities positions in the account, including non-cleared security-based swap positions. The second step would be to add to that amount any credit balance in the account or subtract from that amount any debit balance.[520] The nonbank MSBSP could offset payables and receivables relating to derivatives in the account by applying a qualifying netting agreement with the counterparty. To qualify for this treatment, a netting agreement would need to meet the minimum requirements prescribed in Appendix E to Rule 15c3–1 to qualify for purposes of the credit risk charge discussed above in section II.A.2.b.iv. of this release.[521] These requirements, set forth in paragraph (c)(5) of Rule 18a–3, are designed to ensure that the netting agreement between the nonbank MSBSP and the counterparty permits the nonbank MSBSP to reduce the receivables and payables between the two entities to a single net payment obligation.[522]

If the value of the securities positions plus the amount of any cash in the account exceeds the amount of the debit balance, the account would have *positive equity*.[523] This would mean the counterparty has current exposure to the nonbank MSBSP. On the other hand, if the amount of the debit balance is greater, the account would have *negative equity*.[524] This would mean the nonbank MSBSP has current exposure to the counterparty.

Nonbank MSBSPs would not be required to deliver or collect margin collateral to collateralize potential future exposure.[525] For that reason, Rule 18a–3 would not require nonbank MSBSPs to calculate a *margin* amount, and the rule would not require counterparties to provide margin collateral to nonbank MSBSPs to maintain *equity* levels above the nonbank MSBSP's current exposure. When a counterparty provides margin collateral to collateralize potential future exposure, the counterparty is exposed to credit risk in the amount that the collateral provided to the dealer exceeds the dealer's current exposure to the counterparty. With respect to nonbank SBSDs, collateralizing potential future exposure is intended to promote the financial responsibility of the nonbank SBSD, as the margin collateral received from the counterparty protects the nonbank SBSD from the risks arising from fluctuations in the value of the underlying positions before the collateral can be sold. The counterparty, in turn, would be protected by the net liquid assets test standard applicable to the nonbank SBSD,[526] which is significantly more conservative than the tangible net worth capital standard proposed for nonbank MSBSPs.[527] The counterparties also would be protected by the proposed segregation requirements with respect to the margin collateral delivered by counterparties.[528]

The proposed margin requirements for nonbank MSBSPs are designed to ''neutralize'' the credit risk between a nonbank MSBSP and a counterparty. The collection of collateral from counterparties would strengthen the liquidity of the nonbank MSBSP by collateralizing its current exposure to counterparties. Nonbank MSBSPs, in contrast to nonbank SBSDs, would be required to deliver collateral to counterparties to collateralize their current exposure to the nonbank MSBSP, which would lessen the impact on the counterparties if the nonbank MSBSP failed, and is intended to account for the fact that nonbank MSBSPs would be subject to less stringent capital requirements than nonbank SBSDs.

In addition, as discussed in section II.A.3. of the release, the entities that may need to register as nonbank MSBSPs could include companies that engage in commercial activities that are not necessarily financial in nature (*e.g.,* manufacturing, agriculture, and energy) and for which a net liquid assets test could be impractical. Finally, because of these differences in business models, nonbank MSBSPs may not have the systems and personnel necessary to operate daily margin collateral programs to address potential future exposure.

Request for Comment

The Commission generally requests comment on the proposed daily calculation requirements for nonbank MSBSPs. Commenters are referred to the questions about the daily calculation requirements for nonbank SBSDs above in section II.B.2.b.i. of this release to the extent those questions address provisions in proposed new Rule 18a–3 that also apply to nonbank MSBSPs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Which types of counterparties would be expected to transact with nonbank MSBSPs? Which types of security-based swap transactions would these counterparties enter into with nonbank MSBSPs?

2. Should nonbank MSBSPs be required to calculate a daily *margin* amount for each counterparty? For example, even if they were not required to collect collateral to cover potential future exposure, would the calculation of the *margin* amount better enable them to measure and understand their counterparty risk?

3. If nonbank MSBSPs should calculate a daily *margin* amount, how should such amount be calculated? Should a nonbank MSBSP be required to calculate a *margin* amount using the methods prescribed in paragraph (d) of proposed new Rule 18a–3 or some other method? For example, should nonbank MSBSPs be permitted to use external models to determine a *margin* amount?

4. Would nonbank MSBSPs have the systems and personnel necessary to operate daily margin collateral programs to calculate a daily margin amount?

c. Account Equity Requirements

i. Nonbank SBSDs

A nonbank SBSD would be required to calculate as of the close of each business day: (1) the amount of *equity*

counterparty risk exposure in situations where a default by a counterparty or multiple counterparties would have a more significant adverse impact on the financial condition of the nonbank MSBSP than under more normal circumstances. One consequence of the more frequent calculations could be that the nonbank MSBSP requests that a counterparty deliver collateral during the day pursuant to a ''house'' margin requirement to account for changes in the value of the securities and money market instruments held in the account.

[520] Credit balances would include payables the nonbank MSBSP owed to the counterparty. Payables could relate to cash deposited into the account, the proceeds of the sales of securities held in the account, and interest and dividends earned from securities held in the account. In addition, payables could relate to derivatives in the account such as non-cleared security-based swaps with a net replacement value in the favor of the counterparty. Debit balances would be receivables to the nonbank MSBSP owed by the counterparty. Receivables could relate to derivatives in the account such as non-cleared security-based swaps with a net replacement value in the favor of the nonbank MSBSP.

[521] *See* paragraph (c)(5) of proposed new Rule 18a–3; 17 CFR 240.15c3–1e(c)(4)(iv).

[522] *See* paragraph (c)(5) of proposed new Rule 18a–3.

[523] The proposed rule would define the term *positive equity* to mean *equity* of greater than $0. *See* paragraph (b)(7) of proposed new Rule 18a–3.

[524] The proposed rule would define the term *negative equity* to mean *equity* of less than $0. *See* paragraph (b)(6) of proposed new Rule 18a–3.

[525] *See* paragraph (c)(2)(i) of proposed new Rule 18a-3 (only requiring calculation of the *equity* in the account of each counterparty).

[526] *See* 17 CFR 240.15c3–1; proposed new Rule 18a–1.

[527] *See* proposed new Rule 18a–2.

[528] *See* proposed new Rule 18a–4.

in the account of each counterparty; and (2) a *margin* amount for the account of each counterparty.[529] On the next business day following the calculations, the nonbank SBSD would be required to collect cash, securities, and/or money market instruments from the counterparty in an amount at least equal to the *negative equity* (current exposure) in the account plus the *margin* amount (potential future exposure).[530] The collateral collected would be designed to ensure that the counterparty maintains a minimum level of positive net equity in the account. The proposed rule would require the nonbank SBSD to collect collateral for this purpose from each counterparty, except as discussed below.

A nonbank SBSD would need to collect cash, securities, and/or money market instruments to meet the account *equity* requirements in proposed new Rule 18a–3. Other types of assets would not be eligible as collateral. In addition, under proposed new Rule 18a–3, the fair market value of securities and money market instruments held in the account of a counterparty would need to be reduced by the amount of the deductions the nonbank SBSD would apply to the positions pursuant to Rule 15c3–1, as proposed to be amended, or proposed new Rule 18a–1, as applicable, for the purpose of determining whether the level of *equity* in the account meets the minimum requirement.[531] Accordingly, securities and money market instruments with no ''ready market'' or which cannot be publicly offered or sold because of statutory, regulatory, or contractual arrangements or other restrictions would be subject to a 100% deduction and, therefore, these types of securities and money market instruments would have no value in terms of meeting the account *equity* requirement.[532] All other securities and money market instruments in the account would be reduced in value by the amount of the deductions required in Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1, as applicable to the nonbank SBSD.[533] The amount of the deductions would increase for securities and money market instruments with greater market risk and, thereby, account for the risk that the nonbank SBSD may not be able to liquidate the securities and money market instruments at current market values to satisfy the obligation of a defaulted counterparty.[534] These deductions would limit the types of securities and money market instruments a counterparty could provide as collateral and require a counterparty to increase the amount of collateral delivered to account for the deductions taken on securities collateral in the account.[535]

The prudential regulators and the CFTC are proposing to specifically identify the asset classes that would be eligible collateral for purposes of their margin rules.[536] Proposed new Rule 18a-3 would not limit collateral in this way. However, comment is sought below in section II.B.3. of this release on the question of whether to define the term *eligible collateral* in a manner that is similar to the proposals of the prudential regulators and the CFTC.

The reason for not proposing a definition of *eligible collateral* is that counterparties are expected to engage in a wide range of trading strategies that include security-based swaps. Consequently, the account of a counterparty may hold, for example, the security underlying a security-based swap, as well as a short position, option, and single stock future on the underlying security.[537] Because of the relationship between security-based swaps and these other security positions, permitting various types of securities to count as collateral may be more practical for margin arrangements involving security-based swaps than for other types of derivatives. A more limited definition of eligible collateral could require a counterparty that has *positive equity* in an account equal to or in excess of the *margin* amount to deliver additional collateral to the extent the positions in the account did not meet the definition. The counterparty's credit exposure to the nonbank SBSD therefore would be increased in a way that may not be necessary to account for the nonbank SBSD's potential future exposure to the counterparty.[538]

The Commission is proposing certain additional requirements for eligible collateral, which are modeled on the existing collateral requirements in Appendix E to Rule 15c3–1.[539] As discussed above in section II.A.2.b.iv. of this release, collateral ''ideally'' is ''an asset of stable and predictable value, an asset that is not linked to the value of the transaction in any way, and an asset that can be sold quickly and easily if the need arises.'' [540] The requirements in Appendix E to Rule 15c3–1 are designed to achieve these objectives.[541] The proposed additional requirements include:

- The collateral must be subject to the physical possession or control of the nonbank SBSD;

[529] *See* paragraph (c)(1)(i) of proposed new Rule 18a–3. *See also* paragraph (b)(4) of proposed new Rule 18a–3 (defining the term *equity*).

[530] *See* paragraph (c)(1)(ii) of proposed new Rule 18a-3.

[531] *See* paragraph (c)(3) of proposed new Rule 18a-3.

[532] *See* 17 CFR 240.15c3–1(c)(2)(vii); paragraph (c)(1)(iv) of proposed new Rule 18a–1.

[533] *See* 17 CFR 240.15c3–1(c)(2)(vi); paragraphs (c)(1)(vi)–(vii) of proposed new Rule 18a–1.

[534] *See* 17 CFR 240.15c3–1(c)(2)(vi); paragraphs (c)(1)(vi)–(vii) of proposed new Rule 18a–1.

[535] For example, assume an account holds securities and money market instruments valued at $50, a credit balance of $10, and a debit balance of $58. The *equity* in the account would be $2 ($50 of securities and money market instruments' value + $10 in credits − $58 in debits = $2). Assume that the margin amount calculated for the account is $10. This would mean that the account needs to have *positive equity* of at least $10 (it currently has *positive equity* of only $2). Assume that the deduction under Rule 15c3–1 for the $50 of securities and money market positions held in the account is $7. This would mean that the counterparty would need to deliver $15 in cash (*i.e.,* not $8) to meet the minimum $10 account *equity* requirement ($50 of securities and money market instruments' value − $7 deduction + $10 in credits − $58 in debits + $15 cash collateral deposit = $10). Moreover, if the counterparty delivered securities and/or money market instruments to meet the account *equity* requirement, the fair market value of the securities and money market instruments would need to be greater than $15 because their value would be reduced by the amount of the deduction in Rule 15c3–1 or proposed new Rule 18a–1, as applicable.

[536] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564; *CFTC Margin Proposing Release,* 76 FR 23732. The proposal of the prudential regulators would limit eligible collateral to cash, foreign currency to the extent the payment obligation under the security-based swap or swap is denominated in the currency, obligations guaranteed by the United States as to principal and interest, and, with respect to initial margin only, a senior debt obligation of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Banks, and the Federal Agricultural Mortgage Corporation, or any obligation that is an ''insured obligation,'' as the term is defined in 12 U.S.C. 2277a(3), of a Farm Credit System bank. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27589. The proposal of the CFTC would limit eligible collateral for initial margin to cash, foreign currency to the extent the payment obligation under the security-based swap or swap is denominated in the currency, obligations guaranteed by the United States as to principal and interest, and a senior debt obligation of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Banks, and the Federal Agricultural Mortgage Corporation, or any obligation that is an ''insured obligation,'' as the term is defined in 12 U.S.C. 2277a(3), of a Farm Credit System bank. *CFTC Margin Proposing Release,* 76 FR at 23747. The CFTC's proposal would limit eligible collateral for variation margin to cash and obligations guaranteed by the United States as to principal and interest. *Id.*

[537] *See, e.g.,* FINRA Rule 4210(g) (permitting customer portfolio margining); 17 CFR 240.15c3–1a; Appendix A to proposed new Rule 18a–1.

[538] A counterparty will have credit exposure to a nonbank SBSD to the extent that collateral held in the account of the counterparty has a mark-to-market value in excess of the nonbank SBSD's current exposure to the counterparty.

[539] *See* paragraph (c)(4) of proposed new Rule 18a-3.

[540] *Market Review of OTC Derivative Bilateral Collateralization Practices* at 5.

[541] *See* 17 CFR 240.15c3–1e(c)(4)(v).

• The collateral must be liquid and transferable;

• The collateral must be capable of being liquidated promptly by the nonbank SBSD without intervention by any other party;

• The collateral agreement between the nonbank SBSD and the counterparty must be legally enforceable by the nonbank SBSD against the counterparty and any other parties to the agreement;

• The collateral must not consist of securities issued by the counterparty or a party related to the nonbank SBSD, or to the counterparty; and

• If the Commission has approved the nonbank SBSD's use of a VaR model to compute net capital, the approval allows the nonbank SBSD to calculate deductions for market risk for the type of collateral.[542]

These proposed collateral requirements are designed to ensure that the treatment of collateral requirements remains consistent between the proposed capital and margin requirements. As discussed above in section II.A.2.b.v. of this release, a nonbank SBSD would be required to take a capital charge if a counterparty does not deliver cash, securities, and/or money market instruments to the nonbank SBSD to meet an account *equity* requirement within one business day of the requirement being triggered. In addition, proposed new Rule 18a–3 would require the nonbank SBSD to take prompt steps to liquidate securities and money market instruments in the account to the extent necessary to eliminate the account *equity* deficiency.[543] Under this provision, which is modeled on a similar requirement in the broker-dealer margin rules,[544] a nonbank SBSD could need to liquidate positions in the account to reduce debits arising from those transactions. The rule would not require that the liquidations must be completed within a specific timeframe.[545] Instead, the rule is designed to give the nonbank SBSD the flexibility to conduct an orderly liquidation, taking into account market conditions and the risk profile of the account.

There would be four exceptions to the account *equity* requirements.[546] The first would apply to counterparties that are *commercial end users.*[547] The second would apply to counterparties that are SBSDs.[548] The third would apply to counterparties that are not *commercial end users* and that require their margin collateral to be segregated pursuant to section 3E(f) of the Exchange Act.[549] The fourth would apply to accounts of counterparties that are not *commercial end users* and that hold legacy non-cleared security-based swaps.[550] Under these exceptions, applicable accounts would not need to meet certain account *equity* requirements in proposed new Rule 18a–3 and, therefore, the nonbank SBSD would be exempted from the requirements to take prompt steps to liquidate securities in the account to the extent necessary to eliminate the account *equity* deficiency. However, as discussed above in section II.A.2.b.v. of this release, in these cases the nonbank SBSD would need to take capital charges in lieu of meeting the account *equity* requirements in certain circumstances.[551]

Exception for Commercial End Users

Under the first exception to the account *equity* requirements, a nonbank SBSD would not be required to collect cash, securities, and/or money market instruments to cover the *negative equity* (current exposure) or margin amount (potential future exposure) in the account of a counterparty that is a *commercial end user.*[552] As discussed above in section II.A.2.b.v. of this release, this proposed exception to the requirement to collect collateral is intended to address concerns that have been expressed by *commercial end users* and others that the imposition of margin requirements on commercial companies that use derivatives to mitigate the risk of business activities that are not financial in nature could unduly disrupt their ability to enter into hedging transactions. The proposed exception is intended to permit nonbank SBSDs and *commercial end users* to negotiate individual agreements that would reflect the credit risk of the *commercial end user* and the nature and extent of the non-cleared security-based swap transactions with the end user, without creating an undue impediment to the ability of the *commercial end user* to hedge its commercial risks.[553]

The proposed exception for *commercial end users* also is intended to account for the different risk profiles of *commercial end users* as compared with financial end users.[554] When credit markets are under strain, as in 2008, financial end users, such as hedge funds, can face liquidity stress, which increases their risk of default. Further,

[542] *See* paragraphs (c)(4)(i)–(c)(4)(vi) of proposed new Rule 18a–3.

[543] *See* paragraph (c)(8) of proposed new Rule 18a–3.

[544] *See* 12 CFR 220.4(d) (providing that if a margin call is not met within the required time, the broker-dealer must liquidate securities sufficient to meet the margin call or to eliminate any margin deficiency existing on the day such liquidation is required, whichever is less).

[545] *See* paragraph (c)(8) of proposed new Rule 18a–3.

[546] *See* paragraphs (c)(1)(iii)(A)–(D) of proposed new Rule 18a–3.

[547] *See* paragraph (c)(1)(iii)(A) of proposed new Rule 18a–3.

[548] *See* paragraph (c)(1)(iii)(B)—Alternative A of proposed new Rule 18a–3. An alternative approach is being proposed that would not be an exception to the account *equity* requirement under which a nonbank SBSD would need to collect collateral from another SBSD to cover the *negative equity* in the account and the margin amount for the account. In addition, the collateral collected to cover the margin amount would need to be held by an independent third-party custodian. *See* paragraph (c)(1)(iii)(B)—Alternative B of proposed new Rule 18a–3.

[549] *See* paragraph (c)(1)(iii)(C) of proposed new Rule 18a–3.

[550] *See* paragraph (c)(1)(iii)(D) of proposed new Rule 18a–3.

[551] *See* proposed new paragraph (c)(2)(xiv) of Rule 15c3–1; paragraph (c)(1)(viii) of proposed Rule 18a–1.

[552] *See* paragraph (c)(1)(iii)(A) of proposed Rule 18a–3. The exception would apply to *negative equity* in the account and the margin amount calculated for the account. However, a nonbank SBSD would be required to take a 100% deduction from net worth for the amount of the uncollateralized *negative equity* and take the proposed capital charge in lieu of margin collateral discussed above in section II.A.2.b.v. of this release. *See* 17 CFR 240.15c3–1(c)(2)(iv)(B) (deductions for unsecured receivables); paragraph (c)(1)(iii)(B) of proposed new Rule 18a–1 (deductions for unsecured receivables); proposed new paragraph (c)(2)(xiv) of Rule 15c3–1 (proposed capital charge in lieu of margin); paragraph (c)(1)(viii) of proposed Rule 18a–1 (proposed capital charge in lieu of margin). As an alternative to these capital charges, ANC broker-dealers and stand-alone SBSDs using internal models could take the credit risk charge discussed in section II.A.2.b.iv. of this release. *See* amendments to paragraph (a)(7) of Rule 15c3–1; paragraph (a)(2) of proposed new Rule 18a–1.

[553] The margin rule proposed by the prudential regulators would require the entities subject to the rule to establish credit exposure limits for each nonfinancial end user ''under appropriate credit processes and standards,'' and to collect collateral to the extent that individual exposures exceed those limits. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27587. The margin rule proposed by the CFTC would permit entities subject to the rule and nonfinancial end users ''to set initial margin and variation margin requirements in their discretion'' but each entity subject to the proposed rule would be required to calculate daily exposure amounts for nonfinancial end users for risk management purposes. *See CFTC Margin Proposing Release,* 76 FR at 27736.

[554] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27571 (''Among end users, financial end users are considered more risky than nonfinancial end users because the profitability and viability of financial end users is more tightly linked to the health of the financial system than nonfinancial end users. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity.''). *See also CFTC Margin Proposing Release,* 76 FR at 27735 (''The Commission believes that financial entities, which are generally not using swaps to hedge or mitigate commercial risk, potentially pose greater risk to CSEs than non-financial entities.'').

financial end users as a group, due to the nature of their business, may engage in security-based swap transactions in greater volume than *commercial end users,* increasing the risk of substantial concentration of counterparty exposure to nonbank SBSDs, and potentially creating greater systemic risk from the failure of a single entity.[555]

For purposes of the rule, the term *commercial end user* means any person (other than a natural person) that: (1) Engages primarily in commercial activities that are not financial in nature and that is not a *financial entity* as that term is defined in section 3C(g)(3) of the Exchange Act; [556] and (2) is using non-cleared security-based swaps to hedge or mitigate risk relating to the commercial activities.[557] The proposed definition of *commercial end user* is modeled on the exception to the mandatory clearing provisions for security-based swaps in section 3C of the Exchange Act.[558] Among other things, to qualify for the mandatory clearing exception, one of the counterparties to the security-based swap transaction must not be a *financial entity* and must be using security-based swaps to hedge or mitigate commercial risk.[559]

Under the proposed definition, an individual could not qualify as a *commercial end user.* In addition, because the proposed definition provides that a *commercial end user* must engage primarily in commercial activities that are not financial in nature and must not be a financial entity as defined in section 3C(g)(3) of the Exchange Act, entities such as banks, broker-dealers, FCMs, SBSDs, swap dealers, MSBSPs, swap participants, mutual funds, private funds, commodity pools, and employee benefit plans would not qualify as a *commercial end user.*[560] Furthermore, the proposed definition provides that the *commercial end user* must be using non-cleared security-based swaps to hedge or mitigate commercial risk.

The rationale for exempting *commercial end users* from the requirement to deliver collateral to meet the account *equity* requirements is that these end users often do not deliver collateral by current practice, and requiring them to do so could adversely impact their ability to mitigate the risk of their commercial activities by entering into hedging transactions. If an end user is using non-cleared security-based swaps for purposes other than hedging (*e.g.,* to take directional investment positions), the rationale for exempting the end user from the account *equity* requirements would not apply. An end user that is using non-cleared security-based swaps for investment purposes is not acting like a *commercial end user,* and, as such, no exemption would be available under the rule.

As discussed below in section II.B.2.e. of this release, a nonbank SBSD would be required to establish, maintain, and document procedures and guidelines for monitoring the risk of accounts holding non-cleared security-based swaps.[561] Among other things, a nonbank SBSD would be required to have procedures and guidelines for determining, approving, and periodically reviewing credit limits for each counterparty to a non-cleared security-based swap.[562] Consequently, if a nonbank SBSD does not collect collateral from a *commercial end user,* it would need to establish a credit limit for the end user and periodically review the credit limit in accordance with its risk monitoring guidelines.[563] The rule would not prohibit a nonbank SBSD from requiring margin collateral from a *commercial end user.*

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[555] The margin rules proposed by the prudential regulators and the CFTC would differentiate collateral requirements based on whether a financial end user is ''high risk'' or ''low risk.'' *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27571–27572; *CFTC Margin Proposing Release,* 76 FR at 23736–23737. A ''low risk'' financial end user is defined in their proposals as an entity that: (1) is subject to capital requirements established by a prudential regulator or a state insurance regulator; (2) predominantly uses OTC derivatives for hedging purposes; and (3) does not have significant OTC derivatives exposure. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27572; *CFTC Margin Proposing Release,* 76 FR at 23735–23736. A low risk financial end user would not be required to deliver initial or variation margin if the amounts required are less than certain prescribed thresholds. *See id.* While not all financial end users present the same degree of counterparty risk, an exception from the account *equity* requirements based on the risk profile of the financial end user is not being proposed. This is because margin collateral is an important means of managing credit risk and the concerns expressed with respect to *commercial end users* being required to deliver margin collateral generally do not apply to financial end users as they customarily deliver margin collateral. As discussed in sections II.A.1. and II.A.2.b.i. of this release, the proposed capital standard for nonbank SBSDs is based on the net liquid assets test embodied in Rule 15c3–1. Under this test, most unsecured receivables are deducted in full when computing net capital because of their illiquidity. Proposed new Rule 18a–3 is designed to complement this treatment of unsecured receivables by limiting the exceptions to the requirement to collect collateral from counterparties to circumstances that provide a compelling reason for the trade-off between the risk-mitigating benefits of collateral and practical impediments to delivering collateral. With respect to nonbank SBSDs, there does not appear to be a compelling reason to establish a two-tiered approach for financial end users. First, financial end users generally pose more risk than *commercial end users.* Second, the different credit risk profiles of financial end users may not always be clear, which may make it difficult to differentiate between high and low risk financial end users. Third, market participants have told the Commission staff that financial end users entering into security-based swap transactions generally already deliver collateral to dealers to cover current and potential future exposure.

[556] *See* 15 U.S.C. 78o–3(g)(3). Section 3C(g) of the Exchange Act defines the term *financial entity* to mean: (1) a swap dealer; (2) an SBSD; (3) a major swap participant; (4) an MSBSP; (5) a commodity pool as defined in section 1a(10) of the CEA; (6) a private fund as defined in section 202(a) of the Investment Advisors Act of 1940; (7) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974 (29 U.S.C. 1002); or (8) a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956.

[557] *See* paragraph (b)(2) of proposed new Rule 18a–3.

[558] *Compare* 15 U.S.C. 78c–3(g)(1), *with* paragraph (b)(2) of proposed new Rule 18a–3.

[559] *See* 15 U.S.C. 78c–3(g)(1).

[560] *See, e.g.,* 15 U.S.C. 78c–3(g)(3). The prudential regulators and the CFTC have proposed definitions of *financial end user* and *financial entity,* respectively, in their non-cleared security-based swap margin rules in addition to their proposed definitions of *nonfinancial end user. See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27571 (defining *financial end user*), and *CFTC Capital Proposing Release,* 76 FR at 23736 (defining *financial entity*). As discussed above, the CFTC and prudential regulators are proposing margin requirements that would differentiate collateral requirements based on whether a financial end user or financial entity is ''high risk'' or ''low risk.'' *Id.* In other words, their proposals would provide for potentially different treatment for three classes of entities: (1) Nonfinancial end users; (2) financial end users (low risk and high risk); and (3) entities that are neither a nonfinancial end user nor a financial end user. Therefore, they need to define the terms *financial end user* and *financial entity,* respectively. Because proposed new Rule 18a–3 would treat financial end users no differently than entities that are neither a *commercial end user* nor a financial end user, the Commission's proposed margin rule does not contain a definition of financial end user. However, as discussed below, the proposed rule would provide different treatment for counterparties that are SBSDs.

[561] *See* paragraph (e) of proposed new Rule 18a–3.

[562] *See* paragraph (e)(2) of proposed new Rule 18a–3. This is also consistent with the broker-dealer margin rules. *See* FINRA Rule 4210(d), which requires that FINRA member firms establish procedures to: (1) Review limits and types of credit extended to all customers; (2) formulate their own margin requirements; and (3) review the need for instituting higher margin requirements, mark-to-markets and collateral deposits than are required by the Rule for individual securities or customer accounts. See also FINRA Interpretation 4210(d)/01, available at *http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/industry/p122203.pdf* (noting that FINRA Rule 4210(d) ''requires that members determine the total dollar amount of credit to be extended to any one customer or on any one security to limit the potential loss or exposure to the member. It is important that specific limits be established to prevent any one customer or group of customers from endangering the member's capital.'').

[563] *See id.*

Exception for Counterparties That Are SBSDs

The second exception to the account *equity* requirements in proposed new Rule 18a–3 would apply to counterparties that are SBSDs.[564] Two alternatives with respect to SBSD counterparties are being proposed. Under the first alternative, a nonbank SBSD would not need to collect cash, securities, and/or money instruments to collateralize the margin amount (potential future exposure) in the account of a counterparty that is another SBSD (''Alternative A''). This approach is consistent with the broker-dealer margin rules, which generally do not require a broker-dealer to collect margin collateral from another broker-dealer. Under the second alternative, a nonbank SBSD would be required to collect cash, securities and/or money market instruments to collateralize both the *negative equity* (current exposure) and the margin amount (potential future exposure) in the account of a counterparty that is another SBSD (''Alternative B'').[565] Moreover, the cash, securities, and/or money market instruments would be required to be segregated in an account at an independent third-party custodian pursuant to the requirements of section 3E(f) of the Exchange Act.[566] Alternative B is consistent with the proposals of the prudential regulators and the CFTC.[567]

The two alternatives are being proposed in order to elicit detailed comment on each approach in terms of comparing how they would meet the goals of the Dodd-Frank Act,[568] address systemic issues relating to non-cleared security-based swaps, raise practical issues, alter current market practices and conventions, result in benefits and costs, and impact the security-based swap markets and the participants in those markets.

Under Alternative A, a nonbank SBSD would be required to collect cash, securities, and/or money market instruments from another SBSD only to cover the amount of *negative equity* (the current exposure) in the account of the counterparty.[569] Accordingly, under this approach, the nonbank SBSD would not be required to collect cash, securities, and/or money market instruments from another SBSD to collateralize the *margin* amount (the potential future exposure).[570] In other words, a counterparty that is another SBSD would not be required to maintain a minimum level of *positive equity* in the counterparty's account.

Requiring a nonbank SBSD to deliver collateral to cover potential future exposure could impact its liquidity. As discussed above in sections II.A.1. and II.A.2.b.i. of this release, the proposed capital requirements for nonbank SBSDs are based on a net liquid assets test. The objective of the test is to require the firm to maintain in excess of a dollar of highly liquid assets for each dollar of liabilities in order to facilitate the liquidation of the firm if necessary and without the need for a formal proceeding. When assets are delivered to another party as margin collateral, they become unsecured receivables from the party holding the margin collateral. Consequently, they no longer are readily available to be liquidated by the delivering party. In times of market stress, a nonbank SBSD may need to liquidate assets to raise funds and reduce its leverage. However, if assets are in the control of another nonbank SBSD, they would not be available for this purpose. For this reason, the assets would need to be deducted from net worth when the nonbank SBSD computes net capital under the proposed capital requirements.[571] As a result, the nonbank SBSD would need to maintain the required minimum amount of net capital after taking into account these deductions.

Promoting the liquidity of nonbank SBSDs is the policy consideration underlying Alternative A. In addition, the prudential regulators and the CFTC have received comments on this issue in response to their proposals raising concerns about requiring bank SBSDs and swap dealers to exchange collateral to cover potential future exposure and to have the collateral held by an independent third-party custodian. For example, some commenters assert that imposing segregated initial margin requirements on trades between swap entities would result in a tremendous cost to the financial system in the form of a massive liquidity drain, and that swap dealers will lose the ability to reinvest this collateral to finance other lending or derivatives transactions, thereby reducing capital formation and increasing costs.[572] One commenter stated that, in general, with respect to non-cleared swaps, charging more initial margin (as compared to cleared swaps) could have unintended consequences, including the inefficient use of capital by sophisticated market participants in highly regulated industries, which could create a drag on the financial system, slow economic

[564] *See* paragraph (c)(1)(iii)(B) of proposed new Rule 18a–3.

[565] Alternative B is not an exception to the account *equity* requirements in proposed new Rule 18a–3 because it would require collateral to cover the *negative equity* and margin amount in an account of another SBSD. However, its requirement for how the collateral must be held—at an independent third-party custodian on behalf of the counterparty—is different from how the proposed rule requires that collateral from other types of counterparties be held (other than counterparties that elect segregation under section 3E(f) of the Exchange Act (15 U.S.C. 78c–5(f)).

[566] *See* 15 U.S.C. 78c–5(f).

[567] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564; *CFTC Margin Proposing Release,* 76 FR 23732.

[568] *See* 15 U.S.C. 78o–10(e)(3)(A) (''[t]o offset the greater risk to the security-based swap dealer or major security-based swap participant and the financial system arising from the use of security-based swaps that are not cleared,'' the margin requirements proposed by the Commission and prudential regulators shall ''help ensure the safety and soundness'' of the SBSD and the MSBSP and ''be appropriate for the risk associated with non-cleared security-based swaps held'' by an SBSD and MSBSP).

[569] *See* paragraph (c)(1)(iii)(B) of proposed new Rule 18a–3–Alternative A. To the extent the margin amount was not collateralized, the nonbank SBSD would be required to take the proposed capital charge in lieu of margin collateral discussed above in section II.A.2.b.v. of this release.

[570] *Id.* Like all counterparties to non-cleared security-based swaps, counterparties that are SBSDs would be subject to the risk monitoring requirements in paragraph (e) of proposed new Rule 18a–3.

[571] *See* 17 CFR 240.15c3–1(c)(2)(iv)(B); paragraph (c)(1)(iii)(B) of proposed Rule 18a–1. Collateral provided to another party as margin would be subject to this 100% deduction.

[572] *See, e.g.,* letter from Robert Pickel, Executive Vice Chairman, ISDA, and Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association (''SIFMA''), to David Stawick, Secretary, CFTC (July 11, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47802&SearchText=SIFMA* (''*SIFMA/ISDA Comment Letter to the CFTC''*); letter from Robert Pickel, Executive Vice Chairman, ISDA, and Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, SIFMA, to Jennifer J. Johnson, Secretary, Federal Reserve, *et al.* (July 6, 2011), available at *http://www.fdic.gov/regulations/laws/federal/2011/11c22ad79.PDF* (''*SIFMA/ISDA Comment Letter to the Prudential Regulators''*); letter from the Honorable Darrell Issa, Chairman, Committee on Oversight and Government Reform, U.S. House of Representatives, to Ben Bernanke, Chairman, Federal Reserve *et al.* (July 22, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47943&SearchText=issa*, and letter from Mark Scanlan, Vice President, Agriculture and Rural Policy, Independent Community Bankers of America, to the CFTC *et al.* (July 11, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47762&SearchText=scanlan.* One commenter noted that there is no statutory requirement for covered swap entities to hold initial margin of other covered swap entities at an independent third party custodian. *See* letter from Christine Cochran, President, Commodity Markets Council, to the OCC *et al.* (July 11, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47777&SearchText=cochran.* Here and below, this release refers to public comments on the margin proposals by the CFTC and the prudential regulators to more fully reflect the available views without endorsing those comments or expressing a view as to the validity of the comments.

growth, and diminish customer choice.[573]

Another commenter stated that a combination of daily variation margin, robust operational procedures, legally enforceable netting and collateral agreements, and regulatory capital requirements provide comprehensive risk mitigation for collateralized derivatives, and that any additional initial margin requirements for swaps between swap entities would be unnecessary and unwarranted.[574] A commenter argued that the proposed initial margin requirements are inconsistent with proven market practice, ignore significant differences in credit quality among swap dealers and financial entities which justify different margining treatment, and will lead to excessive amounts of collateral being required in comparison to the actual risks of the underlying swap transactions and portfolios.[575] Finally, a commenter argued that initial margin requirements should differentiate based on credit quality, and that the prudential regulators' margin rulemaking identifies no risk-based justification for layering zero threshold, bilateral initial margin requirements for all swap dealers above and beyond their existing variation margin requirements.[576]

On the other hand, a number of comments submitted in response to the proposals of the prudential regulators and the CFTC supported bilateral margining and argued that it should be extended to require SBSDs and swap dealers to exchange margin collateral with all counterparties.[577] For example, one commenter stated that the financial crisis demonstrated that the premise of one-way margin is flawed.[578] This commenter stated that two-way margin requirements would aid safety and soundness by helping a swap dealer and its counterparty offset their exposures and prevent them from building up exposures they cannot fulfill.[579]

The prudential regulators explained the reasoning behind their proposal as follows:

> Non-cleared swaps transactions with counterparties that are themselves swap entities pose risk to the financial system because swap entities are large players in swap and security-based swap markets and therefore have the potential to generate systemic risk through their swap activities. Because of their interconnectedness and large presence in the market, the failure of a single swap entity could cause severe stress throughout the financial system. Accordingly, it is the preliminary view of the Agencies that all non-cleared swap transactions with swap entities should require margin.[580]

Alternative B is being proposed in light of the policy considerations underlying the proposals of the prudential regulators and the CFTC.[581] Under Alternative B, a nonbank SBSD would be required to obtain cash, securities, and/or money market instruments from another SBSD to cover the *negative equity* (current exposure) and margin amount (potential future exposure) in the other SBSD's account.[582] In addition, the cash, securities, and/or money market instruments delivered to cover the margin amount would need to be carried by an independent third party custodian pursuant to the requirements of section 3E(f) of the Exchange Act.[583] Therefore, not only would there be no exception to the account *equity* requirement for counterparties that are SBSDs, but the treatment of the collateral would be different than for other types of counterparties in that it would be required to be held by an independent third-party custodian.[584]

Exception for Counterparties That Elect Segregation Under Section 3E(f)

Under the third exception to the account *equity* requirements in proposed new Rule 18a–3, a nonbank SBSD would not be required to hold the cash, securities, and/or money market instruments delivered by a counterparty that is not a *commercial end user* to cover the margin amount (potential future exposure), if the counterparty elects to have the cash, securities, and/or money market instruments segregated pursuant to section 3E(f) of the Exchange Act.[585] Section 3E(f) sets forth provisions under which a counterparty to a non-cleared security-based swap with an SBSD can require that collateral to cover potential future exposure must be segregated.[586] Among other things, section 3E(f) provides that the collateral must be segregated in an account carried by an independent third-party custodian and designated as a segregated account for and on behalf of the counterparty.[587]

As discussed below in section II.C. of this release, proposed new Rule 18a–3 would establish certain conditions that

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[573] *See* letter from Mark R. Thresher, Executive Vice President, Chief Financial Officer, Nationwide, to the OCC (June 24, 2011), available at *http://www.federalreserve.gov/SECRS/2011/June/20110628/R–1415/R–1415_062311_81363_349039663039_1.pdf*.

[574] *See SIFMA/ISDA Comment Letter to the CFTC; SIFMA/ISDA Comment Letter to the Prudential Regulators.* This commenter also stated that precedent exists in the broker-dealer margin rules for not imposing any initial margin requirements on trades between swap entities. *Id.*

[575] *See* letter from Don Thompson, Managing Director and Associate General Counsel, J.P. Morgan Chase & Co., to the OCC *et al.* (June 24, 2011), available at *http://www.federalreserve.gov/SECRS/2011/June/20110627/R–1415/R–1415_062311_81366_349039350535_1.pdf* (''*J.P. Morgan Letter*''). Another commenter pointed out that life insurers also typically do not post initial margin and recommended that initial margin requirements be appropriately sized to reflect the potential exposure during the close out of a defaulting party. *See* letter from Carl B. Wilkerson, Vice President and Chief Counsel, Securities and Litigation, American Council of Life Insurers, to the OCC *et al.* (July 11, 2011), available at *http://www.federalreserve.gov/SECRS/2011/July/20110728/R–1415/R–1415_071111_81817_507164831320_1.pdf*.

[576] *See J.P. Morgan Letter.* This commenter stated that initial margin is appropriate in some circumstances, but it must take into account the credit quality of counterparties.

[577] *See, e.g.,* letter from Scott C. Goebel, Senior Vice President, General Counsel, FMR Co., to John Walsh, Acting Comptroller of the Currency, OCC (July 11, 2011); letter from Kevin M. Budd, Associate General Counsel, and Todd F. Lurie, Assistant General Counsel, MetLife, to OCC *et al.* (July 11, 2011); letter from John R. Gidman, on behalf of the Association of Institutional Investors, to Ms. Jennifer Johnson, Secretary, Federal Reserve, *et al.* (July 11, 2011); letter from R. Glenn Hubbard, Co-Chair, John L. Thornton, Co-Chair, and Hal S. Scott, Director, Committee on Capital Markets Regulation, to John Walsh, Acting Comptroller, OCC (July 11, 2011), available at *http://www.federalreserve.gov/SECRS/2011/July/20110719/R–1415/R–1415_071111_81821_322996697020_1.pdf*; letter from Dennis M. Kelleher, President and Chief Executive Officer, and Wallace C. Turbeville, Derivatives Specialist, Better Markets, Inc., to Jennifer J. Johnson, Secretary, Federal Reserve (July 11, 2011), available at *http://www.federalreserve.gov/SECRS/2011/July/20110728/R–1415/R–1415_071111_81861_504963784471_1.pdf*; letter from Americans for Financial Reform, to John Walsh, Acting Comptroller, OCC (July 11, 2011), available at *http://www.federalreserve.gov/SECRS/2011/July/20110728/R–1415/R–1415_071111_81864_448738394756_1.pdf*.

[578] Letter from Karrie McMillan, General Counsel, Investment Company Institute, to David Stawick, Secretary, CFTC (July 11, 2011), available at is *http://www.ici.org/pdf/25344.pdf* (''ICI Letter'').

[579] *See* the ICI Letter.

[580] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27570–27571 (footnote omitted). *See also CFTC Margin Proposing Release,* 76 FR at 23735 (''It is the nature of the dealer business that dealers are at the center of the markets in which they participate. Similarly, a major swap participant, by its terms, is a significant trader. Collectively, [swap dealers and major swap participants] pose greater risk to the markets and the financial system than other swap market participants. Accordingly, under the mandate of Section 4s(e), the Commission believes that they should be required to collect margin from one another.'').

[581] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564; *CFTC Margin Proposing Release,* 76 FR 23744.

[582] *See* paragraph (c)(1)(iii)(B) of proposed Rule 18a–3—Alternative B.

[583] *Id.*

[584] *Id.*

[585] *See* paragraph (c)(1)(iii)(C) of proposed new Rule 18a–3. This exception would not apply to *negative equity* in the counterparty's account, which would need to be collateralized by cash, securities, and/or money market instruments held by the nonbank SBSD. *See* 15 U.S.C. 78c–5(f)(2)(B)(i) (providing that the segregation provisions in section 3E(f) of the Exchange Act do not apply to variation margin payments).

[586] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[587] *See* 15 U.S.C. 78c–5(f)(3).

collateral would need to meet before its value could be included in the determination of the amount of *equity* in an account.[588] Among other conditions, the collateral would need to be subject to the physical possession or control of the nonbank SBSD and capable of being liquidated promptly by the nonbank SBSD without intervention by any other party.[589] Margin collateral segregated pursuant to section 3E(f) of the Exchange Act would not meet either of these conditions. First, the collateral would be in the physical possession or control of an independent third-party custodian rather than the nonbank SBSD. Second, the collateral could not be liquidated by the nonbank SBSD without the intervention of the independent third-party custodian. For these reasons, the value of the margin collateral held by the independent third-party custodian could not be included when determining the amount of *equity* in the account of the counterparty at the nonbank SBSD.

Exception for Accounts Holding Legacy Security-Based Swaps

Under the fourth exception to the account *equity* requirements in proposed new Rule 18a–3, a nonbank SBSD would not be required to collect cash, securities, and/or money market instruments to cover the *negative equity* (current exposure) or margin amount (potential future exposure) in a *security-based swap legacy account.*[590] Proposed new Rule 18a–3 would define *security-based swap legacy account* to mean an account that holds no security-based swaps entered into after the effective date of the rule and that is used to hold only security-based swaps entered into prior to the effective date of the rule, as well as collateral for those security-based swaps.[591] As discussed above in section II.A.2.b.v. of this release, this exception would be designed to address the impracticality of renegotiating contracts governing security-based swap transactions that predate the effectiveness of proposed new Rule 18a–3 in order to come into compliance with the account *equity* requirements in the rule.[592]

Request for Comment

The Commission generally requests comment on the proposed account *equity* requirements for counterparties of nonbank SBSDs in proposed new Rule 18a–3.[593] In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Would it be appropriate to limit the assets that could be used to collateralize the *negative equity* and *margin* amounts in an account to cash, securities, and money market instruments? Are there other types of assets that should be permitted to meet the account *equity* requirements in proposed new Rule 18a–3? If so, identify the other asset types and compare their liquidity to cash, securities, and money market instruments.

2. Is the proposed requirement to take deductions on securities and money market instruments in calculating the amount of *equity* in an account appropriate? If not, explain why not. Are there other measures that a nonbank SBSD could be required to take to address the risk that securities and money market instruments may not be able to be liquidated at current market values to cover the obligations of a defaulted counterparty? If so, explain how the other measures would be an adequate substitute to deductions.

3. Are the proposed conditions (modeled on the Appendix E conditions) for taking into account collateral in determining the amount of *equity* in an account appropriate for proposed new Rule 18a–3? If not, explain why not. Should any individual condition be eliminated? If so, explain why. Are there additional conditions that should be added? If so, identify them and explain how they would promote the goal of ensuring that collateral can be promptly liquidated to cover the obligation of a defaulted counterparty.

4. Is the proposed requirement that a nonbank SBSD take prompt steps to liquidate securities in an account to the extent necessary to eliminate an account *equity* deficiency appropriate? For example, should there be a specific time-frame (*e.g.,* 1, 2, 3, 4, 5, or some other number of business days) in which the nonbank SBSD is required to liquidate securities in the account? If so, explain why a specific time-frame would be preferable to requiring the nonbank SBSD to act promptly.

5. Is the proposed exception to the account *equity* requirements for *commercial end users* appropriate? If not, explain why not. Should *commercial end users* be required to collateralize *negative equity* and the margin amount in their accounts? Explain why or why not. Should the exception apply only to the margin amount (*i.e.,* should *commercial end users* be required to collateralize the *negative equity* in their accounts)? Explain why or why not.

6. Is the proposed definition of *commercial end user* appropriate? If not, explain why not. For example, would the proposed definition of *commercial end user* be too broad, or too narrow, in terms of capturing types of counterparties for which the exception would not be appropriate? If so, explain why and suggest how the definition could be modified to address this issue.

7. Should the rule contain a proposed definition of *financial end user*? If so, explain why. For example, would a definition of *financial end user* similar to the definitions of the prudential regulators and CFTC provide needed clarity to the definition of *commercial end user* (*i.e.,* by specifying certain entities that are not *commercial end users*)?

8. Do *commercial end users* use security-based swaps to hedge commercial risk? If so, identify the type of commercial risk they hedge with security-based swaps and explain how security-based swaps are used to hedge this risk.

9. Should proposed new Rule 18a–3 define the term *commercial risk* for the purpose of providing greater clarity as to the meaning of the term *commercial end user*? If so, how should the term *commercial risk* be defined?

10. Should there be a two-tiered approach with respect to the account *equity* requirements for financial end users based on whether they are low risk or high risk, similar to the proposed approach of the prudential regulators and the CFTC? If so, explain why.

[588] *See* paragraph (c)(4) of proposed new Rule 18a–3.

[589] *See* paragraphs (c)(4)(i)–(iii) of proposed new Rule 18a–3.

[590] *See* paragraph (c)(1)(iii)(D) of proposed new Rule 18a–3. While this exception would apply to *negative equity* in the account and the margin amount calculated for the account, a nonbank SBSD would be required to take a 100% deduction from net worth for the amount of the uncollateralized current exposure and take the proposed capital charge in lieu of margin collateral discussed above in section II.A.2.b.v. of this release. *See* proposed new paragraph (c)(2)(xiv) of Rule 15c3–1; paragraph (c)(1)(viii) of proposed new Rule 18a–1. In addition, like all counterparties to non-cleared security-based swaps, these counterparties would be subject to the risk monitoring requirements in paragraph (e) of proposed new Rule 18a–3.

[591] *See* paragraph (b)(9) of proposed new Rule 18a–3.

[592] As noted above in section II.A.2.b.v. of this release, the CFTC has proposed a similar exception for legacy swaps. *See CFTC Margin Proposing Release,* 76 FR at 23734. The prudential regulators proposed to permit a covered swap entity to exclude pre-effective swaps from initial margin calculations, while requiring these entities to collect variation margin, consistent with industry practice. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27569.

[593] As discussed earlier, the Commission is soliciting comment below in section II.B.3. of this release on whether to define the term eligible collateral in a manner similar to the prudential regulators and the CFTC.

11. How do non-*commercial end users* presently use security-based swaps? For example, do they use them to hedge commercial risk? If so, identify the type of commercial risk they hedge with security-based swaps.

12. With respect to counterparties that are SBSDs, how would Alternatives A and B compare in terms of promoting the goals of the Dodd-Frank Act, including limiting the risks posed by non-cleared security-based swaps? How would each address or fail to address systemic issues relating to non-cleared security-based swaps?

13. What would be the impact of Alternatives A and B on the efficient use of capital?

14. What would be the practical effects of Alternatives A and B on the capital and liquidity positions, or the financial health generally, of nonbank SBSDs? How would each alter current market practices and conventions with respect to collateralizing credit exposures arising from non-cleared security-based swaps? Are there practical issues with respect to Alternatives A and B? If so, identify and explain them.

15. How would the benefits of Alternatives A and B compare? How would the costs compare?

16. How would Alternatives A and B impact the market for security-based swaps? How would they impact participants in those markets?

17. How would Alternatives A and B promote the clearing of security-based swaps? For example, would Alternative B—because of the requirement to fund margin collateral requirements—incentivize nonbank SBSDs to transact in cleared security-based swaps? If so, explain why.

18. What would be the potential impact if the Commission adopted Alternative A and the prudential regulators and the CFTC adopted rules similar to Alternative B? Consider and explain the impact competitively and practically.

19. Would the proposed exception to the account *equity* requirements for counterparties that elect segregation under section 3E(f) of the Exchange Act be appropriate? If not, explain why not.

20. Would the proposed exception to the account *equity* requirements for accounts that elect to hold legacy security-based swaps be appropriate? If not, explain why not.

21. Would it be appropriate to permit legacy security-based swaps to be held in an entity that is not an SBSD? If so, why, and what conditions should be imposed on such an entity?

22. Should counterparties be required to post variation margin with respect to legacy swaps? Is this consistent with current market practice?

23. Should there be an exception from the account *equity* requirements for small banks, savings associations, farm credit system institutions, and credit unions from the account *equity* requirements (*e.g.,* for entities with assets of $10 billion or less)?[594] Explain why or why not.

24. Should there be an exception from the account *equity* requirements for affiliates of the nonbank SBSD? For example, do affiliates present less credit risk than non-affiliates? If there should be an exception for affiliates, should it be limited to certain affiliates? For example, should the exception only apply to affiliates that are subject to capital and other regulatory requirements? Please explain.

25. Should there be an exception for foreign governmental entities? Explain why or why not. Should types of foreign governmental entities be distinguished for purposes of an exception? For example, are there objective benchmarks based on creditworthiness that could be used to distinguish between foreign governmental entities for which the exception to the account *equity* requirements would and would not be appropriate? If so, identify the benchmarks and explain how they could be incorporated into the rule.

26. Do dealers in OTC derivatives currently collect collateral from foreign governmental entities for their OTC derivatives transactions? If so, from which types of foreign governmental entities?

27. Do national foreign governments typically guarantee the obligations of political subdivisions and agencies? If so, identify the types of political subdivisions and agencies that are guaranteed and are not guaranteed.

ii. Nonbank MSBSPs

A nonbank MSBSP would be required to calculate as of the close of each business day the amount of *equity* in the account of each counterparty to a non-cleared security-based swap.[595] On the next business day following the calculation, the nonbank MSBSP would be required to either collect or deliver cash, securities, and/or money market instruments to the counterparty depending on whether there was negative or *positive equity* in the account of the counterparty.[596] Specifically, if the account has *negative equity* as calculated on the previous business day, the nonbank MSBSP would be required to collect cash, securities, and/or money market instruments in an amount equal to the *negative equity*.[597] Conversely, if the account has *positive equity* as calculated on the previous business day, the nonbank MSBSP would be required to deliver cash, securities, and/or money market instruments to the counterparty in an amount equal to the *positive equity*.[598]

Nonbank MSBSPs may not maintain two-sided markets or otherwise engage in activities that would require them to register as an SBSD.[599] They will, however, by definition, maintain substantial positions in particular categories of security-based swaps.[600] These positions could create significant risk to counterparties to the extent the counterparties have uncollateralized current exposure to the nonbank MSBSP. In addition, they could pose significant risk to the nonbank MSBSP to the extent it has uncollateralized current exposure to its counterparties. The proposed account *equity* requirements for nonbank MSBSPs are designed to address these risks by imposing a requirement that nonbank MSBSPs on a daily basis must ''neutralize'' the credit risk between the nonbank MSBSP and the counterparty either by collecting or delivering cash, securities, and/or money market instruments in an amount equal to the positive or *negative equity* in the account.

Unlike nonbank SBSDs, nonbank MSBSPs would not be required to reduce the fair market value of securities and money market instruments held in the account of a counterparty (or delivered to a counterparty) for purposes of determining whether the level of *equity* in the account meets the minimum

[594] *See, e.g.,* 15 U.S.C. 78c–3(g)(3)(B) (requiring the Commission to consider whether to exempt small banks, savings associations, farm credit system institutions and credit unions from the definition of ''financial entity'' contained in Exchange Act section 3C(g)(3)(A) for the purposes of mandatory clearing of security-based swaps). *See also End-User Exception to Mandatory Clearing of Security-Based Swaps,* Exchange Act Release No. 63556 (Dec. 15, 2010), 75 FR 79992, 80000–80002 (Dec. 21, 2010).

[595] *See* paragraph (c)(2)(i) of proposed new Rule 18a–3.

[596] *See* paragraph (c)(2)(ii) of proposed new Rule 18a–3. As indicated, the nonbank MSBSP would need to deliver cash, securities, and/or money market instruments and, consequently, other types of assets would not be eligible as collateral.

[597] *See* paragraph (c)(2)(ii)(A) of proposed new Rule 18a–3. In this case, the nonbank MSBSP would have current exposure to the counterparty in an amount equal to the *negative equity.*

[598] *See* paragraph (c)(2)(ii)(B) of proposed new Rule 18a–3.

[599] *See Entity Definitions Adopting Release,* 77 FR 30596.

[600] *See* 15 U.S.C. 78c(a)(67); *Entity Definitions Adopting Release,* 77 FR 30596.

requirement. As discussed above in section II.B.2.c.i. of this release, the reductions taken by a nonbank SBSD would be based on the deductions that would apply to the positions pursuant to Rule 15c3–1, as proposed to be amended, and proposed new Rule 18a–1, as applicable.[601] Nonbank MSBSPs would not be subject to these rules and, consequently, would not be required to comply with them for purposes of proposed new Rule 18a–3.

Like nonbank SBSDs, nonbank MSBSPs would be subject to the requirements in paragraph (c)(4) of proposed new Rule 18a–3, which are modeled on the existing collateral requirements in Appendix E to Rule 15c3–1.[602] As discussed above in section II.A.2.b.iv of this release, these requirements are designed to ensure that the collateral is an asset of stable and predictable value, an asset that is not linked to the value of the transaction in any way, and an asset that can be sold quickly and easily if the need arises.

Nonbank MSBSPs would be required to take prompt steps to liquidate securities and money market instruments in the account to the extent necessary to eliminate an account *equity* deficiency.[603] These steps could include liquidating non-cleared security-based swap positions in the account to reduce debits arising from those transactions. The rule would not require that the liquidations must be completed within a specific timeframe in order to provide the nonbank MSBSP flexibility to conduct an orderly liquidation, taking into account market conditions and the risk profile of the account.

There would be three exceptions to the account *equity* requirements for nonbank MSBSPs.[604] The first exception would apply to counterparties that are *commercial end users.*[605] Under this exception, the nonbank MSBSP would not be required to collect collateral from a *commercial end user* when the account of the end user has *negative equity.*[606] This exception would be consistent with the proposed exception from the account *equity* requirements for accounts of *commercial end users* at nonbank SBSDs. However, nonbank MSBSPs would not be required to take a credit risk charge or capital charge relating to the amount of the uncollected margin.[607] The reason for this proposed exception is the concern that requiring *commercial end users* to deliver collateral could impair their ability to manage commercial risks through hedging transactions. A nonbank MSBSP would be required to deliver cash, securities, and/or money market instruments to a *commercial end user* as necessary to collateralize the end user's current exposure to the nonbank MSBSP.

Under the second exception, a nonbank MSBSP would not be required to collect cash, securities, and/or money market instruments from an SBSD to collateralize the amount of the *negative equity* in the account of the SBSD. Under the account *equity* requirements in proposed new Rule 18a–3, a nonbank SBSD would be required to collect collateral from a nonbank MSBSP to cover the *negative equity* and margin amount in the account of the nonbank MSBSP carried by the nonbank SBSD.[608] Once a nonbank SBSD collected these amounts, a nonbank MSBSP would have current exposure to the nonbank SBSD, at a minimum, equal to the amount of the *positive equity* required to be maintained in the nonbank MSBSP's account at the nonbank SBSD. A regulatory requirement that the nonbank MSBSP must collect collateral from the nonbank SBSD to collateralize the amount of the *positive equity* in the account at the nonbank SBSD could defeat the purpose of proposed new Rule 18a–3; namely, that nonbank SBSDs collect cash, securities, and/or money market instruments to collateralize their potential future exposure to the counterparties, including nonbank MSBSPs.[609] In essence, the proposed requirements reflect a general preference in favor of requiring counterparties to nonbank SBSDs to fully collateralize their obligations to the nonbank SBSDs.

The third exception would apply to a *security-based swap legacy account.*[610] Under this exception, consistent with the proposed corresponding exception applying to accounts with nonbank SBSDs, a nonbank MSBSP would not be required to collect cash, securities, and/or money market instruments to collateralize the *negative equity* in a security-based swap legacy account. In addition, the MSBSP would not be required to deliver collateral to cover the *positive equity* in the account. This exception would be designed to address the impracticality of renegotiating contracts governing security-based swap transactions that predate the effectiveness of proposed new Rule 18a–3 in order to come into compliance with the account *equity* requirements in the rule.

Request for Comment

The Commission generally requests comment on the proposed account *equity* requirements for counterparties of nonbank MSBSPs in proposed Rule 18a–3. Commenters are referred to the questions about the account *equity* requirements for nonbank SBSDs above in section II.B.2.c.i. of this release to the extent those questions address provisions in proposed new Rule 18a–3 that also apply to nonbank MSBSPs. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the proposed account *equity* requirements for nonbank MSBSPs appropriate? If not, explain why not.

2. Should nonbank MSBSPs be required to reduce the fair market value of securities and money market instruments for purposes of determining whether the level of *equity* in the account meets the minimum requirement? What would be the impact of not requiring nonbank MSBSPs to reduce the fair market value of

[601] *See* paragraph (c)(3) of proposed new Rule 18a–3.

[602] *See* paragraph (c)(4) of proposed new Rule 18a–3; 17 CFR 240.15c3–1e(c)(4)(v).

[603] *See* paragraph (c)(8) of proposed new Rule 18a–3.

[604] *See* paragraph (c)(2)(iii) of proposed new Rule 18a–3. MSBSPs could choose to collect collateral in these cases.

[605] *See* paragraph (c)(2)(iii)(A) of proposed new Rule 18a–3.

[606] *Id.*

[607] *Compare* paragraph (c)(1)(iii)(A) of proposed new Rule 18a–3, *with* paragraph (c)(2)(iii)(A) of proposed Rule new 18a–3.

[608] *See* paragraph (c)(1)(ii) of proposed Rule 18a–3. As discussed above, MSBSPs would not be included in the definition of *commercial end user.* Consequently, an MSBSP would be required to deliver cash, securities, and/or money market instruments to collateralize the *negative equity* and the margin amount in its security-based swap account at a nonbank SBSD.

[609] For example, assume a nonbank SBSD calculates that the account of a nonbank MSBSP has a *negative equity* of $20 (current exposure) and a margin amount of $50 (potential future exposure) pursuant to paragraph (c)(1)(i) of proposed new Rule 18a–3. On the next business day, the nonbank SBSD would need to collect cash, securities, and/or money market instruments to collateralize these amounts pursuant to paragraph (c)(1)(ii) of proposed new Rule 18a–3. Assume the nonbank MSBSP delivers cash as collateral. It would need to deliver $70 in cash, of which $50 (as collateral for the margin amount) would be a receivable from the nonbank SBSD to the nonbank MSBSP. In other words, the $50 (as a receivable from the nonbank SBSD) would be the nonbank MSBSP's current exposure to the nonbank SBSD. If the nonbank MSBSP was required to collect collateral from the nonbank SBSD to cover this amount, the account of the nonbank MSBSP at the nonbank SBSD would not meet the minimum *equity* requirement of $50.

[610] *See* paragraph (c)(2)(iii)(C) of proposed new Rule 18a–3. The term *security-based swap legacy account* would be defined to mean an account that holds no security-based swaps entered into after the effective date of the rule and that is used only to hold security-based swaps entered into prior to the effective date of the rule and collateral for those security-based swaps. *See* paragraph (b)(9) of proposed new Rule 18a–3.

securities and money market instruments for purposes of determining whether the level of *equity* in the account meets the minimum requirement?

3. Should nonbank MSBSPs be required to collect or deliver cash, securities, and/or money market instruments to collateralize a margin amount (potential future exposure) in addition to the *negative equity* amount (current exposure)? Should they be required to deliver cash, securities, and/or money market instruments to a *commercial end user* to collateralize a margin amount? Please explain.

4. Is the proposed exception to the account *equity* requirements for credit exposures to *commercial end users* appropriate? If not, explain why not. For example, because nonbank MSBSPs would not be required to take a credit risk charge or capital charge relating to the amount of uncollected margin collateral, would nonbank MSBSPs be subject to additional risks not applicable to nonbank SBSDs? If so, explain why. If not, explain why not.

5. Is the proposed exception to the account *equity* requirements for credit exposures to SBSDs appropriate? If not, explain why not.

6. Is the proposed exception to the account *equity* requirements for credit exposures in security-based swap legacy accounts appropriate? If not, explain why not.

d. $100,000 Minimum Transfer Amount

Proposed new Rule 18a–3 would establish a minimum transfer amount of $100,000 with respect to a particular counterparty.[611] Under this provision, a nonbank SBSD and a nonbank MSBSP would not be required to collect or deliver collateral to meet an account *equity* requirement if the amount required to be collected or delivered is equal to or less than $100,000. If the minimum transfer amount is exceeded, the entire account *equity* requirement would need to be collateralized, not just the amount of the requirement that exceeds $100,000.

The proposed minimum transfer provision is designed to establish a threshold so that the degree of risk reduction achieved by requiring account *equity* requirements to be collateralized is sufficiently small that the costs of delivering collateral may not be justified. The proposed $100,000 threshold is based on the proposals of the prudential regulators and the CFTC.[612]

Request for Comment

The Commission generally requests comment on the minimum transfer amount in proposed new Rule 18a–3. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is it appropriate to have a minimum transfer amount? If not, explain why not. For example, should an account *equity* requirement be collateralized regardless of the amount of cash, securities, and/or money market instruments that would need to be transferred to meet the requirement?

2. Is $100,000 an appropriate minimum transfer amount? Should the amount be greater than $100,000 (*e.g.,* $150,000, $200,000, $500,000, or some other amount)? If so, identify the amount and explain why it would be a better threshold. Should the amount be less than $100,000 (*e.g.,* $75,000, $50,000, $25,000, or some other amount)? If so, identify the amount and explain why it would be a better threshold.

e. Risk Monitoring and Procedures

A nonbank SBSD would be required to monitor the risk of each account of a counterparty to a non-cleared security-based swap and establish, maintain, and document procedures and guidelines for monitoring the risk of such accounts.[613] The nonbank SBSD also would be required to review, in accordance with written procedures, and at reasonable periodic intervals, its non-cleared security-based swap activities for consistency with the risk monitoring procedures and guidelines.[614] The risk monitoring procedures and guidelines would need to include, at a minimum, procedures and guidelines for:

- Obtaining and reviewing the account documentation and financial information necessary for assessing the amount of current and potential future exposure to a given counterparty permitted by the nonbank SBSD;
- Determining, approving, and periodically reviewing credit limits for each counterparty, and across all counterparties;
- Monitoring credit risk exposure to the security-based swap dealer from non-cleared security-based swaps, including the type, scope, and frequency of reporting to senior management;
- Using stress tests to monitor potential future exposure to a single counterparty and across all counterparties over a specified range of possible market movements over a specified time period;
- Managing the impact of credit exposure related to non-cleared security-based swaps on the nonbank SBSD's overall risk exposure;
- Determining the need to collect collateral from a particular counterparty, including whether that determination was based upon the creditworthiness of the counterparty and/or the risk of the specific non-cleared security-based swap contracts with the counterparty;
- Monitoring the credit exposure resulting from concentrated positions with a single counterparty and across all counterparties, and during periods of extreme volatility; and
- Maintaining sufficient equity in the account of each counterparty to protect against the largest individual potential future exposure of a non-cleared security-based swap carried in the account of the counterparty as measured by computing the largest maximum possible loss that could result from the exposure.

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[611] *See* paragraph (c)(6) of proposed Rule 18a–3.

[612] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27575; *CFTC Margin Proposing Release,* 76 FR at 23735 (''In order to reduce transaction costs, proposed § 23.150 would establish a 'minimum transfer amount' of $100,000. Initial and variation margin payments would not be required to be made if below that amount. This amount was selected in consultation with the prudential regulators. It represents an amount sufficiently small that the level of risk reduction might not be worth the transaction costs of moving the money. It only affects the timing of collection; it does not change the amount of margin that must be collected once the $100,000 level is exceeded.''). Some commenters to the CFTC and Prudential Regulators proposed margin rules, while generally supporting the use of minimum transfer amounts, stated that they should have the flexibility to set higher minimum transfer amounts and that minimum transfer amounts up to $250,000 were more consistent with prevailing industry practice. *See* letter from the Coalition for Derivatives End-Users, to David A. Stawick, Secretary, CFTC (July 11, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47804*; letter from Carl B. Wilkerson, Vice President & Chief Counsel, Securities & Litigation, American Council of Life Insurers, to the Prudential Regulators and David A. Stawick, Secretary, CFTC (July 11, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47742*; letter from Lisa M. Ledbetter, Vice President and Deputy General Counsel, Legislative and Regulatory Affairs, Freddie Mac, to David A. Stawick, Secretary, CFTC (July 11, 2011), available at *http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47771*.

[613] *See* paragraph (e) of proposed new Rule 18a–3. Paragraph (e) of proposed new Rule 18a–3 would not apply to nonbank MSBSPs. As discussed below, the proposed risk monitoring procedures are designed to address the risk that results from dealing in non-cleared security-based swaps (*i.e.,* the type of activity that would require a nonbank MSBSP to register as an SBSD). *See* 15 U.S.C. 78o–10(a)(1); *Entity Definitions Proposing Release,* 75 FR at 80174. As discussed above in section II.A.3 of this release, a nonbank MSBSP would be required to comply with Rule 15c3–4, which requires an entity subject to its provisions to establish a risk management control system.

[614] *See* paragraph (e) of proposed new Rule 18a–3.

These proposed requirements are modeled on similar requirements in FINRA Rule 4240, which establishes an interim pilot program imposing margin requirements for transactions in credit default swaps executed by a FINRA member.[615] As discussed above in section II.A.2.c. of this release, nonbank SBSDs would be required to comply with Rule 15c3–4.[616] Rule 15c3–4 requires an OTC derivatives dealer to establish, document, and maintain a system of internal risk management controls to assist in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.[617] Risk management systems are designed to help ensure an awareness of, and accountability for, the risks taken throughout a firm and to develop tools to address those risks.[618] A key objective of a risk management system is to ensure that a firm does not ignore any material source of risk.[619]

The procedures and guidelines that a nonbank SBSD would establish pursuant to proposed new Rule 18a–3 would be a part of the broader system of risk management controls the nonbank SBSD would establish pursuant to Rule 15c3–4.[620] The requirement in proposed new Rule 18a–3 is designed to require specific risk management procedures and guidelines with respect to the risks of acting as a dealer in non-cleared security-based swaps, which could result in a nonbank SBSD carrying accounts for significant numbers of counterparties and effecting numerous transactions for counterparties on a daily basis. For example, the nonbank SBSD would be required to have procedures and guidelines for determining, approving, and periodically reviewing credit limits for each counterparty, and across all counterparties.[621] In addition, the nonbank SBSD would be required to have procedures and guidelines for determining the need to collect collateral from a particular counterparty, including whether that determination was based upon the creditworthiness of the counterparty and/or the risk of the specific non-cleared security-based swap contracts with the counterparty.[622] As discussed above in section II.B.2.c.i. of this release, nonbank SBSDs would not be required to collect collateral from a *commercial end user* to meet the account *equity* requirements in proposed new Rule 18a–3.[623] However, the firm would be required to determine credit limits for the end user and analyze the need for collecting collateral from the end user. These risk monitoring procedures and guidelines are designed to prevent the nonbank SBSD from allowing its credit exposure to the end user to reach a level that creates a substantial risk that the default of the end user could have a material adverse impact on the nonbank SBSD.

Request for Comment

The Commission generally requests comment on the requirements in proposed new Rule 18a–3 to monitor risk and to have risk monitoring procedures and guidelines. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are the required elements of the risk monitoring procedures and guidelines appropriate? If not, explain why not. Should there be additional or alternative required elements to the risk monitoring procedures and guidelines? If so, identify them and explain why they should be included.

2. Are the descriptions of the required elements of the risk monitoring procedures and guidelines in paragraphs (e)(1) through (8) of proposed new Rule 18a–3 sufficiently clear in terms of what is proposed to be required of nonbank SBSDs? If not, explain why not and suggest changes to make the elements more clear.

3. Is it appropriate to require that the risk monitoring procedures and guidelines be a part of the system of risk management control prescribed in Rule 15c3–4? If not, explain why not.

4. What are the current practices of dealers in OTC derivatives in terms of monitoring the risk of counterparties? Are the requirements in proposed new Rule 18a–3 consistent with current practices? Are they more limited or are they broader than current practices?

5. Should nonbank MSBSPs be subject to the requirements of paragraph (e) of proposed new Rule 18a–3? If so, explain why. If not, explain why not.

3. Specific Request for Comment To Limit the Use of Collateral

Proposed new Rule 18a–3 does not specifically identify classes of assets that could be used to meet the account *equity* requirements in the rule. The Commission, however, is considering whether it would be appropriate to adopt limits on eligible collateral similar to those the prudential regulators and the CFTC proposed.[624] Specifically, comment is sought on whether proposed new Rule 18a–3 should define the term *eligible collateral* in order to narrowly prescribe the classes of assets that would qualify as collateral to meet the account *equity* requirements. For example, one approach would be to limit *eligible collateral* to cash and U.S. government securities.

Limiting eligible collateral to cash and U.S. government securities could be a way to ensure that a nonbank SBSD will be able to liquidate the collateral promptly and at current market prices if necessary to cover the obligations of a defaulting counterparty. During a period of market stress, the value of collateral other than cash pledged as margin also may come under stress through rapid market declines and systemic liquidations and deleveraging by financial institutions. Generally, U.S. government securities are substantially less susceptible to this risk than other types of securities and, in fact, may become the investment of choice during a period of market stress as investors seek the relative safety of these securities.[625]

Another approach would be to adopt the definition of *eligible collateral* proposed by the prudential regulators or to adopt the ''forms of margin'' proposed by the CFTC.[626] Both of these proposed approaches would extend eligible collateral beyond cash and U.S. government securities but would not permit the use of certain securities (*e.g.,* listed equities that would be permitted by proposed Rule 18a–3).

The Commission also seeks comment in response to the following questions, including empirical data in support of comments:

1. Should the types of assets that could be used to meet the nonbank

[615] *See* FINRA Rule 4240. The risk monitoring requirements in FINRA Rule 4240 were, in turn, modeled on risk monitoring requirement in SRO portfolio margining rules. *See* FINRA Rule 4210(g); Rules 12.4 and 15.8A of the CBOE.

[616] 17 CFR 240.15c3–4.

[617] *Id.*

[618] *See* Joint Forum, Bank of International Settlements, *Trends in Risk Integration and Aggregation,* (Aug. 2003), available at *http://www.bis.org/publ/joint07.pdf.*

[619] *Id.*

[620] 17 CFR 240.15c3–4.

[621] *See* paragraph (e)(2) of proposed new Rule 18a–3.

[622] *See* paragraph (e)(6) of proposed new Rule 18a–3.

[623] *See* paragraph (c)(1)(iii)(A) of proposed new Rule 18a–3.

[624] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27578; *CFTC Margin Proposing Release,* 76 FR at 23738–23739.

[625] *See* IMF, *Global Financial Stability Report, The Quest for Lasting Stability* (Apr. 2012), available at *http://www.imf.org/external/pubs/ft/gfsr/2012/01/pdf/text.pdf.*

[626] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27578; *CFTC Margin Proposing Release,* 76 FR at 23738–23739 (proposing that only certain types of financial instruments be eligible collateral).

SBSD account *equity* requirements in proposed new Rule 18a–3 be more limited? Explain why or why not. For example, are the proposed provisions that would require a nonbank SBSD to mark-to-market the value of the collateral, apply haircuts to the collateral, and adhere to the collateral requirements incorporated from Appendix E to Rule 15c3–1 sufficient to ensure that collateral is able to serve the purpose of protecting the nonbank SBSD from the credit exposure of a counterparty to a non-cleared security-based swap? If so, explain why. If not, explain why not.

2. Explain the risk to nonbank SBSDs if they are permitted to accept a broader range of securities and money market instruments (as proposed in new Rule 18a–3) to meet the account *equity* requirements.

3. Should the types of assets that could be used to meet the nonbank MSBSP account *equity* requirements in proposed new Rule 18a–3 be more limited? Explain why or why not. Since nonbank MSBSPs would not be required to apply haircuts to the collateral or adhere to the collateral requirements incorporated from Appendix E to Rule 15c3–1, should the types of collateral they are allowed to accept be more limited? Explain why or why not.

4. Explain the risk to nonbank MSBSPs if they are permitted to accept a broader range of securities and money market instruments (as proposed in new Rule 18a–3) to meet the account *equity* requirements.

5. If the term *eligible collateral* is defined for purposes of proposed new Rule 18a–3, should the definition include securities of government-sponsored entities? If so, identify the government-sponsored entities and explain why the securities of the identified entity would be appropriate collateral. Alternatively, explain why securities of government-sponsored entities generally or individually should not be included in a potential definition of eligible collateral.

6. If the term *eligible collateral* is defined for purposes of proposed new Rule 18a–3, should the definition include immediately-available cash funds denominated in a foreign currency when the currency is the same currency in which payment obligations under the security-based swap are required to be settled? If so, should eligible collateral be limited to specific foreign currencies? If so, identify the currencies and explain why the identified currencies would be appropriate collateral. Alternatively, explain why foreign currencies generally or individually should not be included in a potential definition of *eligible collateral.*

7. If the term *eligible collateral* is defined for purposes of proposed new Rule 18a–3, should the definition include immediately-available cash funds denominated in foreign currency even in cases where the currency is not the same currency in which payment obligations under the security-based swap are required to be settled? If so, should eligible collateral be limited to specific foreign currencies? If so, identify the currencies and explain why the identified currencies would be appropriate collateral in this circumstance. Alternatively, explain why foreign currencies in this circumstance should not be included in a potential definition of *eligible collateral.*

8. If the term *eligible collateral* is defined for purposes of proposed new Rule 18a–3, should the definition include securities of foreign sovereign governments? If so, identify the foreign sovereign governments and explain why the securities of the identified foreign sovereign governments would be appropriate collateral. Alternatively, explain why securities of foreign sovereign governments should not be included in the definition of *eligible collateral.*

9. If the term *eligible collateral* is defined for purposes of proposed new Rule 18a–3, should the definition include a fully paid *margin equity security,* as that term is defined in 12 CFR 220.2,[627] in the case where a non-cleared equity security-based swap references the margin equity security? If so, explain why margin equity securities would be appropriate collateral in this circumstance. Alternatively, explain why margin equity securities in this circumstance should not be included in the definition of *eligible collateral.*

10. Should there be separate *eligible collateral* requirements for collateralizing *negative equity* and the margin amount? For example, should the assets permitted to collateralize *negative equity* be limited to cash and U.S. government securities, while the assets permitted to collateralize the margin amount encompass a broader range of securities?

C. Segregation

1. Background

The U.S. Bankruptcy Code provides special protections for *customers* of stockbrokers (the ''stockbroker liquidation provisions'').[628] Among other protections, *customers* share ratably with other customers ahead of all other creditors in the *customer property* held by the failed stockbroker.[629] Segregation requirements are designed to identify customer property as distinct from the proprietary assets of the firm and to protect customer property by, for example, preventing the firm from using it to make proprietary investments. The goal of segregation is to facilitate the prompt return of customer property to customers either before or during a liquidation proceeding if the firm fails.[630]

The Dodd-Frank Act contains provisions designed to ensure that cash and securities held by an SBSD relating to security-based swaps will be deemed customer property under the stockbroker liquidation provisions.[631] In particular, section 3E(g) of the Exchange Act provides, among other things, that a security-based swap shall be considered to be a *security* as such term is ''used in section 101(53A)(B) and subchapter III of title 11, United States Code'' [632] and in the stockbroker liquidation provisions.[633] Section 3E(g) also provides that an account that holds a security-based swap shall be considered to be a *securities account* as that term is ''defined'' in the stockbroker liquidation provisions.[634] In addition, section 3E(g) provides that the terms *purchase* and *sale* as defined in sections 3(a)(13) and (14) of the Exchange Act, respectively, shall be applied to the terms *purchase* and *sale* as used in the

[627] Regulation T defines *margin equity security* as a margin security that is an equity security (as defined in section 3(a)(11) of the Exchange Act). *See* 12 CFR 220.2.

[628] *See* 11 U.S.C. 741–753. SIPA provides similar protections for ''customers'' of registered broker-dealers. *See* 15 U.S.C. 78aaa *et seq.* However, SIPA also provides additional protections such as the right for each customer to receive an advance of up to $500,000 to facilitate the prompt satisfaction of a claim for securities and cash ($250,000 of the $500,000 may be used to satisfy the cash portion of a claim).

[629] *See* 11 U.S.C. 752.

[630] *See* Michael P. Jamroz, *The Customer Protection Rule,* 57 Bus. Law. 1069 (May 2002).

[631] *See* Public Law 111–203 § 763(d) adding section 3E(g) to the Exchange Act (15 U.S.C. 78c–5(g)).

[632] *See* 15 U.S.C. 78c–5(g); 11 U.S.C. 101(53A)(B). Section 101(53A)(B) defines a *stockbroker* to mean a person—(1) with respect to which there is a customer, as defined in section 741, subchapter III, title 11, United States Code (the definition section of the stockbroker liquidation provisions); and (2) that is engaged in the business of effecting transactions in *securities*—(i) for the account of others; or (ii) with members of the general public, from or for such person's own account. 11 U.S.C. 101(53A)(B).

[633] *See* 15 U.S.C. 78c–5(g); 11 U.S.C. 741–753.

[634] *See* 15 U.S.C. 78c–5(g); 11 U.S.C. 741. There is no definition of *securities account* in 11 U.S.C. 741. The term *securities account* is used in 11 U.S.C. 741(2) and (4) in defining the terms *customer* and *customer property.*

stockbroker liquidation provisions.[635] Finally, section 3E(g) provides that the term *customer* as defined in the stockbroker liquidation provisions excludes any person to the extent the person has a claim based on a non-cleared security-based swap transaction except to the extent of any margin delivered to or by the customer with respect to which there is a customer protection requirement under section 15(c)(3) of the Exchange Act or a segregation requirement.[636]

The provisions of section 3E(g) of the Exchange Act apply the customer protection elements of the stockbroker liquidation provisions to cleared security-based swaps, including related collateral, and, if subject to segregation requirements, to collateral delivered as margin for non-cleared security-based swaps.[637] The Dodd-Frank Act established segregation requirements for cleared and non-cleared security-based swaps and provided the Commission with the authority to adopt rules with respect to segregation. In particular, section 763 of the Dodd-Frank Act amended the Exchange Act to add new section 3E.[638] Section 3E sets forth requirements applicable to SBSDs and MSBSPs with respect to the segregation of cleared and non-cleared security-based swap collateral and provides the Commission with rulemaking authority in this area.[639] The Commission also has concurrent authority under section 15(c)(3) of the Exchange Act to prescribe segregation requirements for broker-dealers.[640]

Section 3E(b)(1) of the Exchange Act provides that a broker, dealer, or SBSD shall treat and deal with all money, securities, and property of any security-based swap customer received to margin, guarantee, or secure a cleared security-based swap transaction as belonging to the customer.[641] Section 3E(b)(2) provides that the money, securities, and property shall be separately accounted for and shall not be commingled with the funds of the broker, dealer, or SBSD or used to margin, secure, or guarantee any trades or contracts of any security-based swap customer or person other than the person for whom the money, securities, or property are held.[642]

Section 3E(c)(1) of the Exchange Act provides that, notwithstanding section 3E(b), money, securities, and property of cleared security-based swap customers of a broker, dealer, or SBSD may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency.[643] Section 3E(c)(2) further provides that the Commission may by rule, regulation, or order prescribe terms and conditions under which money, securities, and property of a customer with respect to cleared security-based swaps may be commingled and deposited with any other money, securities, and property received by the broker, dealer, or SBSD and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swap customer of the broker, dealer, or SBSD.[644]

With respect to non-cleared security-based swaps, section 3E(f)(1)(A) of the Exchange Act provides that an SBSD and an MSBSP shall be required to notify a counterparty of the SBSD or MSBSP at the beginning of a non-cleared security-based swap transaction that the counterparty has the right to require the segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty.[645] Section 3E(f)(1)(B) provides that, if requested by the counterparty, the SBSD or MSBSP shall segregate the funds or other property for the benefit of the counterparty and, in accordance with such rules and regulations as the Commission may promulgate, maintain the funds or other property in a segregated account separate from the assets and other interests of the SBSD or MSBSP.[646] Section 3E(f)(3) provides that the segregated account shall be carried by an independent third-party custodian and be designated as a segregated account for and on behalf of the counterparty (''individual segregation'').[647] In the case of non-cleared security-based swaps, therefore, each counterparty has the right to require its collateral to be isolated in an account at an independent custodian that identifies the counterparty by name, rather than commingled with collateral of other counterparties.

The objective of individual segregation is for the funds and other property of the counterparty to be carried in a manner that will keep these assets separate from the bankruptcy estate of the SBSD or MSBSP if it fails financially and becomes subject to a liquidation proceeding. Having these assets carried in a bankruptcy-remote manner protects the counterparty from the costs of retrieving assets through a bankruptcy proceeding caused, for example, because another counterparty of the SBSD or MSBSP defaults on its obligations to the SBSD or MSBSP.

Section 3E(f)(2)(B)(i) of the Exchange Act provides that the segregation requirements for non-cleared security-based swaps do not apply to variation margin payments, so that the right of a counterparty to require individual account segregation applies only to initial and not variation margin.[648] It also provides that the segregation requirements shall not preclude any commercial arrangement regarding the investment of segregated funds or other property that may only be invested in such investments as the Commission may permit by rule or regulation, and the related allocation of gains and losses

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[635] *See* 15 U.S.C. 78c–5(g); 11 U.S.C. 741–753. Section 3(a)(13) of the Exchange Act, as amended by the Dodd-Frank Act (Pub. L. 111–203 § 761(a)), defines the term *purchase* to mean, in the case of security-based swaps, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require. 15 U.S.C. 78c(a)(13). Section 3(a)(14) of the Exchange Act, as amended by the Dodd-Frank Act (Pub. L. 111–203 § 761(a)), defines the term *sale* to mean, in the case of security-based swaps, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require. *See* 15 U.S.C. 78c(a)(14).

[636] *See* 15 U.S.C. 78c–5(g); 11 U.S.C. 741(2).

[637] *See* 15 U.S.C. 78c–5(g); 11 U.S.C. 741–753.

[638] *See* Public Law 111–203 § 763; 15 U.S.C. 78c–5.

[639] *See* 15 U.S.C. 78c–5. Unlike the grants of capital and margin rulemaking authority in the Dodd-Frank Act, section 3E does not divide rulemaking authority for segregation requirements for SBSDs and MSBSPs between the Commission and the prudential regulators. *Compare* 15 U.S.C. 78o–10(e)(1), *with* 15 U.S.C. 78c–5. Consequently, the Commission's rulemaking authority in this area extends to bank SBSDs and bank MSBSPs. 15 U.S.C. 78c–5.

[640] *See* 15 U.S.C. 78o(c)(3). *See also* Public Law 111–203 § 771 (codified at 15 U.S.C. 78o–10(e)(3)(B)). Section 771 of the Dodd-Frank Act states that unless otherwise provided by its terms, its provisions relating to the regulation of the security-based swap markets do not divest any appropriate Federal banking agency, the Commission, the CFTC, or any other Federal or State agency, of any authority derived from any other provision of applicable law. *See* Public Law 111–203 § 771. In addition, section 15F(e)(3)(B) of the Exchange Act provides that nothing in section 15F ''shall limit, or be construed to limit, the authority'' of the Commission ''to set financial responsibility rules for a broker or dealer * * * in accordance with Section 15(c)(3).'' 15 U.S.C. 78o–8(e)(3)(B).

[641] *See* section 3E(b)(1) of the Exchange Act (15 U.S.C. 78c–5(b)(1)). As indicated, the provisions of section 3E(b) do not apply to MSBSPs.

[642] *See* section 3E(b)(2) of the Exchange Act (15 U.S.C. 78c–5(b)(2)).

[643] *See* section 3E(c)(1) of the Exchange Act (15 U.S.C. 78c–5(c)(1)).

[644] *See* section 3E(c)(2) of the Exchange Act (15 U.S.C. 78c–5(c)(2)).

[645] *See* 15 U.S.C. 78c–5(f)(1)(A). *See also* section 3E(f)(2)(A) of the Exchange Act, which provides that the provisions of section 3E(f)(1) apply only to a security-based swap between a counterparty and SBSD or MSBSP that is not submitted for clearing to a clearing agency. *See* 15 U.S.C. 78c–5(f)(2)(A).

[646] *See* 15 U.S.C. 78c–5(f)(1)(B).

[647] *See* 15 U.S.C. 78c–5(f)(3).

[648] *See* 15 U.S.C. 78c–5(f)(2)(B)(i).

resulting from any investment of the segregated funds or other property.[649] Finally, section 3E(f)(4) provides that if the counterparty does not choose to require segregation of funds or other property, the SBSD or MSBSP shall send a quarterly report to the counterparty that the firm's back office procedures relating to margin and collateral requirements are in compliance with the agreement of the counterparties.[650]

Pursuant, in part, to the grants of rulemaking authority in sections 3E and 15(c)(3) of the Exchange Act, the Commission is proposing new Rule 18a–4 to establish segregation requirements for SBSDs with respect to cleared and non-cleared security-based swaps that would supplement the requirements in section 3E.[651] Proposed new Rule 18a–4 would apply to all types of SBSDs (*i.e.,* it would apply to bank SBSDs, stand-alone SBSDs, and broker-dealer SBSDs).[652] As discussed in more detail below, proposed new Rule 18a–4 would prescribe detailed requirements for how cash, securities, and money market instruments of a customer with cleared security-based swaps must be segregated when an SBSD commingles those assets with the cash and securities of other customers (''omnibus segregation'') pursuant to section 3E(c)(1) of the Exchange Act.[653] In addition, the proposed rule would require that cash, securities, and money market instruments of a customer with respect to non-cleared security-based swaps must be treated in the same manner as cash, securities, and money market instruments of a customer with respect to cleared security-based swaps in cases where the counterparty does not elect individual segregation[654] *and* does not affirmatively waive segregation altogether.[655] In other words, proposed new Rule 18a–4 would establish an alternative omnibus, or ''commingled'', segregation approach for non-cleared security-based swaps. This approach would be the default requirement under which an SBSD would be required to segregate securities and funds relating to non-cleared security-based swaps and, therefore, apply in the absence of a counterparty electing individual segregation or affirmatively waiving segregation.[656]

The omnibus segregation requirements in Rule 18a–4 would not apply to MSBSPs.[657] Consequently, if an MSBSP holds collateral from a counterparty with respect to non-cleared security-based swaps, it would be subject only to the segregation requirements in section 3E of the Exchange Act with respect to the collateral, and would not be required to segregate the collateral unless the counterparty required individual segregation under section 3E.[658] The omnibus segregation requirements in Rule 18a–4 may not be practical for MSBSPs for the same reasons discussed in sections II.A.3. and II.B.2. of this release with respect to the proposed capital and margin requirements for MSBSPs (*i.e.,* the potentially wide range of business models under which nonbank MSBSPs may operate under the proposed rule, and the uncertain impact that requirements designed for broker-dealers could have on these entities). MSBSPs will instead be subject to the provisions in section 3E(f) of the Exchange Act, which provide certain baseline segregation requirements for non-cleared security-based swaps.[659] In addition, counterparties would be able to negotiate customized segregation agreements with MSBSPs, subject to these provisions.[660]

As discussed in more detail below, the omnibus segregation requirements of Rule 18a–4 are modeled on the provisions of the broker-dealer segregation rule—Rule 15c3–3.[661] Rule 15c3–3 is designed ''to give more specific protection to customer funds and securities, in effect forbidding brokers and dealers from using customer assets to finance any part of their businesses unrelated to servicing securities customers; *e.g.,* a firm is virtually precluded from using customer funds to buy securities for its own account.''[662] To meet this objective, Rule 15c3–3 requires a broker-dealer that maintains custody of customer securities and cash (a ''carrying broker-dealer'') to take two primary steps to safeguard these assets. The steps are designed to protect customers by segregating their securities and cash from the broker-dealer's proprietary business activities. If the broker-dealer fails financially, the securities and cash should be readily available to be returned to the customers. In addition, if the failed broker-dealer is liquidated in a formal proceeding under SIPA, the securities and cash should be isolated and readily identifiable as ''customer property'' and, consequently, available to be distributed to customers ahead of other creditors.[663]

The first step required by Rule 15c3–3 is that a carrying broker-dealer must maintain physical possession or control over customers' fully paid and excess margin securities.[664] Physical possession or control means the broker-dealer must hold these securities in one of several locations specified in Rule 15c3–3 and free of liens or any other

[649] *See* 15 U.S.C. 78c–5(f)(2)(B)(ii). No requirements are being proposed at this time pursuant to the authority in section 3E(f)(1)(B)(ii) of the Exchange Act.

[650] *See* section 3E(f)(4) of the Exchange Act (15 U.S.C. 78c–5(f)(4)).

[651] *See* 15 U.S.C. 78c–5; 15 U.S.C. 78o(c)(3).

[652] Unlike section 15F of the Exchange Act that divides responsibility for capital and margin rules between the Commission and the prudential regulators, section 3E of the Exchange Act provides authority solely to the Commission. *Compare* 15 U.S.C. 78o–10, *with* 15 U.S.C. 78c–5.

[653] *See* 15 U.S.C. 78c–5(c)(1).

[654] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[655] *See* 15 U.S.C. 78c–5(f)(4).

[656] As discussed below in section II.C.2.c. of this release, an SBSD would be required to obtain a subordination agreement from a counterparty that waives segregation. By entering into the subordination agreement, the counterparty would affirmatively waive segregation. The absence of a subordination agreement would mean that the counterparty is presumed not to have waived segregation and the SBSD would need to treat the counterparty's cash, securities, and/or money market instruments pursuant to the omnibus segregation requirements of proposed new Rule 18a–4.

[657] As discussed in more detail below, MSBSPs would be subject to a notification requirement. *See* paragraph (d)(1) of proposed new Rule 18a–4.

[658] The provisions of section 3E of the Exchange Act governing cleared security-based swaps do not apply to nonbank MSBSPs. *See* 15 U.S.C. 78c–5(b) (referring specifically to a ''broker, dealer, or security-based swap dealer'' and not to an MSBSP.).

[659] *See* 15 U.S.C. 78c–5(f).

[660] *Id.*

[661] *See* 17 CFR 240.15c3–3.

[662] *See Net Capital Requirements for Brokers and Dealers,* Exchange Act Release No. 21651 (Jan. 11, 1985), 50 FR 2690, 2690 (Jan. 18, 1985). *See also Broker-Dealers; Maintenance of Certain Basic Reserves,* Exchange Act Release No. 9856 (Nov. 10, 1972), 37 FR 25224, 25224 (Nov. 29, 1972).

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

[664] *See* 17 CFR 240.15c3–3(d). The term *fully paid securities* includes all securities carried for the account of a customer in a special cash account as defined in Regulation T promulgated by the Board of Governors of the Federal Reserve System, as well as margin equity securities within the meaning of Regulation T which are carried for the account of a customer in a general account or any special account under Regulation T during any period when section 8 of Regulation T (12 CFR 220.8) specifies that margin equity securities shall have no loan value in a general account or special convertible debt security account, and all such margin equity securities in such account if they are fully paid: provided, however, that the term ''fully paid securities'' shall not apply to any securities which are purchased in transactions for which the customer has not made full payment. 17 CFR 240.15c3–3(a)(3). The term *margin securities* means those securities carried for the account of a customer in a general account as defined in Regulation T, as well as securities carried in any special account other than the securities referred to in paragraph (a)(3) of Rule 15c3–3. 17 CFR 240.15c3–3(a)(4). The term *excess margin securities* means those securities referred to in paragraph (a)(4) of Rule 15c3–3 carried for the account of a customer having a market value in excess of 140 percent of the total of the debit balances in the customer's account or accounts encompassed by paragraph (a)(4) of Rule 15c3–3 which the broker-dealer identifies as not constituting margin securities. 17 CFR 240.15c3–3(a)(5).

interest that could be exercised by a third-party to secure an obligation of the broker-dealer.[665] Permissible locations include a bank, as defined in section 3(a)(6) of the Exchange Act, and a clearing agency.[666]

The second step is that a carrying broker-dealer must maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers.[667] The account must be titled ''Special Account for the Exclusive Benefit of Customers of the Broker-Dealer'' (''customer reserve account'').[668] The amount of net cash owed to customers is computed pursuant to a formula set forth in Exhibit A to Rule 15c3–3 (''Exhibit A formula'').[669] Under the Exhibit A formula, the broker-dealer adds up customer credit items (*e.g.,* cash in customer securities accounts) and then subtracts from that amount customer debit items (*e.g.,* margin loans).[670] If credit items exceed debit items, the net amount must be on deposit in the customer reserve account in the form of cash and/or qualified securities.[671] A broker-dealer cannot make a withdrawal from the customer reserve account until the next computation and even then only if the computation shows that the reserve requirement has decreased.[672] The broker-dealer must make a deposit into the customer reserve account if the computation shows an increase in the reserve requirement.

In addition, the Exhibit A formula permits the broker-dealer to offset *customer* credit items only with *customer* debit items.[673] This means the broker-dealer can use customer cash to facilitate customer transactions such as financing customer margin loans and borrowing securities to make deliveries of securities customers have sold short.[674] As discussed above in section II.B. of this release, the broker-dealer margin rules require securities customers to maintain a minimum level of *equity* in their securities accounts. In addition to protecting the broker-dealer from the consequences of a customer default, this *equity* serves to over-collateralize the customers' obligations to the broker-dealer. This buffer protects the customers whose cash was used to facilitate the broker-dealer's financing of securities purchases and short-sales by customers. For example, if the broker-dealer fails, the customer debits, because they generally are over-collateralized, should be attractive assets for another broker-dealer to purchase or, if not purchased by another broker-dealer, they should be able to be liquidated to a net positive equity.[675] The proceeds of the debits sale or liquidation can be used to repay the customer cash used to finance the customer obligations. This cash plus the funds and/or U.S. government securities held in the customer reserve account should equal or exceed the total amount of customer credit items (*i.e.,* the total amount owed by the broker-dealer to its customers).[676]

Proposed new Rule 18a–4 would contain certain provisions that are modeled on corresponding provisions of Rule 15c3–3.[677] Paragraph (a) of the proposed rule would define key terms used in the rule.[678] Paragraph (b) would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all *excess securities collateral* (a term defined in paragraph (a)) and specify certain locations where *excess securities collateral* could be held and would be deemed to be in the SBSD's control.[679] Paragraph (c) would require an SBSD to maintain a special account for the exclusive benefit of security-based swap customers and have on deposit in that account at all times an amount of cash and/or *qualified securities* (a term defined in paragraph (a)) determined through a computation using the formula in Exhibit A to proposed new Rule 18a–4.[680] A broker-dealer SBSD would need to treat security-based swap accounts separately from other securities accounts and, consequently, would need to perform separate possession and control and reserve account computations for security-based swap accounts and other securities accounts. The former would be subject to the possession and control and reserve account requirements in proposed new Rule 18a–4 and the latter would continue to be subject to the analogous requirements in Rule 15c3–3. This would keep separate the segregated customer property related to security-based swaps from customer property related to other securities, including property of retail securities customers.

Paragraph (d) of Rule 18a–4 would contain certain additional provisions that do not have analogues in Rule 15c3–3. First, it would require an SBSD and an MSBSP to provide the notice required by section 3E(f)(1)(A) of the Exchange Act prior to the execution of the first non-cleared security-based swap transaction with the counterparty.[681] Second, it would require the SBSD to obtain subordination agreements from counterparties that opt out of the segregation requirements in proposed

[665] *See* 17 CFR 240.15c3–3(c). Customer securities held by the carrying broker-dealer are not assets of the firm. Rather, the carrying broker-dealer holds them in a custodial capacity and the possession and control requirement is designed to ensure that the carrying broker-dealer treats them in a manner that allows for their prompt return.

[666] *Id.*

[667] 17 CFR 240.15c3–3(e). The term ''qualified security'' is defined in Rule 15c3–3 to mean a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States (''U.S. government security''). *See* 17 CFR 240.15c3–3(a)(6).

[668] *See* 17 CFR 240.15c3–3(e)(1). The purpose of giving the account this title is to alert the bank and creditors of the broker-dealer that this reserve fund is to be used to meet the broker-dealer's obligations to customers (and not the claims of general creditors) in the event the broker-dealer must be liquidated in a formal proceeding.

[669] 17 CFR 240.15c3–3a.

[670] *See id.*

[671] 17 CFR 240.15c3–3(e). Customer cash is a balance sheet item of the carrying broker-dealer (*i.e.,* the amount of cash received from a customer increases the amount of the carrying broker-dealer's assets and creates a corresponding liability to the customer). The reserve formula is designed to isolate these broker-dealer assets so that an amount equal to the net liabilities to customers is held as a reserve in the form of cash or U.S. government securities. The requirement to establish this reserve is designed to effectively prevent the carrying broker-dealer from using customer funds for proprietary business activities such as investing in securities. The goal is to put the carrying broker-dealer in a position to be able to readily meet its cash obligations to customers by requiring the firm to make deposits of cash and/or U.S. government securities into the customer reserve account in the amount of the net cash owed to customers.

[672] *See* 17 CFR 240.15c3–3(e).

[673] *See* 17 CFR 240.15c3–3a.

[674] For example, if a broker-dealer holds $100 for customer A, the broker-dealer can use that $100 to finance a security purchase of customer B. The $100 the broker-dealer owes customer A is a credit in the formula and the $100 customer B owes the broker-dealer is a debit in the formula. Therefore, under the Exhibit A formula there would be no requirement to maintain cash and/or U.S. government securities in the customer reserve account. However, if the broker-dealer did not use the $100 held in customer A's account for this purpose, there would be no offsetting debit and, consequently, the broker-dealer would need to have on deposit in the customer reserve account cash and/or U.S. government securities in an amount at least equal to $100.

[675] The attractiveness of the over-collateralized debits facilitates the bulk transfer of customer accounts from a failing or failed broker-dealer to another broker-dealer.

[676] *See Net Capital Requirements for Broker-Dealers; Amended Rules,* Exchange Act Release No. 18417 (Jan. 13, 1982), 47 FR 3512, 3513 (Jan. 25, 1982) (''The alternative approach is founded on the concept that, if the debit items in the Reserve Formula can be liquidated at or near their contract value, these assets along with any cash required to be on deposit under the [customer protection] rule, will be sufficient to satisfy all liabilities to customers (which are represented as credit items in the Reserve Formula).'').

[677] *Compare* 17 CFR 240.15c3–3, *with* proposed new Rule 18a–4.

[678] *Compare* 17 CFR 240.15c3–3(a), *with* paragraph (a) of proposed new Rule 18a–4.

[679] *Compare* 17 CFR 240.15c3–3(b)–(d), *with* paragraph (b) of proposed new Rule 18a–4.

[680] *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (c) of proposed new Rule 18a–4.

[681] *See* 15 U.S.C. 78c–5(f)(1)(A); paragraph (d)(1) of proposed new Rule 18a–4.

new Rule 18a–4 because they either elect individual segregation pursuant to the provisions of section 3E(f) of the Exchange Act[682] or agree that the SBSD need not segregate their assets at all.[683]

As discussed in more detail below, the omnibus segregation requirements in proposed new Rule 18a–4 are designed to accommodate the operational aspects of an SBSD collecting cash, securities, and/or money market instruments from security-based swap customers to margin cleared security-based swaps and delivering cash, securities, and/or money market instruments to registered clearing agencies to meet margin requirements of the clearing agencies with respect to the customers' transactions. Similarly, the omnibus segregation requirements are designed to accommodate the current practice of dealers in OTC derivatives to collect cash, securities, and/or money market instruments from a counterparty to cover current and potential future exposure arising from an OTC derivatives transaction with the counterparty and concurrently deliver cash, securities, and/or money market instruments to another dealer as collateral for an OTC derivatives transaction that hedges (takes the opposite side of) the OTC derivatives transaction with the counterparty. At the same time, the omnibus segregation requirements are designed to isolate, identify, and protect cash, securities, and/or money market instruments received by the SBSD as collateral for cleared and non-cleared security-based swaps, whether the collateral is held by the SBSD, a registered clearing agency, or another SBSD.

Finally, the Commission is proposing a conforming amendment to add new paragraph (p) to Rule 15c3–3 to state that a broker-dealer that is registered as an SBSD pursuant to section 15F of the Exchange Act must also comply with the provisions of Rule 18a–4.[684] This proposed amendment would clarify that a broker-dealer SBSD must comply with both Rule 15c3–3 and Rule 18a–4.

Request for Comment

The Commission generally requests comment on the approach of proposed new Rule 18a–4. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Should there be rules under section 3E(f)(1)(B)(i) of the Exchange Act with respect to how an SBSD and an MSBSP must segregate funds and other property relating to non-cleared security-based swaps to supplement the individual segregation provisions in section 3E(f)? If so, describe the types of requirements the rules should impose.

2. Should there be rules under section 3E(f)(2)(B)(ii)(I) of the Exchange Act with respect to how an SBSD and an MSBSP may invest funds or other property relating to non-cleared security-based swaps to supplement the individual segregation provisions in section 3E(f)? If so, describe the types of requirements the rules should impose. For example, should the rules require that the funds may be invested only in U.S. government securities or in *qualified securities* as that term is defined in paragraph (a)(5) of proposed new Rule 18a–4? Explain why or why not.

3. Is it appropriate to model the segregation provisions for security-based swap customers on the provisions of Rule 15c3–3? If not, explain why and identify another segregation model.

4. Should MSBSPs be required to comply with all the omnibus segregation requirements of proposed new Rule 18a–4? If so, explain why. If not, explain why not.

5. Should the omnibus segregation requirements accommodate the ability to hold swaps in security-based swap customer accounts to facilitate a portfolio margin treatment for related or offsetting positions in the account? What practical or legal impediments may exist to doing so? If swaps could be held in the account along with security-based swaps, how would the existence of differing bankruptcy regimes for securities and commodities instruments impact the ability to unwind positions or distribute assets to customers in the event of insolvency of the SBSD?

2. Proposed Rule 18a–4

a. Possession and Control of Excess Securities Collateral

Paragraph (b)(1) of Rule 18a–4 would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers.[685] Physical possession or control as used in Rule 15c3–3 means a broker-dealer cannot lend or hypothecate securities subject to the requirement and must hold them itself or, as is more common, in a satisfactory control location.[686] As discussed below, physical possession or control is intended to have the same meaning in proposed new Rule 18a–4.

The term *security-based swap customer* would be defined to mean any person from whom or on whose behalf the SBSD has received or acquired or holds funds or other property for the account of the person with respect to a cleared or non-cleared security-based swap transaction.[687] The definition would exclude a person to the extent that person has a claim for funds or other property which by contract, agreement or understanding, or by operation of law, is part of the capital of the SBSD or is subordinated to all claims of security-based swap customers of the SBSD.[688] This proposed definition of *security-based swap customer* is modeled on the current definition of *customer* in Rule 15c3–3.[689] As discussed above, an SBSD would be required to obtain subordination agreements from counterparties that elect individual segregation pursuant to the self-executing provisions of section 3E(f) of the Exchange Act[690] or that waive segregation.[691] Because these counterparties would enter into subordination agreements, they would not meet the definition of *security-based swap customer* and, consequently, the omnibus segregation requirements of proposed new Rule 18a–4 would not apply to their funds and other property.[692]

[682] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[683] *See* 15 U.S.C. 78c–5(f)(4).

[684] *See* proposed paragraph (p) of Rule 15c3–3.

[685] This paragraph is modeled on paragraph (b)(1) of Rule 15c3–1. *Compare* 17 CFR 240.15c3–1(b)(1), *with* paragraph (b)(1) of proposed new Rule 18a–4.

[686] *See Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR 12862.

[687] *See* paragraph (a)(6) of proposed new Rule 18a–4. Paragraph (a)(1) of proposed Rule 18a–4 would define the term *cleared security-based swap* to mean a security-based swap that is, directly or indirectly, submitted to and cleared by a clearing agency registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q–1). Any other security-based swap would be a non-cleared security-based swap.

[688] *See* paragraph (a)(6) of proposed new Rule 18a–4.

[689] *Compare* 17 CFR 240.15c3–3(a)(1), *with* paragraph (a)(6) of proposed new Rule 18a–4. The proposed definition also is based on the definitions of ''customer'' in 11 U.S.C. 741(2) and 15 U.S.C. 78*lll*(2), which, respectively, apply to liquidations of stockbrokers under the stockbroker liquidation provisions and broker-dealers under the SIPA. As discussed above in section II.C.1 of this release, under these liquidation provisions, customers receive special protections such as priority claims to customer property over general creditors. *See* 11 U.S.C. 101 *et seq.;* 15 U.S.C. 78aaa *et seq.*

[690] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[691] *See* 15 U.S.C. 78c–5(f)(4).

[692] Counterparties that elect individual segregation would not need the protections of the omnibus segregation requirements because their funds and other property would be held by an independent third-party custodian and, therefore, the third-party custodian—rather than the SBSD—would owe the securities and funds to the counterparty. Counterparties that waive segregation,

Proposed new Rule 18a–4 would define the term *excess securities collateral* to mean securities and money market instruments carried for the account of a security-based swap customer that have a market value in excess of the current exposure of the SBSD to the customer, excluding: (1) Securities and money market instruments held in a *qualified clearing agency account* but only to the extent the securities and money market instruments are being used to meet a margin requirement of the clearing agency resulting from a security-based swap transaction of the customer; and (2) securities and money market instruments held in a *qualified registered security-based swap dealer account* but only to the extent the securities and money market instruments are being used to meet a margin requirement of the other SBSD resulting from the SBSD entering into a non-cleared security-based swap transaction with the other SBSD to offset the risk of a non-cleared security-based swap transaction between the SBSD and the customer. The proposed definition of *excess securities collateral* is based on the provisions of Rule 15c3–3 requiring a broker-dealer to maintain physical possession or control of *fully paid* and *excess margin securities* (*i.e.,* securities that are not being used to secure the obligations of the customer to the broker-dealer).[693] Under the proposed definition of *excess securities collateral,* securities and money market instruments of a security-based swap customer of the SBSD that are not being used to collateralize the SBSD's current exposure to the customer would need to be in the physical possession or control of the SBSD unless one of the two exceptions in the definition applies to the securities and money market instruments.

The first exception in the definition refers to securities and money market instruments held in a *qualified clearing agency account* but only to the extent the securities and money market instruments are being used to meet a margin requirement of the clearing agency resulting from a security-based swap transaction of the customer. This exception is designed to accommodate the margin requirements of clearing agencies, which will require SBSDs to deliver margin collateral to the clearing agency to cover exposures arising from cleared security-based swaps of the SBSD's security-based swap customers.[694] Customer securities and money market instruments provided to the clearing agency for this purpose would not meet the definition of *excess securities collateral* and, therefore, would not be subject to the physical possession or control requirement.[695] This exception would allow the clearing agency to hold the securities as collateral against obligations of the SBSD's customers arising from their cleared security-based swaps.

The term *qualified clearing agency account* would be defined to mean an account of an SBSD at a clearing agency established to hold funds and other property in order to purchase, margin, guarantee, secure, adjust, or settle cleared security-based swaps of the SBSD's security-based swap customers that meets the following conditions:

- The account is designated ''Special Clearing Account for the Exclusive Benefit of the Cleared Security-Based Swap Customers of [name of the SBSD]'';[696]
- The clearing agency has acknowledged in a written notice provided to and retained by the SBSD that the funds and other property in the account are being held by the clearing agency for the exclusive benefit of the security-based swap customers of the SBSD in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the SBSD with the clearing agency;[697] and
- The account is subject to a written contract between the SBSD and the clearing agency which provides that the funds and other property in the account shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the clearing agency or any person claiming through the clearing agency, except a right, charge, security interest, lien, or claim resulting from a cleared security-based swap transaction effected in the account.[698]

These provisions are designed to ensure that securities and money market instruments of security-based swap customers related to cleared security-based swaps provided to a clearing agency are isolated from the proprietary assets of the SBSD and identified as property of the security-based swap customers.

The second exception in the definition of *excess securities collateral* is for securities and money market instruments held in a *qualified registered security-based swap dealer account* but only to the extent the securities and money market instruments are being used to meet a margin requirement of the other SBSD resulting from the SBSD entering into a non-cleared security-based swap transaction with the other SBSD to offset the risk of a non-cleared security-based swap transaction between the SBSD and the customer. This exception is designed to accommodate the practice of dealers in OTC derivatives transactions maintaining ''matched books'' of transactions in which an OTC derivatives transaction with a counterparty is hedged with an offsetting transaction with another dealer. SBSDs, as dealers in security-based swaps, are expected to actively manage the risk of their non-cleared security-based swap positions by entering into offsetting transactions with other SBSDs.[699] These other SBSDs may require margin collateral from the SBSD.[700] Customer securities and

in effect, have agreed that their funds and other property can be used by the SBSD for its proprietary business purposes. Therefore, they have agreed to forego the benefits of segregation.

[693] *See* 17 CFR 240.15c3–3(d); 17 CFR 240.15c3–3(a)(3) (defining the term *fully paid securities*); 17 CFR 240.15c3–3(a)(4) (defining the term *margin securities*); 17 CFR 240.15c3–3(a)(5) (defining the term *excess margin securities*).

[694] As discussed above, security-based swap clearing agencies will require SBSDs to deliver margin collateral for the security-based swap transactions of the SBSD's customers that are cleared by the clearing agency.

[695] While the Commission is proposing this exemption, these customer securities and money market instruments would still be required to be included in the SBSD's reserve formula calculation under proposed new Rule 18a–4a.

[696] *See* paragraph (a)(3)(i) of proposed new Rule 18a–4. This provision is modeled on paragraph (e)(1) of Rule 15c3–3, which requires a broker-dealer to maintain a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (a)(3)(i) of proposed new Rule 18a–4.

[697] *See* paragraph (a)(3)(ii) of proposed new Rule 18a–4. This provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a written notification from a bank where it maintains a customer reserve account. *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(3)(iii) of proposed new Rule 18a–4.

[698] *See* paragraph (a)(3)(iii) of proposed new Rule 18a–4. This provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a contract from a bank where it maintains a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(3)(ii) of proposed new Rule 18a–4.

[699] For example, assume an SBSD and a counterparty enter into a CDS security-based swap on XYZ Company with a notional amount of $10 million and term of five years and in which the SBSD is the seller of protection and counterparty is the buyer of protection. The SBSD could enter into a matching transaction (a CDS security-based swap on XYZ Company with a notional amount of $10 million and term of five years) with another SBSD in which the SBSD is the buyer of protection and the other SBSD is the seller of protection. This would match the transaction with the counterparty with the transaction with the other SBSD and hedge the SBSD's risk resulting from the transaction with the customer.

[700] As discussed above in section II.B.2.c.i. of this release, an SBSD would not be required to collect collateral equal to the margin amount if the counterparty was another SBSD under the

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money market instruments provided to another SBSD for this purpose would be excepted from the definition of *excess securities collateral* and, therefore, would not be subject to the physical possession or control requirement. Thus, this provision would allow an SBSD to finance customer transactions in non-cleared security-based swaps by using customer collateral to secure offsetting transactions with another SBSD, provided that the collateral is held in an account with the other SBSD that meets certain requirements.

The term *qualified registered security-based swap dealer account* (''qualified SBSD account'') would be defined to mean an account at another SBSD registered with the Commission pursuant to section 15F of the Exchange Act that is not an affiliate of the SBSD and that meets the following conditions:

- The account is designated ''Special Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of the SBSD]'';[701]
- The account is subject to a written acknowledgement by the other SBSD provided to and retained by the SBSD that the funds and other property held in the account are being held by the other SBSD for the exclusive benefit of the security-based swap customers of the SBSD in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the SBSD with the other SBSD;[702]
- The account is subject to a written contract between the SBSD and the other SBSD which provides that the funds and other property in the account shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the other SBSD or any person claiming through the SBSD, except a right, charge, security interest, lien, or claim resulting from a non-cleared security-based swap transaction effected in the account;[703] and
- The account and the assets in the account are not subject to any type of subordination agreement.[704]

These conditions are largely identical to the conditions for a qualified clearing agency account and are similarly designed to ensure that securities and money market instruments of security-based swap customers relating to non-cleared security-based swaps provided to another SBSD are isolated from the proprietary assets of the SBSD and are identified as property of the security-based swap customers. Further, the account and the assets in the account could not be subject to any type of subordination agreement. This condition is designed to ensure that if the other SBSD holding the qualified SBSD account fails, the SBSD accountholder will be treated as a security-based swap customer in a liquidation proceeding and, therefore, could make a *pro rata* claim for customer property with other customers ahead of all other creditors.[705]

Paragraph (b)(2) of proposed new Rule 18a–4 would identify five satisfactory control locations for *excess securities collateral*.[706] Rule 15c3–3 identifies the same locations as satisfactory control locations.[707] Proposed new Rule 18a–4 would provide that an SBSD has *control* of *excess securities collateral* only if the securities and money market instruments:

- Are represented by one or more certificates in the custody or control of a clearing corporation or other subsidiary organization of either national securities exchanges, or of a custodian bank in accordance with a system for the central handling of securities complying with the provisions of Exchange Act Rule 8c–1(g) and Exchange Act Rule 15c2–1(g) the delivery of which certificates to the SBSD does not require the payment of money or value, and if the books or records of the SBSD identify the security-based swap customers entitled to receive specified quantities or units of the securities so held for such security-based swap customers collectively;[708]
- Are the subject of bona fide items of transfer; provided that securities and money market instruments shall be deemed not to be the subject of bona fide items of transfer if, within 40 calendar days after they have been transmitted for transfer by the SBSD to the issuer or its transfer agent, new certificates conforming to the instructions of the SBSD have not been received by the SBSD, the SBSD has not

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Alternative A account *equity* requirement in proposed new Rule 18a–3. *See* paragraph (c)(1)(iii)(B)—Alternative A of proposed new Rule 18a–3. Consequently, an SBSD would not be required to maintain a minimum level of *positive equity* in its account at another SBSD with respect to non-cleared security-based swaps. This would mean that the SBSD may not need to provide collateral to the other SBSD other than an amount necessary to cover the current exposure of the other SBSD, which, in turn could reduce the need to use securities and money market instruments of security-based swap customers to collateralize hedging transactions. However, under the Alternative B account *equity* requirement, an SBSD would be required to provide collateral equal to the margin amount to the other SBSD. *See* paragraph (c)(1)(iii)(B)—Alternative B of proposed new Rule 18a–3. This could increase the need to use securities and money market instruments of security-based swap customers to collateralize hedging transactions.

[701] *See* paragraph (a)(4)(i) of proposed new Rule 18a–4. Similar to the proposed conditions for a qualified clearing agency account, this provision is modeled on paragraph (e)(1) of Rule 15c3–3, which requires a broker-dealer to maintain a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (a)(4)(i) of proposed new Rule 18a–4.

[702] *See* paragraph (a)(4)(ii) of proposed new Rule 18a–4. Similar to the proposed conditions for a qualified clearing agency account, this provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a written notification from a bank where it maintains a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(4)(ii) of proposed new Rule 18a–4.

[703] *See* paragraph (a)(4)(iii) of proposed new Rule 18a–4. Similar to the proposed conditions for a qualified clearing agency account, this provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a contract from a bank where it maintains a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(4)(iii) of proposed new Rule 18a–4.

[704] *See* paragraph (a)(4)(iv) of proposed new Rule 18a–4.

[705] *See* paragraph (a)(6) of proposed new Rule 18a–4 (excluding persons who subordinate their claims against the SBSD to all other creditors from the definition of security-based swap customer).

[706] *See* paragraph (b)(2) of proposed new Rule 18a–4.

[707] *Compare* 17 CFR 240.15c3–3(c), *with* paragraph (b)(2) of proposed new Rule 18a–4. Rule 15c3–3 identifies two control locations that the Commission is not proposing be identified in proposed new Rule 18a–4. First, paragraph (c)(2) of Rule 15c3–3 identifies as a control location ''a special omnibus account in the name of such broker or dealer with another broker or dealer in compliance with the requirements of section 4(b) of Regulation T under the Act (12 CFR 220.4(b)), such securities being deemed to be under the control of such broker or dealer to the extent that he has instructed such carrying broker or dealer to maintain physical possession or control of them free of any charge, lien, or claim of any kind in favor of such carrying broker or dealer or any persons claiming through such carrying broker or dealer.'' *See* 17 CFR 240.15c3–3(c)(2). Stand-alone SBSDs are not expected to maintain such accounts. Second, Rule 15c3–3 identifies as a control location ''a foreign depository, foreign clearing agency or foreign custodian bank which the Commission upon application from a broker or dealer, a registered national securities exchange or a registered national securities association, or upon its own motion shall designate as a satisfactory control location for securities.'' *See* 17 CFR 240.15c3–3(c)(4). *See also Interpretative Release: Guidelines for Control Locations for Foreign Securities,* Exchange Act Release No. 10429 (Oct. 12, 1973), 38 FR 29217, 29217 (Oct. 23, 1973). As discussed below, the last control location identified in Rule 15c3–3 and proposed to be identified in new Rule 18a–4 is such other location ''as the Commission shall upon application from a broker or dealer find and designate to be adequate for the protection of customer securities.'' *See* 17 CFR 240.15c3–3(c)(7) and paragraph (b)(2)(v) of proposed new Rule 18a–4. Under the Commission's proposal, SBSDs seeking to have a foreign depository, foreign clearing agency, or foreign custodian bank identified as a satisfactory control location would need to apply to the Commission under paragraph (b)(2)(v) of proposed new Rule 18a–4.

[708] *See* paragraph (b)(2)(i) of proposed new Rule 18a–4. This provision is modeled on paragraph (c)(1) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(c)(1), *with* paragraph (b)(2)(i) of proposed new Rule 18a–4.

received a written statement by the issuer or its transfer agent acknowledging the transfer instructions and the possession of the securities and money market instruments, or the security-based swap dealer has not obtained a revalidation of a window ticket from a transfer agent with respect to the certificate delivered for transfer; [709]

- Are in the custody or control of a bank as defined in section 3(a)(6) of the Act, the delivery of which securities and money market instruments to the SBSD does not require the payment of money or value and the bank having acknowledged in writing that the securities and money market instruments in its custody or control are not subject to any right, charge, security interest, lien or claim of any kind in favor of a bank or any person claiming through the bank; [710]
- Are held in or are in transit between offices of the SBSD; or are held by a corporate subsidiary if the SBSD owns and exercises a majority of the voting rights of all of the voting securities of such subsidiary, assumes or guarantees all of the subsidiary's obligations and liabilities, operates the subsidiary as a branch office of the SBSD, and assumes full responsibility for compliance by the subsidiary and all of its associated persons with the provisions of the Federal securities laws as well as for all of the other acts of the subsidiary and such associated persons; [711] or
- Are held in such other locations as the Commission shall upon application from an SBSD find and designate to be adequate for the protection of customer securities. [712]

The identification of these locations as satisfactory control locations is designed to limit where the SBSD can hold *excess securities collateral.* The identified locations are places from which the securities and money market instruments can promptly be retrieved and returned to the security-based swap customers.

Paragraph (b)(3) of Rule 18a–4 would require that each business day the SBSD must determine from its books and records the quantity of *excess securities collateral* that the firm had in possession and control as of the close of the previous business day and the quantity of *excess securities collateral* the firm did not have in possession or control on that day. [713] The paragraph would provide further that the SBSD must take steps to retrieve *excess securities collateral* from certain specifically identified non-control locations if securities and money market instruments of the same issue and class are at these locations. [714] Specifically, paragraph (b)(3) would provide that if securities or money market instruments of the same issue and class are:

- Subject to a lien securing an obligation of the SBSD, then the SBSD, not later than the next business day on which the determination is made, must issue instructions for the release of the securities or money market instruments from the lien and must obtain physical possession or control of the securities and money market instruments within two business days following the date of the instructions; [715]
- Held in a qualified clearing agency account, then the SBSD, not later than the next business day on which the determination is made, must issue instructions for the release of the securities or money market instruments by the clearing agency and must obtain physical possession or control of the securities or money market instruments within two business days following the date of the instructions; [716]
- Held in a qualified SBSD account maintained by another SBSD, then the SBSD, not later than the next business day on which the determination is made, must issue instructions for the release of the securities and money market instruments by the other SBSD and must obtain physical possession or control of the securities or money market instruments within two business days following the date of the instructions; [717]
- Loaned by the SBSD, then the SBSD, not later than the next business day on which the determination is made, must issue instructions for the return of the loaned securities and money market instruments and must obtain physical possession or control of the securities or money market instruments within five business days following the date of the instructions; [718]
- Failed to receive more than 30 calendar days, then the SBSD, not later than the next business day on which the determination is made, must take prompt steps to obtain physical possession or control of the securities or money market instruments through a buy-in procedure or otherwise; [719]
- Receivable by the SBSD as a security dividend, stock split or similar distribution for more than 45 calendar days, then the SBSD, not later than the next business day on which the determination is made, must take

[709] *See* paragraph (b)(2)(ii) of proposed new Rule 18a–4. This provision is modeled on paragraph (c)(3) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(c)(3), *with* paragraph (b)(2)(ii) of proposed new Rule 18a–4.

[710] *See* paragraph (b)(2)(iii) of proposed new Rule 18a–4. This provision is modeled on paragraph (c)(5) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(c)(5), *with* paragraph (b)(2)(iii) of proposed new Rule 18a–4.

[711] *See* paragraph (b)(2)(iv) of proposed new Rule 18a–4. This provision is modeled on paragraph (c)(6) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(c)(6), *with* paragraph (b)(2)(iv) of proposed new Rule 18a–4.

[712] *See* paragraph (b)(2)(v) of proposed new Rule 18a–4. This provision is modeled on paragraph (c)(7) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(c)(7), *with* paragraph (b)(2)(v) of proposed new Rule 18a–4. *See Guidelines for Control Locations for Foreign Securities,* Exchange Act Release No. 10429 (Oct. 12, 1973, 38 FR 29217 (Oct. 23, 1973) (prescribing the process under Rule 15c3–3 for a broker-dealer to apply to the Commission to utilize a foreign control location). Among other things, certain conditions must be met for the foreign control location to be deemed satisfactory. A broker-dealer must represent in an application to the Commission that the conditions are satisfied. An application submitted shall be considered accepted unless the Commission rejects the application within 90 days of receipt by the Commission. *Id.*

[713] *See* paragraph (b)(3) of proposed new Rule 18a–4. The provisions in this paragraph are modeled on the provisions in paragraph (d) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(d), *with* paragraph (b)(3) of proposed new Rule 18a–4.

[714] *See* paragraph (b)(3) of proposed new Rule 18a–4.

[715] *See* paragraph (b)(3)(i) of proposed new Rule 18a–4. This provision is modeled on paragraph (d)(1) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(d)(1), *with* paragraph (b)(3)(i) of proposed new Rule 18a–4.

[716] *See* paragraph (b)(3)(ii) of proposed new Rule 18a–4. As discussed above, securities held in a qualified clearing agency account are not *excess securities collateral,* but only to the extent the securities are being used to meet a margin requirement of the clearing agency resulting from a security-based swap transaction of the customer. *See* paragraph (a)(2)(i) of proposed new Rule 18a–4. Consequently, if securities held in a qualified clearing agency account are not necessary to meet a margin requirement of the clearing agency, they would be *excess securities collateral* and the SBSD would need to move them to a satisfactory control location.

[717] *See* paragraph (b)(3)(iii) of proposed new Rule 18a–4. As discussed above, securities held in a qualified SBSD account are not *excess securities collateral* but only to the extent the securities are being used to meet a margin requirement of the other SBSD resulting from the SBSD entering into a non-cleared security-based swap transaction with the other SBSD to offset the risk of a non-cleared security-based swap transaction between the SBSD and the customer. *See* paragraph (a)(2)(ii) of proposed new Rule 18a–4. Consequently, if securities held in a qualified clearing agency account are not necessary to meet a margin requirement of the other SBSD and/or are not collateralizing a transaction that offsets the risk of n non-cleared security-based swap with the customer, they would be *excess securities collateral* and the SBSD would need to move them to a satisfactory control location.

[718] *See* paragraph (b)(3)(iv) of proposed new Rule 18a–4. This provision is modeled on paragraph (d)(1) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(d)(1), *with* paragraph (b)(3)(iv) of proposed new Rule 18a–4.

[719] *See* paragraph (b)(3)(v) of proposed new Rule 18a–4. This provision is modeled on paragraph (d)(2) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(d)(2), *with* paragraph (b)(3)(v) of proposed new Rule 18a–4.

prompt steps to obtain physical possession or control of the securities or money market instruments through a buy-in procedure or otherwise;[720] or

• Included on the books or records of the SBSD as a proprietary short position or as a short position for another person more than 10 business days (or more than 30 calendar days if the SBSD is a market maker in the securities), then the SBSD must, not later than the business day following the day on which the determination is made, take prompt steps to obtain physical possession or control of such securities or money market instruments.[721]

Request for Comment

The Commission generally requests comment on the proposed physical possession and control requirements in proposed new Rule 18a–4. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are possession and control requirements modeled on Rule 15c3–3 appropriate for security-based swaps? If not, explain why not.

2. Is the proposed definition of *security-based swap customer* appropriate? If not, explain why not and suggest modifications to the definition.

3. Is the proposed definition of *excess securities collateral* appropriate? If not, explain why not and suggest modifications to the definition.

4. Is the proposed exception in the definition of *excess securities collateral* for securities and money market instruments held in a qualified clearing agency account appropriate? If not, explain why not. Would this proposed exception raise practical or legal issues? If so, explain why.

5. Is the proposed definition of *qualified clearing agency account* appropriate? If not, explain why not and suggest modifications to the definition.

6. Is the proposed exception in the definition of *excess securities collateral* for securities and money market instruments held in a *qualified registered security-based swap dealer account* appropriate? If not, explain why not. Would this proposed exception raise practical or legal issues? If so, explain why.

7. Is the proposed definition of *qualified registered security-based swap dealer account* appropriate? For example, is the condition that the qualified registered security-based swap dealer account not be held by an affiliate of the SBSD appropriate? If the definition is not appropriate, explain why not and suggest modifications to the definition.

8. How do dealers in OTC derivatives that will be security-based swaps use offsetting transactions to hedge the risk of these positions? Would the proposed possession and control requirements for non-cleared security-based swaps adversely affect the ability of SBSDs to enter into hedging transactions? If so, explain why and suggest modifications to the requirements that could address this issue.

9. Are the control locations identified in proposed new Rule 18a–4 appropriate for security-based swaps? If not, explain why not. Should the two additional control locations in paragraphs (c)(2) and (c)(4) of Rule 15c3–3 that are not being incorporated into proposed new Rule 18a–4 be included in the rule? If so, explain why.

10. Should the process for applying to the Commission to have a location designated to be adequate for the protection of customer securities and money market instruments under paragraph (b)(2)(v) of proposed new Rule 18a–4 be similar to the current process for a broker-dealer to utilize a foreign control location under Rule 15c3–3 (*i.e.,* a process in which the SBSD must submit an application representing that certain conditions are met and in which an application is deemed accepted if not specifically rejected by the Commission within 90 days)? Alternatively, should the Commission be required to formally act on each application through the issuance of an order?

11. Are the steps in paragraph (b)(3) of proposed new Rule 18a–4 that an SBSD would be required to take to move securities and money market instruments from non-control locations to control locations appropriate for security-based swaps? If not, explain why not.

12. Are there any possession and control provisions in Rule 15c3–3 that are not being incorporated in proposed new Rule 18a–4 that should be included in the rule? If so, identify them and explain why they should be incorporated into proposed new Rule 18a–4.

b. Security-Based Swap Customer Reserve Account

Paragraph (c)(1) of Rule 18a–4 would require an SBSD, among other things, to maintain a *special account for the exclusive benefit of security-based swap customers* separate from any other bank account of the SBSD.[722] The term *special account for the exclusive benefit of security-based swap customers* (''Rule 18a–4 Customer Reserve Account'') would be defined to mean an account at a bank that is not the SBSD or an affiliate of the SBSD and that meets the following conditions:

• The account is designated ''Special Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of the SBSD]'';[723]

• The account is subject to a written acknowledgement by the bank provided to and retained by the SBSD that the funds and other property held in the account are being held by the bank for the exclusive benefit of the security-based swap customers of the SBSD in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the SBSD with the bank;[724] and

• The account is subject to a written contract between the SBSD and the bank which provides that the funds and other property in the account shall at no time be used directly or indirectly as security for a loan or other extension of credit to the SBSD by the bank and, shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank.[725]

[720] *See* paragraph (b)(3)(vi) of proposed new Rule 18a–4. This provision is modeled on paragraph (d)(3) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(d)(3), *with* paragraph (b)(3)(vi) of proposed new Rule 18a–4.

[721] *See* paragraph (b)(3)(vii) of proposed new Rule 18a–4. This provision is modeled on a proposed amendment to Rule 15c3–3 that is still pending. *See Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR at 12895. The provisions of paragraph (b)(3)(vii) of proposed new Rule 18a–4 are intended to achieve the same objectives of the proposed amendments to Rule 15c3–3. *See id.* at 12865–66 (explaining the basis for the proposed amendment to Rule 15c3–3).

[722] *See* paragraph (c) of proposed new Rule 18a–4. The provisions of paragraph (c) of proposed new Rule 18a–4 are modeled on paragraph (e) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (c) of proposed new Rule 18a–4.

[723] *See* paragraph (a)(7)(i) of proposed new Rule 18a–4. Similar to the proposed conditions for a qualified clearing agency account and a qualified SBSD account, this provision is modeled on paragraph (e)(1) of Rule 15c3–3, which requires a broker-dealer to maintain a ''Special Reserve Bank Account for the Exclusive Benefit of Customers'' (the ''Rule 15c3–3 Customer Reserve Account''). *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (a)(7)(i) of proposed new Rule 18a–4.

[724] *See* paragraph (a)(7)(ii) of proposed new Rule 18a–4. Similar to the proposed conditions for a qualified clearing agency account and a qualified SBSD account, this provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a written notification from a bank where it maintains a Rule 15c3–3 Customer Reserve Account. *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(7)(ii) of proposed new Rule 18a–4.

[725] *See* paragraph (a)(7)(iii) of proposed new Rule 18a–4. Similar to the proposed conditions for a qualified clearing agency account and a qualified SBSD account, this provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a written contract from a bank where it maintains a ''Special Reserve Bank

These conditions are largely identical to the conditions for a qualified clearing agency account and qualified SBSD account and are similarly designed to ensure that cash and qualified securities deposited into the special bank account (as discussed below) are isolated from the proprietary assets of the SBSD and identified as property of the security-based swap customers.

Paragraph (c)(1) of proposed new Rule 18a–4 would provide that the SBSD must at all times maintain in a Rule 18a–4 Customer Reserve Account, through deposits into the account, cash and/or qualified securities in amounts computed in accordance with the formula set forth in Exhibit A to Rule 18a–4.[726] The formula in Exhibit A to proposed new Rule 18a–4 is modeled on the formula in Exhibit A to Rule 15c3–1, which requires a broker-dealer to add up various credit items and debit items.[727] The credit items include credit balances in customer accounts and funds obtained through the use of customer securities.[728] The debit items include money owed by customers (*e.g.,* from margin lending), securities borrowed by the broker-dealer to effectuate customer short sales, and required margin posted to certain clearing agencies as a consequence of customer securities transactions.[729] If, under the formula, customer credit items exceed customer debit items, the broker-dealer must maintain cash and/or qualified securities in that net amount in a Rule 15c3–3 Customer Reserve Account.

The formula in Exhibit A for determining the amount to be maintained in a Rule 18a–4 Customer Reserve Account similarly would require an SBSD to add up credit items and debit items.[730] If, under the formula, the credit items exceed the debit items, the SBSD would be required to maintain cash and/or qualified securities in that net amount in a Rule 18a–4 Customer Reserve Account.[731] The credit and debit items identified in Exhibit A to proposed new Rule 18a–4 are the same as the credit and debit items in Exhibit A to Rule 15c3–1, though Exhibit A to proposed new Rule 18a–4 would identify two additional debit items.[732] As discussed above, SBSDs will be required to deliver collateral to meet margin requirements of clearing agencies arising from cleared security-based swap transactions of their customers. In addition, SBSDs may deliver collateral to other SBSDs to meet margin requirements under proposed new Rule 18a–3 and, possibly, to meet ''house'' margin requirements of the other SBSD with respect to non-cleared security-based swaps the SBSD is using to hedge the risk of customer non-cleared security-based swaps. Consequently, Exhibit A to proposed new Rule 18a–4 would identify the following debit items that are not identified in Exhibit A to Rule 15c3–3:

- Margin related to cleared security-based swap transactions in accounts carried for security-based swap customers required and on deposit at a clearing agency registered with the Commission pursuant to section 17A of the Exchange Act (15 U.S.C. 78q–1); and
- Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers held in a qualified registered SBSD account at another SBSD.

These debit items would serve the same purpose as the debit items in Exhibit A to Rule 15c3–3 that identify margin required and on deposit at the Options Clearing Corporation, a registered clearing agency, and a DCO.[733]

If the total credits exceed the total debits, an SBSD would need to maintain that amount on deposit in a Rule 18a–4 Customer Reserve Account in the form of funds and/or qualified securities.[734] An SBSD would be permitted under the proposed rule to use qualified securities to meet this account deposit requirement to implement section 3E(d) of the Exchange Act.[735] Section 3E(d) provides that money of security-based swap customers received by an SBSD to margin, guarantee, or secure a cleared security-based swap may be invested in obligations of the United States, obligations fully guaranteed as to principal and interest by the United States, general obligations of a State or any subdivision of a State (''municipal securities''), and in any other investment that the Commission may by rule or regulation prescribe.[736] Section 3E(d) further provides that such investments shall be made in accordance with such rules and regulations and subject to such conditions as the Commission may prescribe.[737]

The term *qualified security* as used in proposed new Rule 18a–4 would be defined to mean: (1) Obligations of the United States; (2) obligations fully guaranteed as to principal and interest by the United States; and (3) general obligations of any State or subdivision of a State that are not traded flat or are not in default, were part of an initial offering of $500 million or greater, and were issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year-end.[738] Rule 15c3–3 contains a similar definition of *qualified security,* except the definition does not include municipal securities.[739]

While section 3E(d) of the Exchange Act permits the use of municipal

Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(7)(iii) of proposed new Rule 18a–4.

[726] *See* paragraph (c)(1) of proposed new Rule 18a–4; Exhibit A to proposed new Rule 18a–4.

[727] *Compare* 17 CFR 240.15c3–3a, *with* Exhibit A to proposed new Rule 18a–4.

[728] *See* 17 CFR 240.15c3–3a, Items 1–9. Broker-dealers are permitted to use customer margin securities to, for example, obtain bank loans to finance the funds used to lend to customers to purchase the securities. The amount of the bank loan is a credit in the formula because this is the amount that the broker-dealer would need to pay the bank to retrieve the securities. Similarly, broker-dealers may use customer margin securities to make stock loans to other broker-dealers in which the lending broker-dealer typically receives cash in return. The amount payable to the other broker-dealer on the stock loan is a credit in the formula because this is the amount the broker-dealer would need to pay the other broker-dealer to retrieve the securities.

[729] *See* 17 CFR 240.15c3–3a, Items 10–14. Item 13 identifies as a debit item margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in accounts of securities customers. *See* 17 CFR 240.15c3–3a, Item 13. Similarly, Item 14 identifies as a debit item margin related to security futures products written, purchased, or sold in accounts carried for security-based swap customers required and on deposit with a clearing agency registered with the Commission under section 17A of the Exchange Act (15 U.S.C. 78q–1) or a DCO registered with the CFTC under section 5b of the CEA (7 U.S.C. 78q–1). These debits reflect the fact that customer options and security futures transactions that are cleared generate margin requirements in which the broker-dealer must deliver collateral to the Options Clearing Corporation in the case of options or a clearing agency or DCO in the case of security futures products. Identifying the collateral delivered to the Options Clearing Corporation, a clearing agency, or a DCO as a debit item permits the broker-dealer to use customer cash or securities to meet margin requirements generated by customer transactions.

[730] *See* proposed new Rule 18a–4a. Exhibit A to Rule 15c3–3 has a number of ''Notes'' that provide further explanation of the credit and debit items. *See* 17 CFR 240.15c3–3a, Notes A–G. Exhibit A to proposed new Rule 18a–4 would have substantially similar notes. *See* Notes A–G to Exhibit A to proposed new Rule 18a–4.

[731] As discussed above, the account would need to be at a bank that is not the SBSD or an affiliate of the SBSD and that meets certain additional conditions. *See* paragraph (a)(7) of proposed new Rule 18a–4.

[732] *Compare* 17 CFR 240.15c3–3a, *with* Exhibit A to proposed new Rule 18a–4.

[733] *See* 17 CFR 240.15c3–3a, Items 13–14.

[734] *See* paragraph (c)(1) of proposed new Rule 18a–4.

[735] 15 U.S.C. 78c–5(d).

[736] *Id.*

[737] *Id.*

[738] *See* paragraph (a)(5) of proposed new Rule 18a–4.

[739] *See* 17 CFR 240.15c3–3(a)(6) (defining the term *qualified security* to mean a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States).

securities, the rule imposes conditions on their use designed to ensure that only municipal securities with the most reliable valuations—and therefore greater safety and liquidity—are permitted to meet the Rule 18a–4 Customer Reserve Account funding requirement in paragraph (c)(1) of proposed new Rule 18a–4 (consistent with the objective of the current definition of ''qualified security'' in Rule 15c3–3).[740] Because of the diversity and breadth of the municipal market, the availability of issuer information and the related ability to value and trade a particular municipal security can vary considerably.[741] The objective of segregation requirements is to isolate customer assets from a firm's proprietary business and, therefore, enable the firm to quickly return the assets to the customers if the firm fails. Rule 15c3–3 limits the definition of qualified securities to U.S. government securities to ensure that securities deposited in a customer reserve account can be liquidated quickly at current market values even in stressed market conditions. The proposed conditions for depositing municipal securities into the SBSD's Rule 18a–4 Customer Reserve Account are designed to help ensure that only securities that are likely to have significant issuer information available and that can be valued and liquidated quickly at current market values are permitted to meet the minimum account deposit requirement.[742]

The first proposed condition for municipal securities is that they must be general obligation bonds. General obligation bonds are backed by the full faith and credit and/or taxing authority of the issuer.[743] They normally are issued to finance non-revenue producing public works projects (*e.g.,* schools and roads) and generally are paid off with funds from taxes or fees. Issuers typically have the ability to raise taxes in order to service the debt obligations of these municipal securities. In contrast, revenue bonds are issued to fund projects that will eventually generate revenue (*e.g.,* a toll road). The anticipated revenue is used to make payments of principal and interest owing on the bonds. Revenue bonds generally do not permit the bondholders to compel taxation or legislative appropriation of funds not pledged for the purpose of servicing the debt obligations of these municipal securities.[744] Consequently, the creditworthiness of revenue bonds depends on the success of the project being financed, whereas the creditworthiness of general obligation bonds ultimately depends on the taxing authority of the issuer. Therefore, general obligation bonds tend to have lower rates of default than other types of municipal securities.[745] In order to limit the use of municipal securities in the Rule 18a–4 Customer Reserve Account to the most creditworthy instruments,[746] the proposed definition of *qualified security* would limit the use of municipal securities to general obligation bonds.

The second proposed condition for the use of municipal securities is that they must be part of an initial offering of $500 million or greater. The size of the initial offering is an indication of the size of the market for a particular issuer's municipal securities. Additionally, the secondary market for a municipal security is generally smaller than for the initial offering.[747] The $500 million threshold is designed to be large enough to ensure that the market for a particular issuer's securities is large enough that the securities can be liquidated quickly and at their current market price in order to raise cash to return to an SBSD's customers.

The third proposed condition for the use of municipal securities is that they must be issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year-end.[748] Prices for municipal securities issued by issuers that have published relatively current information about their financial condition may tend to be more transparent than prices for municipal securities issued by issuers for which such financial information is not available, because investors and analysts have more current information to assess the creditworthiness of the issuer and to inform pricing decisions.[749]

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[740] *See* paragraphs (a)(5)(iii)(A)–(C) of proposed new Rule 18a–4.

[741] Despite its size and importance, the municipal securities market has not been subject to the same level of regulation as other sectors of the U.S. capital markets. *See* Commission, *Report on the Municipal Securities Market* (July 31, 2012) (''*Municipal Securities Report''*), available at *http://www.sec.gov/news/studies/2012/munireport073112.pdf.* The *Municipal Securities Report* notes concerns about access to issuer information; the presentation and comparability of information; and the existence/adequacy of disclosure controls and procedures. *Id.* at iv, 108–09. For example, the *Municipal Securities Report* notes that studies have shown that disclosure of audited annual financial statements by many municipal issuers is particularly slow. *Id.* at 76. By the time annual financial statements are filed or otherwise publicly available, many municipal market analysts and investors believe that the financial information has diminished usefulness or has lost relevance in assessing the current financial position of a municipal issuer. *Id.* Correspondingly, weaker or more distressed entities are more likely to have later audit completion times. *Id.* In addition, the *Municipal Securities Report* notes that although there have been improvements in the availability of pricing information about completed trades (*i.e.,* post-trade information), the secondary market for municipal securities remains opaque. Investors have very limited access to information regarding which market participants would be interested in buying or selling a municipal security, and at which prices (*i.e.,* pre-trade information). *Id.* at vi, 115.

[742] *See Municipal Securities Report* at 113–115 (recognizing the municipal securities market's ''relatively low liquidity'' and the ''relatively opaque'' pre-trade information about municipal securities' prices).

[743] *See Municipal Securities Report* at 7.

[744] *Id.*

[745] *See, e.g.,* Moody's Investor Services (''Moody's''), *Special Comment: U.S. Municipal Bonds Defaults and Recoveries, 1970–2011,* at 1 (Mar. 7, 2012), available at *http://www.moodys.com/research documentcontentpage.aspx?docid=PBC_140114. See also Municipal Securities Report,* at 7 (noting reports indicate that a majority of defaults in the municipal securities market are in conduit revenue bonds issued for nongovernmental purposes, such as multi-family housing, healthcare (hospitals and nursing homes), and industrial development bonds (for economic development and manufacturing purposes).

[746] *See* Fitch Ratings (''Fitch''), *Default Risk and Recovery Rates on U.S. Municipal Bonds,* note 116, at 1 (Jan. 9, 2007), available at *http://www.cdfa.net/cdfa/cdfaweb.nsf/ordredirect.html?open&id=fitchdefaultreport.html* Fitch is not aware of any state or local municipality of size that has experienced a permanent or extended default on its general obligation bonds since the Great Depression, so that in one of its studies, Fitch assumed a 100% recovery rate on general obligation bonds). *Id. See also* Moody's, *Special Comment: Moody's US Municipal Bond Rating Scale,* 11 (Nov. 2002), available at *http://www.moodys.com/sites/products/DefaultResearch/2001700000407258.pdf.* Similarly, Moody's acknowledged the ''anticipated near 100% recovery rate on any defaulted general obligation bond,'' because there have been no defaults among Moody's-rated issuers of general obligation bonds since at least 1970. *Id.*

[747] While almost all municipal bonds trade in the first month following the initial offering, only 15% trade in the second month, and even fewer trade in subsequent months. *Municipal Securities Report* at 113–14 (citing Richard C. Green, Burton Hollifield and Normal Schürhoff, *Financial Intermediation and the Costs of Trading in an Opaque Market,* 20 Rev. Fin. Stud. 275, 282 (2007)).

[748] *See, e.g., Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to Additional Voluntary Submissions by Issuers to the MSRB's Electronic Municipal Market Access System (''EMMA®''),* Exchange Act Release No. 62183 (May 26, 2010), 75 FR 30876 (June 2, 2010) (''MSRB Rule Filing''). The MSRB stated that, ''issuers that seek to make their financial information available under the voluntary annual filing undertaking also would be bringing the timing of their disclosures into closer conformity with the timeframes that investors in the registered securities market have come to rely upon.'' *Id.* at 30882.

[749] *See* MSRB Notice 2010–15 (June 2, 2010), available at *http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010–15.aspx?n=1* (requesting voluntary submissions of audited financial statements within 120 calendar days of the fiscal year-end, or as a transitional alternative available through December 31, 2013, within 150 calendar days of the fiscal year-end). Timely financial reporting ''is critical to the

As discussed above, an SBSD would be required to add up credit items and debit items pursuant to the formula in Exhibit A to proposed new Rule 18a–1. If, under the formula, the credit items exceed the debit items, the SBSD would be required to maintain cash and/or qualified securities in that net amount in the Rule 18a–4 Customer Reserve Account. Paragraph (c)(1) of proposed new Rule 18a–4 would require an SBSD to take certain deductions for purposes of this requirement.[750] The amount of cash and/or qualified securities in the Rule 18a–4 Customer Reserve Account would need to equal or exceed the amount required pursuant to the formula in Exhibit A to proposed new Rule 18a–1*after* applying the deductions.

First, the SBSD would need to deduct the percentage of the value of municipal securities specified in paragraph (c)(2)(vi) of Rule 15c3–1.[751] Paragraph (c)(2)(vi) of Rule 15c3–1 prescribes the standardized haircuts a broker-dealer must apply to municipal securities when computing net capital. For the purposes of proposed new Rule 18a–4, the SBSD would need to apply the standardized haircuts to municipal securities held in the Rule 18a–4 Customer Reserve Account even if the firm is approved to use VaR models for purposes of computing its net capital under Appendix E to Rule 15c3–1, as proposed to be amended, or proposed new Rule 18a–1. The purpose of these deductions would be to account for potential market losses that may be incurred when municipal securities held in a Rule 18a–4 Customer Reserve Account are liquidated to return funds to security-based swap customers.

Second, the SBSD would need to deduct the aggregate value of the municipal securities of a single issuer to the extent the value exceeds 2% of the amount required to be maintained in the Rule 18a–4 Customer Reserve Account. The Commission preliminarily believes that this deduction would serve as a reasonable benchmark designed to avoid the potential that the SBSD might use customer funds to establish a concentrated position in municipal securities of a single issuer. A concentrated position could be more difficult to liquidate at current market values.

Third, the SBSD would need to deduct the aggregate value of all municipal securities to the extent the amount of the securities exceeds 10% of the amount required to be maintained in the Rule 18a–4 Customer Reserve Account. The Commission preliminarily believes that this deduction would serve as a reasonable benchmark designed to limit the amount of customer funds an SBSD could invest in municipal securities.[752] As noted above, the segregation provisions are designed to prevent an SBSD from using customer property for proprietary business purposes such as paying expenses. The purpose of the deposits into the Rule 18a–4 Customer Reserve Account is to create a reserve to protect the funds of security-based swap customers. The deposits are not intended as a means for the SBSD to earn investment returns by, for example, establishing positions in higher yielding municipal securities. The 10% threshold is designed to limit the ability of the SBSD to use the Rule 18a–4 Customer Reserve Account deposit requirement to invest in municipal securities, for the purpose of obtaining higher yields than U.S. government securities.

Fourth, the SBSD would be required to deduct the amount of funds held in a Rule 18a–4 Customer Reserve Account at a single bank to the extent the amount exceeds 10% of the equity capital of the bank as reported by the bank in its most recent Consolidated Report of Condition and Income (''Call Report'').[753] This provision is consistent with a pending proposed amendment to Rule 15c3–3.[754] As the Commission stated when proposing the amendment to Rule 15c3–3:

> Broker-dealers must deposit cash or ''qualified securities'' into the customer reserve account maintained at a ''bank'' under Rule 15c3–3(e). Rule 15c3–3(f) further requires the broker-dealer to obtain a written contract from the bank in which the bank agrees not to re-lend or hypothecate securities deposited into the reserve account. Consequently, the securities should be readily available to the broker-dealer. Cash deposits, however, are fungible with other deposits carried by the bank and may be freely used in the course of the bank's commercial lending activities. Therefore, to the extent a broker-dealer deposits cash in a reserve bank account, there is a risk the cash could be lost or inaccessible for a period if the bank experiences financial difficulties. This could adversely impact the broker-dealer and its customers if the balance of the reserve deposit is concentrated at one bank in the form of cash.[755]

The deduction in proposed new Rule 18a–4 is designed to address the same risk to SBSDs that the Commission identified with respect to concentrating in a single bank cash deposits in a customer reserve account maintained under Rule 15c3–1.

Paragraph (c)(2) of proposed new Rule 18a–4 would provide that it is unlawful for an SBSD to accept or use credits identified in the items of the formula set forth in Exhibit A to proposed new Rule 18a–4 except to establish debits for the specified purposes in the items of the formula.[756] This provision would prohibit the SBSD from using customer cash and cash realized from the use of customer securities for purposes other than those identified in the debit items in Exhibit A to proposed new Rule 18a–4. Thus, the SBSD would be prohibited from using customer cash to, for example, pay expenses.

Paragraph (c)(3) of proposed new Rule 18a–4 would provide that the computations necessary to determine the amount required to be maintained in the Rule 18a–4 Customer Reserve Account must be made daily as of the close of the previous business day and any deposit required to be made into the account must be made on the next business day following the computation no later than one hour after the opening of the bank that maintains the account.[757] Paragraph (c)(3) also would provide that the SBSD may make a

functioning of an efficient trading market,'' especially since bond ratings are only updated when a significant change is about to occur, and credit reports represent a costly alternative. *Municipal Securities Report* at 74 (citing Jeff L. Payne and Kevin L. Jensen, *An Examination of Municipal Audit Delay,* J. Acc. & Pub. Pol'y, Vol. 21, Issue 1, 3 (2002)).

[750] *See* paragraph (c)(1) of proposed new Rule 18a–4.

[751] *See* 17 CFR 240.15c3–1(c)(2)(vi)(B).

[752] *Compare* to Rule 15c3–1(c)(2)(vi)(M)(*1*) (imposing undue concentration charges on certain securities in the proprietary account of a broker-dealer whose market value exceeds more than 10% of the ''net capital'' of a broker-dealer before application of haircuts).

[753] With the passage of the Dodd-Frank Act, the supervision of savings associations was transferred from the Office of Thrift Supervision to the OCC for federal savings associations and to the FDIC for state savings associations on the ''transfer date,'' which is defined as one year after enactment of the Dodd-Frank Act, subject to an additional six month extension. *See* section Public Law 111–203 §§ 300–378. *See also List of OTS Regulations to be Enforced by the OCC and the FDIC Pursuant to the Dodd-Frank Act,* OCC, FDIC, 76 FR 39246 (July 6, 2011). Supervision of savings and loan holding companies and their subsidiaries (other than depository institutions) was transferred from the OTS to the Federal Reserve. Therefore, in February 2011, the OTS, the OCC, and the FDIC proposed to require, ''savings associations currently filing the Thrift Financial Report to convert to filing the Consolidated Reports of Condition and Income or Call Reports beginning with the reporting period ending on March 31, 2012.'' *Proposed Agency Information Collection Activities; Comment Request,* 76 FR 7082, 7082 (Feb. 8, 2011).

[754] *Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR at 12864.

[755] *Id.*

[756] *See* paragraph (c)(2) of proposed new Rule 18a–4. This provision is modeled on paragraph (e)(2) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(e)(2), *with* paragraph (c)(2) of proposed new Rule 18a–4.

[757] *See* paragraph (c)(3) of proposed new Rule 18a–4.

withdrawal from the Rule 18a–4 Customer Reserve Account only if the amount remaining in the account after the withdrawal is equal to or exceeds the amount required to be maintained in the account.[758]

Proposed new Rule 18a–4 would require a daily computation as opposed to the weekly computation that is required by Rule 15c3–3. The margin requirements of clearing agencies and other SBSDs for security-based swaps are expected generally to be determined on a daily basis, which will require SBSDs to deliver collateral to, and receive the return of collateral from, clearing agencies and other SBSDs on a daily basis.[759] If the Rule 18a–4 Customer Reserve Account computation were performed on a weekly basis, the SBSD might need to fund margin requirements relating to customer security-based swaps using its own funds for up to a week because the customer cash necessary to meet the requirement is ''locked up'' in the Rule 18a–4 Customer Reserve Account and cannot be withdrawn for a number of days, which could cause liquidity strains on the SBSD.

Finally, paragraph (c)(4) of proposed new Rule 18a–4 would require an SBSD to promptly deposit funds or qualified securities into a Rule 18a–4 Customer Reserve Account of the SBSD if the amount of funds and/or qualified securities held in one or more Rule 18a–4 Customer Reserve Accounts falls below the amount required to be maintained pursuant to the rule.[760] This proposal is designed to require an SBSD to use its own resources to fund the deposit requirement if there is a shortfall in the amount of cash or qualified securities maintained in its Rule 18a–4 Customer Reserve Account.

Request for Comment

The Commission generally requests comment on the requirements for the Rule 18a–4 Customer Reserve Account in proposed new Rule 18a–4. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Are Rule 18a–4 Customer Reserve Account requirements modeled on Rule 15c3–3 appropriate for security-based swaps? If not, explain why not.

2. Is the proposed definition of *special account for the exclusive benefit of security-based swap customers* appropriate? If not, explain why not and suggest modifications to the definition.

3. Are the proposed credit and debit items in Exhibit A to proposed new Rule 18a–4 appropriate? If not, explain why not. Are there alternative or additional credit and debit items that should be included in the formula? If so, describe them and explain why they should be included in the formula.

4. How would the formula computation for a broker-dealer SBSD differ from the formula computation for a stand-alone SBSD? For example, the debit items relating to financing securities transactions would not apply to stand-alone SBSDs as financing securities transactions would need to be conducted in a broker-dealer. Consequently, should there be a separate Exhibit A formula for stand-alone SBSDs?

5. Are the two additional debit items in Exhibit A to proposed new Rule 18a–4 relating to margin collateral required and on deposit at clearing agencies, DCOs, and other SBSDs appropriate? If not, explain why not.

6. Note G to Exhibit A to proposed new Rule 18a–4 is analogous to Note G to Exhibit A to Rule 15c3–3. Note G to Exhibit A to Rule 15c3–3 prescribes (and Note G to Exhibit A to proposed new Rule 18a–1 would prescribe) the conditions for when a clearing agency or DCO can qualify for purposes of including debits in the reserve formula under Item 14 (margin related to security futures products). Should these conditions apply to when a clearing agency would qualify for purposes of including debits in the Rule 18a–4 Customer Reserve Account formula under Item 15? If so, explain why. If not, explain why not. For example, could the Note G conditions, if applied to Item 15, be used instead of the proposed definition of *qualified clearing agency account* in proposed new Rule 18a–4? Would the Note G conditions be a workable alternative to the proposed definition? Would the Note G conditions achieve the same customer protection objectives as the proposed definition?

7. Is the proposed definition of *qualified security* appropriate? If not, explain why not and suggest modifications to the definition. For example, should additional types of securities be included in the definition? If so, identify the types of securities and explain why they should be included in the definition and how their inclusion would meet the objective of segregation that customer cash is not used to make proprietary investments.

8. Is the proposed condition to the definition of qualified security that municipal securities be general obligation bonds in the definition appropriate? If not, explain why not. Identify other types of municipal securities that should be included and explain how their inclusion would be consistent with the objective that only the most highly liquid securities (*i.e.,* securities capable of being liquidated at market value even during times of market stress) be permitted to meet the Rule 18a–4 Customer Reserve Account deposit requirement.

9. It is expected that the proposed condition that municipal securities be part of an initial offering of $500 million or greater in the definition of *qualified security* would limit qualifying securities to a very small percentage of general obligation municipal security issuances.[761] Would the $500 million threshold be appropriate? If not, explain why not. For example, should this threshold be a greater amount (*e.g.,* $750 million, $1 billion, or some other amount) or a lesser amount (*e.g.,* $250 million, $100 million, or some other amount)? If so, indicate the recommended threshold and explain why it would be preferable.

10. Is the proposed condition that municipal securities must be issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year-end in the definition of *qualified security* appropriate? If not, explain why not.

11. The MSRB Rule Filing contemplates those issuers who are engaged in the voluntary annual filing undertaking will be able to provide the information to the MSRB's Electronic Muni Market Access System within 150 calendar days after the end of the applicable fiscal year prior to January 1, 2014. The 150 calendar day time frame is an interim measure and would no longer be available after January 1, 2014. Should municipal securities that otherwise meet the definition of qualified securities be permitted if the issuer submits financial information within 150 calendar days after the end of the applicable fiscal year during this transitional period that would end on January 1, 2014?

12. Is the proposed deduction for municipal securities held in a Rule 18a–4 Customer Reserve Account equal to the percentage specified in paragraph

[758] *Id.*

[759] As discussed above in section II.B.2.b.i. of this release, proposed new Rule 18a–3 would require a nonbank SBSD to calculate the *equity* in the account of each counterparty on a daily basis and to collect collateral needed to collateralize an account *equity* requirement on the next business day. *See* paragraphs (c)(1)(i)–(ii) of proposed new Rule 18a–3.

[760] *See* paragraph (c)(4) of proposed new Rule 18a–4.

[761] Data source: Mergent's Municipal Bond Securities Database.

(c)(2)(vi) of Rule 15c3–1 appropriate? If not, explain why not.

13. Is the proposed deduction for municipal securities of a single issuer held in a Rule 18a–4 Customer Reserve Account in excess of 2% of the amount required to be maintained in the account appropriate? If not, explain why not. For example, should the threshold be greater (*e.g.,* 3%, 5%, 7%, 10%, or some other amount) or lesser (*e.g.,* 1.5%, 1%, 0.5%, or some other amount)? If so, identify the recommended threshold and explain why it would be preferable.

14. Is the proposed deduction for municipal securities held in a Rule 18a–4 Customer Reserve Account in excess of 10% of the amount required to be maintained in the account appropriate? If not, explain why not. For example, should the threshold be greater (*e.g.,* 15%, 20%, 25%, 30%, or some other amount) or lesser (*e.g.,* 7%, 5%, 3%, or some other amount)? If so, identify the recommended threshold and explain why it would be preferable.

15. Is the proposed deduction for the amount that funds held in a Rule 18a–4 Customer Reserve Account at a single bank exceed 10% of the equity capital of the bank as reported by the bank in its most recent Call Report appropriate? If not, explain why not. For example, should the threshold be greater (*e.g.,* 15%, 20%, 25%, 30%, or some other amount) or lesser (*e.g.,* 7%, 5%, 3%, or some other amount)? If so, identify the recommended threshold and explain why it would be preferable.

16. Is it appropriate to require that the computations to determine the amount required to be maintained in the Rule 18a–4 Customer Reserve Account must be made daily as of the close of the previous business day and any deposit required to be made into the account must be made on the next business day following the computation? If not, explain why not. For example, should the computations be required on a weekly basis consistent with Rule 15c3–3? If so, explain why.

17. Are there any customer reserve account provisions in Rule 15c3–1 that are not being incorporated in proposed new Rule 18a–4 that should be included in the rule? If so, identify them and explain why they should be incorporated into proposed new Rule 18a–4.

18. More generally, are there any provisions in Rule 15c3–1 that are not being incorporated in proposed new Rule 18a–4 that should be included in the rule? If so, identify them and explain why they should be incorporated into proposed new Rule 18a–4.

c. Special Provisions for Non-Cleared Security-Based Swap Counterparties

Paragraph (d) of proposed new Rule 18a–4 would require an SBSD and an MSBSP to provide the notice required by section 3E(f)(1)(A) of the Exchange Act prior to the execution of the first non-cleared security-based swap with the counterparty.[762] Paragraph (d) also would require an SBSD to obtain subordination agreements from counterparties that opt out of the omnibus segregation requirements in proposed new Rule 18a–4 because they either elect individual segregation pursuant to the self-executing provisions of section 3E(f) of the Exchange Act[763] or agree that the SBSD need not segregate their assets at all.[764]

Notice Requirement

The provisions in section 3E(f) of the Exchange Act allow a program by which a counterparty to non-cleared security-based swaps with an SBSD or an MSBSP can choose individual segregation.[765] These provisions provide a framework of baseline requirements that can be supplemented by commercial arrangements between counterparties and SBSDs and MSBSPs. Proposed new Rule 18a–4 would augment these provisions by prescribing when the notice specified in section 3E(f)(1)(A) must be provided to the counterparty by the SBSD or MSBSP. Section 3E(f)(1)(A) provides that an SBSD and an MSBSP shall be required to notify the counterparty at the ''beginning'' of a non-cleared security-based swap transaction about the right to require segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty.[766] To provide greater clarity as to the meaning of ''beginning'' as used in the statute, paragraph (d)(1) of proposed new Rule 18a–4 would require an SBSD or MSBSP to provide the notice in writing to a counterparty prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the effective date of the rule.[767] Consequently, the notice would need to be given in writing to the counterparty prior to the execution of a transaction and, therefore, before the counterparty is required to deliver margin collateral to the SBSD or MSBSP. The notice, therefore, would give the counterparty an opportunity to determine whether to elect individual segregation, waive segregation, or, by not electing individual segregation or waiving segregation, to have the collateral segregated pursuant to the omnibus segregation provisions of proposed new Rule 18a–4.

Subordination Agreements

Paragraph (d)(2) of proposed new Rule 18a–4 would require an SBSD to obtain agreements from counterparties that either elect individual segregation or waive segregation altogether that such counterparties subordinate all of their claims against the SBSD to the claims of security-based swap customers.[768] By entering into subordination agreements, these counterparties would not meet the definition of *security-based swap customer* in proposed new Rule 18a–4.[769] They also would not be entitled to share ratably with security-based swap customers in the fund of customer property held by the SBSD if it is liquidated. This provision would be consistent with text in Rule 15c3–3 concerning the exclusion of persons whose interests are subordinated from the definition of ''customer.''[770]

As discussed in section II.C.1. of this release, segregation requirements are designed to identify customer property as distinct from the proprietary assets of the firm and to protect the customer property by, for example, preventing the firm from using it to make proprietary investments. The goal of segregation is to facilitate the prompt return of customer property to customers either before or during a liquidation proceeding if the firm fails. However, if a counterparty's property is held by a third-party custodian because the counterparty elects individual segregation or if the counterparty waives segregation, there is no need to isolate the counterparty's property since it is with the third-party custodian in the former case or the counterparty has agreed that the SBSD can use it for proprietary purposes in the latter case. The subordination provisions in proposed new Rule 18a–4 are designed to clarify the rights of counterparties

[762] *See* 15 U.S.C. 78c–5(f)(1)(A); paragraph (d)(1) of proposed new Rule 18a–4.

[763] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[764] *See* 15 U.S.C. 78c–5(f)(4).

[765] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[766] *See* 15 U.S.C. 78c–5(f)(4).

[767] *See* paragraph (c)(1) of proposed new Rule 18a–4.

[768] *See* paragraph (d)(2) of proposed new Rule 18a–4.

[769] *See* paragraph (a)(6) of proposed new Rule 18a–4.

[770] *See* paragraph (a)(1) of Rule 15c3–3 defining ''customer'' for purposes of Rule 15c3–3 to specifically exclude ''any other person to the extent that person has a claim for property or funds which by contract, agreement or understanding, or by operation of law, is part of the capital of the broker-dealer or is subordinated to the claims of creditors of the broker-dealer. 17 CFR 240.15c3–3(a)(1).

that have their property held by the SBSD and elect segregation and the rights of counterparties that either elect to have their property held by a third-party custodian or waive segregation.

An SBSD would need to obtain a conditional subordination agreement from a counterparty that elects individual segregation.[771] The agreement would be conditional because the subordination agreement required under the proposed rule would not be effective in a case where the counterparty's assets are included in the bankruptcy estate of the SBSD. Specifically, the proposed rule would provide that the counterparty would need to subordinate claims but only to the extent that funds or other property provided by the counterparty to the independent third-party custodian are not treated as *customer property* under the stockbroker liquidation provisions in a liquidation of the security-based swap dealer.[772] Counterparties that choose individual segregation are opting to have their funds and other property held in a manner that makes the counterparty's property bankruptcy remote from the SBSD. If the arrangement is effective, the counterparties should not have any *customer* claims to cash, securities, or money market instruments used to margin their non-cleared security-based swap transactions in a liquidation of the SBSD, as their property will be held by the independent third party custodian. However, because there is a possibility that an individual segregation arrangement would not be effective, the subordination agreement of a counterparty that chooses individual segregation would be conditioned on the funds and other property of the counterparty not being included in the bankruptcy estate of the SBSD. If a counterparty elects individual segregation but the election is not effective in keeping the counterparty's assets bankruptcy remote, then the counterparty should be treated as a *security-based swap customer* with a *pro rata* priority claim to customer property.

An SBSD also would need to obtain an unconditional subordination agreement from a counterparty that waives segregation altogether.[773] By opting out of segregation, the counterparty agrees that cash, securities, and money market instruments delivered to the SBSD can be used by the SBSD for proprietary purposes and need not be isolated from the proprietary assets of the SBSD. Therefore, these counterparties are foregoing the protections of segregation, which include the right to share ratably with other customers in customer property held by the SBSD. If these counterparties were deemed *security-based swap customers,* they could have a *pro rata* priority claim on customer property. This result could disadvantage the security-based swap customers that did not waive segregation by diminishing the amount of customer property available to be distributed to customers.

Request for Comment

The Commission generally requests comment on the special provisions for non-cleared security-based swaps in proposed new Rule 18a–4. In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

1. Is the requirement to have notice be given in writing prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the effective date of the rule appropriate? If not, explain why not. Should the notice be required on a periodic basis such as monthly or annually? If so, explain why. If not, explain why not. Should the notice be required before every transaction? If so, explain why. If not, explain why not.

2. Describe the current practices and arrangements for individual segregation. For example, are these arrangements based on tri-party agreements between the SBSD, counterparty, and independent third-party custodian? If so, describe the terms of the these third-party agreements. Under these agreements, how would the SBSD perfect its security interest in the funds and other property held by the third-party custodian? What terms would the counterparty require that are designed to ensure that funds or property held by the independent third-party custodian at the time of a liquidation proceeding of the SBSD are not included in the bankruptcy estate of the SBSD?

3. Is it appropriate to require counterparties electing individual segregation to subordinate their claims to security-based swap customers? If not, explain why not and describe other measures that could be taken to ensure that security-based swap customers whose cash, securities, and money market instruments are subject to the omnibus segregation requirements have a first priority claim to these assets over counterparties whose funds and other property are individually segregated at a third party custodian.

4. Is it appropriate to require counterparties who waive all right to segregation to subordinate their claims to security-based swap customers? If not, explain why not and describe other measures that could be taken to ensure that security-based swap customers whose cash, securities, and money market instruments are subject to the omnibus segregation requirements have a first priority claim to these assets over counterparties who waive all right to segregation.

III. General Request for Comment

In responding to the specific requests for comment above, interested persons are encouraged to provide supporting data and analysis and, when appropriate, suggest modifications to proposed rule text. Responses that are supported by data and analysis provide great assistance to the Commission in considering the practicality and effectiveness of proposed new requirements as well as weighing the benefits and costs of proposed requirements. In addition, commenters are encouraged to identify in their responses a specific request for comment by indicating the section number of the release.

The Commission also seeks comment on the proposals as a whole. In this regard, the Commission seeks comment, including empirical data in support of comments, on the following:

1. Are there financial responsibility programs other than the broker-dealer financial responsibility program that could serve as a better model for establishing financial responsibility requirements for SBSDs and MSBSPs? If so, identify the program and explain how it would be a better model for implementing the provisions of the Dodd-Frank Act mandating capital and margin requirements for nonbank SBSDs and nonbank MSBSPs.

2. Should any of the proposed quantitative requirements (*e.g.,* minimum capital thresholds, margin risk factor, standardized haircuts) be modified? If so, how? Are there new quantitative requirements that should be used? What would be the financial or other consequences for individual firms and the financial markets of such modified or new quantitative requirements and how would such consequences differ from the proposed requirements? Please provide detailed data regarding such consequences and describe in detail any econometric or other mathematical models, or economic analyses of data, that would

[771] *See* paragraph (d)(2)(i) of proposed new Rule 18a–4.

[772] *Id.*

[773] *See* paragraph (d)(2)(ii) of proposed new Rule 18a–4.

be relevant for evaluating or modifying any quantitative requirements.

3. How would the proposals integrate with provisions in other titles and subtitles of the Dodd-Frank Act and any regulations or proposed regulations under those other titles and subtitles?

4. How would the proposals integrate with other proposals applicable to SBSDs or MSBSPs in the Exchange Act and any applicable regulations adopted under authority in the Exchange Act?

5. As discussed throughout this release, many of the proposed amendments are based on dollar amounts that are prescribed in existing requirements. Should any of these proposed dollar amounts be adjusted to account for inflation?

6. What should the implementation timeframe be for the proposed amendments and new rules? For example, should the compliance date be 90, 120, 150, 180, or some other number of days after publication? Should the proposed requirements have different time frames before their compliance dates are triggered? For example, would it take longer to come into compliance with certain of these proposals than others? If so, rank the requirements in terms of the length of time it would take to come into compliance with them and propose a schedule of compliance dates.

IV. Paperwork Reduction Act

Certain provisions of the proposed rule amendments and proposed new rules would contain a new ''collection of information'' within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[774] The Commission is submitting the proposed rule amendments and proposed new rules to the Office of Management and Budget (''OMB'') for review in accordance with the PRA. 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 OMB control number. The titles for the collections of information are:

(1) Rule 18a–1 and related appendices, Net capital requirements for security-based swap dealers for which there is not a prudential regulator (a proposed new collection of information);

(2) Rule 18a–2, Capital requirements for major security-based swap participants for which there is not a prudential regulator (a proposed new collection of information);

(3) Rule 18a–3, Non-cleared security-based swap margin requirements for security-based swap dealers and major security-based swap participants for which there is not a prudential regulator (a proposed new collection of information);

(4) Rule 18a–4, Segregation requirements for security-based swap dealers and major security-based swap participants (a proposed new collection of information); and

(5) Rule 15c3–1 Net capital requirements for brokers or dealers (OMB Control Number 3235–0200).

The burden estimates contained in this section do not include any other possible costs or economic effects beyond the burdens required to be calculated for PRA purposes.

A. Summary of Collections of Information Under the Proposed Rules and Rule Amendments

1. Proposed Rule 18a–1 and Amendments to Rule 15c3–1

Section 764 of the Dodd-Frank Act added section 15F to the Exchange Act.[775] Section 15F(e)(1)(B) of the Exchange Act provides that the Commission shall prescribe capital and margin requirements for nonbank SBSDs and nonbank MSBSPs. Proposed new Rule 18a–1 [776] would establish minimum capital requirements for stand-alone SBSDs and the amendments to Rule 15c3–1 [777] would augment the current capital requirements for broker-dealers to address broker-dealers that register as SBSDs and to enhance the provisions applicable to ANC broker-dealers (all of which the Commission preliminarily estimates would register as SBSDs). The proposed new rule and amendments would establish a number of new collection of information requirements.

First, under proposed Rule 18a–1, a stand-alone SBSD would need to apply to the Commission to be authorized to use internal models to compute net capital.[778] As part of the application process, a stand-alone SBSD would be required to provide the Commission staff with, among other things: (1) A comprehensive description of the firm's internal risk management control system; (2) a description of the VaR models the firm will use to price positions and compute deductions for market risk; (3) a description of the firm's internal risk management controls over the VaR models, including a description of each category of person who may input data into the models; and (4) a description of the back-testing procedures that that firm will use to review the accuracy of the VaR models.[779] In addition, under proposed Rule 18a–1, a stand-alone SBSD authorized to use internal models would review and update the models it uses to compute market and credit risk, as well as backtest the models.

Second, under proposed Rule 18a–1 and amendments to Rule 15c3–1, nonbank SBSDs that are approved to use models to compute deductions for market and credit risk under Rule 18a–1 and ANC broker-dealers would be required to perform a liquidity stress test at least monthly and, based on the results of that test, maintain liquidity reserves to address funding needs.[780] The result of the test must be provided within 10 business days to senior management that has the responsibility to oversee risk management of the nonbank SBSD or ANC broker-dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the nonbank SBSD and at least annually by senior management of the nonbank SBSD.[781] In addition, if such a nonbank SBSD or ANC broker-dealer is part of a consolidated entity using liquidity stress tests, the nonbank SBSD or ANC broker-dealer would need to justify and document any differences in the assumptions used in their liquidity stress tests from those used in the liquidity stress tests of the consolidated entity.[782] Furthermore, the nonbank SBSDs and ANC broker-dealers would be required to establish a written contingency funding plan.[783] The plan would need to address the policies and roles and responsibilities of relevant personnel for meeting the liquidity needs of the firm and communications with the public and other market participants during a liquidity stress event.[784]

Third, nonbank SBSDs, including broker-dealer SBSDs, would be required to comply with certain requirements of

[774] 44 U.S.C. 3501 *et seq.;* 5 CFR 1320.11.

[775] *See* Public Law 111–203 § 764; 15 U.S.C. 78o–10.

[776] *See* proposed new Rule 18a–1. *See also* section II.A. of this release.

[777] *See* proposed amendments to Rule 15c3–1. *See also* section II.A. of this release.

[778] *See* paragraphs (a)(2) and (d) of proposed new Rule 18a–1. This collection of information requirement already exists in Rule 15c3–1 and applies to broker-dealers seeking to become ANC broker-dealers.

[779] *See* paragraph (d) of proposed new Rule 18a–1.

[780] *See* proposed new paragraph (f) to Rule 15c3–1; paragraph (f) of proposed new Rule 18a–1.

[781] *See* proposed new paragraph (f)(1) to Rule 15c3–1; paragraph (f)(1) of proposed new Rule 18a–1.

[782] *See* proposed new paragraph (f)(2) of Rule 15c3–1; paragraph (f)(2) of proposed new Rule 18a–1.

[783] *See* proposed new paragraph (f)(4) of Rule 15c3–1; paragraph (f)(3) of proposed new Rule 18a–1.

[784] *Id.*

Rule 15c3–4.[785] Rule 15c3–4 requires OTC derivatives dealers and firms subject to its provisions, to establish, document, and maintain a system of internal risk management controls to assist the firm in managing the risks associated with business activities, including market, credit, leverage, liquidity, legal, and operational risks.[786]

Fourth, under paragraph (c)(2)(vi)(O)(*1*)(*iii*) of Rule 15c3–1 and paragraph (c)(1)(vi)(A)(*3*)(*i*) of proposed new Rule 18a–1, broker-dealers, broker-dealers registered as SBSDs, and stand-alone SBSDs not using models would be required to use an industry sector classification system that is documented and reasonable in terms of grouping types of companies with similar business activities and risk characteristics, used for credit default swap reference names for purposes of calculating ''haircuts'' on security-based swaps under the applicable net capital rules.[787] These firms could use a classification system of a third-party or develop their own classification system, subject to these limitations, and would need to be able to demonstrate the reasonableness of the system they use.[788]

Fifth, under paragraph (i) of proposed Rule 18a–1, stand-alone SBSDs would be required to provide the Commission with certain written notices with respect to equity withdrawals.[789]

Finally, under paragraph (c)(5) of Appendix D to proposed Rule 18a–1, a stand-alone SBSD would be required to file with the Commission two copies of any proposed subordinated loan agreement (including nonconforming subordinated loan agreements) at least 30 days prior to the proposed execution date of the agreement.[790] The rule would also require an SBSD to file with the Commission a statement setting forth the name and address of the lender, the business relationship of the lender to the SBSD, and whether the SBSD carried an account for the lender effecting transactions in security-based swaps at or about the time the proposed agreement was filed.[791]

2. Proposed Rule 18a–2

Proposed new Rule 18a–2 would establish capital requirements for nonbank MSBSPs.[792] In particular, a nonbank MSBSP would be required at all times to have and maintain positive tangible net worth.[793] The proposed definition of *tangible net worth* would allow nonbank MSBSPs to include as regulatory capital assets that would be deducted from net worth under Rule 15c3–1, such as property, plants, equipment, and unsecured receivables. At the same time, it would require the deduction of goodwill and other intangible assets.[794]

Because MSBSPs, by definition, will be entities that engage in a substantial security-based swap business, the Commission is proposing that they be required to comply with Rule 15c3–4,[795] which requires OTC derivatives dealers and other firms subject to its provisions to establish, document, and maintain a system of internal risk management controls to assist the firm in managing the risks associated with their business activities, including market, credit, leverage, liquidity, legal, and operational risks.[796]

3. Proposed Rule 18a–3

Proposed new Rule 18a–3 would establish minimum margin requirements for non-cleared security-based swap transactions entered into by nonbank SBSDs and nonbank MSBSPs.[797] Proposed Rule 18a–3 would prescribe the requirements for nonbank SBSDs or nonbank MSBSPs to collect or post collateral with regard to non-cleared security-based swap transactions. The provisions of proposed Rule 18a–3 contain a collection of information requirement for nonbank SBSDs. Specifically, paragraph (e) of proposed Rule 18a–3 would require a nonbank SBSD to monitor the risk of each account and establish, maintain, and document procedures and guidelines for monitoring the risk of accounts as part of the risk management control system required by Rule 15c3–4.[798] In addition, the rule would require a nonbank SBSD to review, in accordance with written procedures and at reasonable periodic intervals, its non-cleared security-based swap activities for consistency with the risk monitoring procedures and guidelines required by paragraph (e) of Rule 18a–3. The nonbank SBSD would also be required to determine whether information and data necessary to apply the risk monitoring procedures and guidelines required by paragraph (e) of Rule 18a–3 are accessible on a timely basis and whether information systems are available to adequately capture, monitor, analyze, and report relevant data and information. Finally, the rule would require that the risk monitoring procedures and guidelines must include, at a minimum, procedures and guidelines for:

- Obtaining and reviewing account documentation and financial information necessary for assessing the amount of current and potential future exposure to a given counterparty permitted by the SBSD;
- Determining, approving, and periodically reviewing credit limits for each counterparty, and across all counterparties;
- Monitoring credit risk exposure to the SBSD from non-cleared security-based swaps, including the type, scope, and frequency of reporting to senior management;
- Using stress tests to monitor potential future exposure to a single counterparty and across all counterparties over a specified range of possible market movements over a specified time period;
- Managing the impact of credit exposure related to non-cleared security-based swaps on the SBSD's overall risk exposure;
- Determining the need to collect collateral from a particular counterparty, including whether that determination was based upon the creditworthiness of the counterparty and/or the risk of the specific non-cleared security-based swap contracts with the counterparty;
- Monitoring the credit exposure resulting from concentrated positions with a single counterparty and across all counterparties, and during periods of extreme volatility; and
- Maintaining sufficient equity in the account of each counterparty to protect against the largest individual potential future exposure of a non-cleared security-based swap carried in the

[785] *See* 17 CFR 240.18a–1(g); 15c3–1(a)(10)(ii). *See also* 17 CFR 240.15c3–4.

[786] *Id.*

[787] *See* paragraph (c)(2)(vi)(O)(*1*)(*iii*) of Rule 15c3–1; paragraph (c)(1)(vi)(A)(*3*)(*i*) of proposed new Rule 18a–1.

[788] *See* proposed new paragraph (c)(2)(vi)(O)(*1*)(*iii*)(*A*) of Rule 15c3–1; paragraph (c)(1)(vii)(A)(*3*)(*i*) of proposed new Rule 18a–1.

[789] *See* paragraph (i) of proposed new Rule 18a–1.

[790] *See* paragraph (c)(5) of proposed new Rule 18a–1d.

[791] *Id.*

[792] *See* proposed new Rule 18a–2. *See also* section II.A.3 of this release.

[793] *See* paragraph (a) of proposed new Rule 18a–2.

[794] The proposed definition of *tangible net worth* under proposed new Rule 18a–2 is consistent with the CFTC's proposed definition of *tangible net equity*. *See CFTC Capital Proposing Release,* 76 FR at 27828 (Defining *tangible net equity* as ''equity as determined under U.S. generally accepted accounting principles, and excludes goodwill and other intangible assets.'').

[795] *See* paragraph (c) of proposed new Rule 18a–2.

[796] *See* 17 CFR 240.15c3–4.

[797] *See* proposed new Rule 18a–3. *See also* section II.B. of this release for a more detailed description of the proposed rule.

[798] *See* paragraph (e) to proposed new Rule 18a–3.

account of the counterparty as measured by computing the largest maximum possible loss that could result from the exposure.

4. Proposed Rule 18a–4

Proposed new Rule 18a–4 would establish segregation requirements for cleared and non-cleared security-based swap transactions, which would apply to all types of SBSDs (*i.e.,* they would apply to bank SBSDs, nonbank stand-alone SBSDs, and broker-dealer SBSDs), as well as notification requirements for SBSDs and MSBSPs.[799] The provisions of proposed Rule 18a–4 are modeled on Rule 15c3–3, the broker-dealer segregation rule.[800] Paragraph (a) of the proposed new rule would define key terms used in the rule.[801] Paragraph (b) would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all *excess securities collateral* (a term defined in paragraph (a)) and specify certain locations where *excess securities collateral* could be held and deemed in the SBSD's control.[802] Paragraph (c) would require an SBSD to maintain a special account for the exclusive benefit of security-based swap customers and have on deposit in that account at all times an amount of cash and/or *qualified securities* (a term defined in paragraph (a)) determined through a computation using the formula in Exhibit A to proposed new Rule 18a–4.[803]

Paragraph (d) of proposed new Rule 18a–4 would contain provisions that are not modeled specifically on Rule 15c3–1. First, it would require an SBSD and an MSBSP to provide the notice required by section 3E(f)(1)(A) of the Exchange Act to a counterparty in writing prior to the execution of the first non-cleared security-based swap transaction with the counterparty.[804] Second, it would require the SBSD to obtain subordination agreements from counterparties that opt out of the segregation requirements in proposed new Rule 18a–4 because they either elect individual segregation pursuant to the self-executing provisions of section 3E(f) of the Exchange Act [805] or agree that the SBSD need not segregate their assets at all.[806]

Additionally, paragraph (a)(3) of proposed new Rule 18a–4 would define *qualified clearing agency account* to mean an account of an SBSD at a clearing agency established to hold funds and other property in order to purchase, margin, guarantee, secure, adjust, or settle cleared security-based swaps of the SBSD's security-based swap customers that meets the following conditions (which would contain collection of information requirements):

- The account is designated ''Special Clearing Account for the Exclusive Benefit of the Cleared Security-Based Swap Customers of [name of the SBSD]''; [807]
- The clearing agency has acknowledged in a written notice provided to and retained by the SBSD that the funds and other property in the account are being held by the clearing agency for the exclusive benefit of the cleared security-based swap customers of the SBSD in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the SBSD with the clearing agency; [808] and
- The account is subject to a written contract between the SBSD and the clearing agency which provides that the funds and other property in the account shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the clearing agency or any person claiming through the clearing agency, except a right, charge, security interest, lien, or claim resulting from a cleared security-based swap transaction effected in the account.[809]

Under paragraph (a)(4) of proposed new Rule 18a–4, a qualified SBSD account would be defined to mean an account at another SBSD registered with the Commission pursuant to section 15F of the Exchange Act that is not an affiliate of the SBSD and that meets conditions that are largely identical to the conditions for a qualified clearing agency account. Finally, paragraph (c)(1) of proposed new Rule 18a–4 would require an SBSD, among other things, to maintain a *special account for the exclusive benefit of security-based swap customers* separate from any other bank account of the SBSD.[810] The term *special account for the exclusive benefit of security-based swap customers* would be defined under paragraph (a)(7) of proposed new Rule 18a–4 to mean an account at a bank that is not an affiliate of the SBSD and that meets conditions that are largely identical to the conditions for a qualified clearing agency account and qualified SBSD account.[811]

Paragraph (c)(1) of proposed new Rule 18a–4 would provide that the SBSD must at all times maintain in a Rule 18a–4 Customer Reserve Account, through deposits into the account, cash and/or qualified securities in amounts computed in accordance with the formula set forth in Exhibit A to Rule 18a–4.[812] The formula in Exhibit A to proposed new Rule 18a–4 is modeled on the formula in Exhibit A to Rule 15c3–3.[813] Paragraph (c)(3) of proposed new Rule 18a–4 would provide that the computations necessary to determine the amount required to be maintained in the special bank account must be made daily as of the close of the previous business day and any deposit required to be made into the account must be made on the next business day following the computation no later than 1 hour after the opening of the bank that maintains the account.[814]

B. Proposed Use of Information

As discussed more fully above, the Commission and SROs, as applicable, would use the information collected under new Rules 18a–1, 18a–2, 18a–3 and 18a–4, as well as the amendments to Rule 15c3–1 to determine whether an SBSD, MSBSP, or ANC broker-dealer, as applicable, is in compliance with each applicable rule and to help fulfill their oversight responsibilities. The

[799] *See* proposed new Rule 18a–4. *See also* section II.C. of this release for a more detailed description of the proposal.

[800] 17 CFR 240.15c3–3.

[801] *Compare* 17 CFR 240.15c3–3(a), *with* paragraph (a) of proposed new Rule 18a–4.

[802] *Compare* 17 CFR 240.15c3–3(b)–(d), *with* paragraph (b) of proposed new Rule 18a–4.

[803] *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (c) of proposed new Rule 18a–4.

[804] *See* 15 U.S.C. 78c–5(f)(1)(A); proposed paragraph (d)(1) of proposed new Rule 18a–4.

[805] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[806] *See* 15 U.S.C. 78c–5(f)(4).

[807] *See* paragraph (a)(3)(i) of proposed new Rule 18a–4. This provision is modeled on paragraph (e)(1) of Rule 15c3–3, which requires a broker-dealer to maintain a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (a)(3)(i) of proposed new Rule 18a–4.

[808] *See* paragraph (a)(3)(ii) of proposed new Rule 18a–4. This provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a written notification from a bank where it maintains a customer reserve account. *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(3)(ii) of proposed new Rule 18a–4.

[809] *See* paragraph (a)(3)(iii) of proposed new Rule 18a–4. This provision is modeled on paragraph (f) of Rule 15c3–3, which requires a broker-dealer to obtain a contract from a bank where it maintains a ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' *Compare* 17 CFR 240.15c3–3(f), *with* paragraph (a)(3)(ii) of proposed new Rule 18a–4.

[810] *See* paragraph (c) of proposed new Rule 18a–4. The provisions of paragraph (c) of proposed new Rule 18a–1 are modeled on paragraph (e) of Rule 15c3–3. *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (c) of proposed new Rule 18a–4.

[811] *See* paragraph (a)(7) of proposed new Rule 18a–4. *See also* Section II.C.1. of this release for a more detailed description of the proposed requirements.

[812] *See* paragraph (c)(1) of proposed new Rule 18a–4; Exhibit A to proposed new Rule 18a–4.

[813] *See* 17 CFR 240.15c3–3a.

[814] *See* paragraph (c)(3) of proposed new rule 18a–4.

collections of information would also help to ensure that SBSD, MSBSPs and broker-dealers are meeting their obligations under the proposed rules and rule amendments and have the required policies and procedures in place.

Proposed new Rules 18a–1 and 18a–2, as well as the proposed amendments to Rule 15c3–1 would be integral parts of the Commission's financial responsibility program for SBSDs and MSBSPs, and ANC broker-dealers, respectively. Proposed Rule 18a–1 and Rule 15c3–1 are designed to ensure that nonbank SBSDs and broker-dealers (including broker-dealer SBSDs), respectively, have sufficient liquidity to meet all unsubordinated obligations to customers and counterparties and, consequently, if the SBSD or broker-dealer fails, sufficient resources to wind-down in an orderly manner without the need for a formal proceeding. The collections of information in proposed new Rule 18a–1, Rule 18a–2 and the amendments to Rule 15c3–1 would facilitate the monitoring of the financial condition of nonbank SBSDs, nonbank MSBSPs and broker-dealers by the Commission.

Proposed new Rule 18a–3 would prescribe, among other things, requirements for nonbank SBSDs to collect collateral with regard to non-cleared security-based swap transactions. Under proposed Rule 18a–3, a nonbank SBSD would be required to establish and implement risk monitoring procedures with respect to counterparty accounts.[815] The purpose of the proposed rule is to limit risks to individual firms and systemic risk arising from non-cleared security-based swaps. The collections of information in proposed Rule 18a–3 would assist examiners in determining whether SBSDs are in compliance with requirements in the rule.

Proposed new Rule 18a–4 would establish segregation requirements for cleared and non-cleared security-based swap transactions, which would apply to all types of SBSDs (*i.e.,* they would apply to bank SBSDs, nonbank stand-alone SBSDs, and broker-dealer SBSDs), as well as establish notice requirements for SBSDs and MSBSPs. Proposed new Rule 18a–4 would be an integral part of the Commission's financial responsibility program for SBSDs. Its purpose is to protect the rights of security-based swap customers and their ability to promptly obtain their property from an SBSD. The collection of information requirements in the proposed new rule would facilitate the process by which the Commission monitors how SBSDs are fulfilling their custodial responsibilities to SBSD customers. Proposed Rule 18a–4 also would require that an SBSD provide certain notices to counterparties.[816] These notices would alert counterparties to the alternatives available to them with respect to segregation of non-cleared security-based swaps. The Commission staff would use this new collection of information in its examination and oversight program.

C. Respondents

Consistent with the *Entity Definitions Adopting Release,* the Commission staff estimates that 50 or fewer entities ultimately may have to register with the Commission as SBSDs.[817] In addition, consistent with the *Entity Definitions Adopting Release,* based on available data regarding the single-name credit default swap market—which the Commission believes will comprise the majority of security-based swaps—the Commission staff estimates that the number of MSBSPs likely will be five or fewer and, in actuality, may be zero.[818] Therefore, to capture the likely number of MSBSPs that may be subject to the collections of information for purposes of this PRA, the Commission staff estimates for purposes of this PRA that 5 entities will register with the Commission as MSBSPs. Accordingly, for the purposes of calculating PRA reporting burdens, the Commission staff estimates there are 50 SBSDs and 5 MSBSPs respondents.

The Commission previously estimated that 16 broker-dealers would likely seek to register as SBSDs.[819] The Commission is retaining this estimate for purposes of this release.[820] Accordingly, for the purposes of calculating PRA reporting burdens, the Commission staff estimates there are 16 broker-dealer SBSDs.

Because proposed Rules 18a–1 and 18a–3 would apply only to nonbank SBSDs, including nonbank subsidiaries of bank holding companies the Federal Reserve regulates, the number of respondents subject to these proposed rules would be less than the 50 entities expected to register with the Commission as an SBSD, as many of the dealers that currently engage in OTC derivative activities are banks, and would therefore be ''bank SBSDs.'' [821] Because the Commission staff estimates that 16 broker-dealers would likely register as SBSDs, there would be an estimated maximum of 34 bank SBSDs.[822] However, because of business planning purposes, risk management purposes, potential regulatory requirements, or other reasons, some of these entities would likely register with the Commission as nonbank stand-alone SBSDs. Therefore, as stated above, because many of the dealers that currently engage in OTC derivatives activities are banks, the Commission staff estimates that approximately 75% of the maximum estimated bank SBSDs will register as bank SBSDs, and the remainder (approximately 25%) will register as stand-alone nonbank SBSDs. As a result, for purposes of the reporting burdens, the Commission staff estimates that approximately 9 entities will register as stand-alone SBSDs.[823] Therefore, for purposes of the reporting burdens, the Commission staff estimates

[815] *See* paragraph (e) of proposed new Rule 18a–3.

[816] *See* paragraphs (a) and (c) of proposed new Rule 18a–4.

[817] *Entity Definitions Adopting Release,* 77 FR at 30725. This estimate—which potentially overstates the number of potential entities that ultimately have to register with the Commission as SBSDs—is consistent with the data regarding activities and positions of participants in the single-name credit default swap market summarized in a memorandum of the Commission staff. *See Memorandum* (Mar. 15, 2012), available at *http://www.sec.gov/comments/s7-39-10/s73910-154.pdf* (''*CDS Data Analysis''*). Depending on the final capital requirements as well as other requirements for SBSDs and how businesses choose to respond to such requirements, the actual number of SBSDs may be significantly fewer. *See Business Conduct Standards for Security-Based Swap Dealers and Major-Security Based Swap Participants,* Exchange Act Release No. 64766 (June 29, 2011), 76 FR 42396, 42442 (July 18, 2011) (''*Business Conduct Release''*). *See also SBSD Registration Proposing Release,* 76 FR at 65808.

[818] *Entity Definitions Adopting Release,* 77 FR at 30727, 30729. The number of MSBSPs likely will depend on the final capital requirements and other requirements for MSBSPs and how businesses choose to respond to such requirements. *See Business Conduct Release,* 76 FR at 42442. *See also SBSD Registration Proposing Release,* 76 FR at 65808.

[819] *See SBSD Registration Proposing Release,* 76 FR at 65808. No comments were received on this estimate.

[820] *Id.*

[821] *See, e.g., ISDA Margin Survey 2012* (May 2012), at Appendix 1, available at *http://www2.isda.org/functional-areas/research/surveys/margin-surveys/* (''*ISDA Margin Survey 2012''*). ISDA is a global trade association for OTC derivatives. The ISDA margin survey is conducted annually to examine the state of collateral use and management among derivatives dealers and end-users. *See id.; ISDA Margin Survey 2011,* available at *http://www2.isda.org/functional-areas/research/surveys/margin-surveys/* (''*ISDA Margin Survey 2011''*). Appendix 1 to the survey lists firms that responded to the survey including the largest dealer banks. *See ISDA Margin Survey 2012* at Appendix 1; *ISDA Margin Survey 2011* at Appendix 1. *See also* Economic Analysis in section V.A. of this release (discussing overview of OTC derivatives market).

[822] 50 SBSDs − 16 broker-dealer SBSDs = 34 maximum estimated bank SBSDs.

[823] 34 maximum estimated bank SBSDs × 25% = 8.5, rounded to 9 stand-alone nonbank SBSDs.

that approximately 25 nonbank SBSDs would be subject to Rules 18a–1 and 18a–3.[824]

Of the 9 stand-alone SBSDs, the Commission staff estimates that, based on its experience with ANC broker-dealers and OTC derivatives dealers, the majority of stand-alone SBSDs would apply to use internal models.[825] Consequently, the Commission is estimating that 6 of the 9 stand-alone SBSDs would apply to use internal models under Rule 18a–1. Because the Commission staff estimates that 6 stand-alone SBSDs would apply to the Commission to use internal models, the Commission staff estimates that three stand-alone SBSDs would not use models.[826] For purposes of estimating the number of respondents with respect to the proposed amendments to Rule 15c3–1, the Commission staff estimates that there would be 10 respondents currently subject to the collection of information as it relates to Appendix E to Rule 15c3–1.[827] Finally, because the Commission staff estimates that 10 of the broker-dealers registered as SBSDs would be ANC broker-dealers, the Commission staff estimates that 6 broker-dealers registered as SBSDs would not use internal models.[828]

Type of respondent	Number of respondents
SBSDs	50
Bank SBSDs	25
Nonbank SBSDs	25
Broker-Dealer SBSDs	16
Stand-Alone SBSD	9
ANC Broker-Dealer SBSDs	10
Broker-Dealer SBSDs (Not Using Models)	6
Stand-Alone SBSDs (Using Models)	6
Stand-Alone SBSDs (Not Using Models)	3
Nonbank MSBSPs	5

[824] 16 broker-dealer SBSDs + 9 stand-alone SBSDs = 25 nonbank SBSDs.

[825] *See* section II.A.2.a.iii. of this release (discussing minimum capital requirements for stand-alone SBSDs); section II.A.2.b.iii. of this release (discussing the use of VaR models). VaR models, while more risk sensitive than standardized haircuts, tend to substantially reduce the amount of the deductions to tentative net capital in comparison to the standardized haircuts because the models recognize more offsets between related positions than the standardized haircuts. Therefore, the Commission expects that stand-alone SBSDs that have the capability to use internal models to calculate net capital would chose to do so.

[826] 9 stand-alone SBSDs − 6 stand-alone SBSDs using internal models = 3 stand-alone SBSDs not using models.

[827] These 10 broker-dealer respondents likely would also register as SBSDs because these entities are expected to engage in a broad range of activities.

[828] 16 broker-dealers registered as SBSDs − 10 ANC broker-dealer SBSDs = 6 broker-dealer SBSDs not using internal models.

The Commission generally requests comment on all aspects of these estimates of the number of respondents. Commenters should provide specific data and analysis to support any comments they submit with respect to the number of respondents, including identifying any sources of industry information that could be used to estimate the number of respondents.

D. Total Initial and Annual Recordkeeping and Reporting Burden

1. Proposed Rule 18a–1 and Amendments to Rule 15c3–1

Proposed Rule 18a–1 and the proposed amendments to Rule 15c3–1 would have collection of information requirements that result in one-time and annual hour burdens for nonbank SBSDs and ANC broker-dealers. The estimates in this section are based in part on the Commission's experience with burden estimates for similar collections of information requirements, including the current collection of information requirements for Rule 15c3–1.[829]

First, under paragraph (a)(2) of proposed Rule 18a–1, the Commission is proposing that a stand-alone SBSD be required to file an application for authorization to compute net capital using internal models.[830] The requirements for the application would be set forth in paragraph (d) of proposed Rule 18a–1, which is modeled on the application requirements of Appendix E to Rule 15c3–1.[831] ANC broker-dealers—the number of which would include broker-dealer SBSDs that seek to use internal models—currently are subject to this application requirement. Consequently, the Commission staff estimates that the proposed requirements of paragraph (d) of Rule 18a–1 would result in one-time and annual hour burdens for stand-alone SBSDs.[832]

Based on its experience with ANC broker-dealers and OTC derivatives dealers, the Commission expects that stand-alone SBSDs that apply to the Commission to use internal models to calculate net capital will already have developed models to calculate market and credit risk and will already have developed internal risk management control systems. On the other hand, the Commission notes that proposed Rule 18a–1 contains additional requirements that stand-alone SBSDs may not yet have incorporated into their models and control systems.[833] Therefore, stand-alone SBSDs would incur one-time hour burdens and start-up costs in order to develop their VaR models in accordance with the requirements of proposed Rule 18a–1, as well as to submit such models along with its application under paragraph (d) of proposed Rule 18a–1 to the Commission for approval.

These estimates are based on currently approved PRA estimates for the ANC firms and OTC derivatives dealers.[834] While these estimates are averages, the burdens may vary depending on the size and complexity of each stand-alone SBSD.

The Commission staff estimates that each of the 6 stand-alone nonbank SBSDs that apply to use the internal models would spend approximately 1,000 hours to develop and submit its VaR model and the description of its risk management control system to the Commission as well as to create and compile the various documents to be included with the application and to work with the Commission staff through the application process.[835] This includes approximately 100 hours for an in-house attorney to complete a review of the application.[836] Consequently, the Commission staff estimates that the total burden associated with the application process for the stand-alone SBSDs would result in an industry-wide one-time hour burden of approximately 6,000 hours.[837] In addition, the Commission staff allocated 75% (4,500 hours) of these one-time burden hours [838] to internal burden and the

[829] 17 CFR 240.15c3–1.

[830] A broker-dealer SBSD seeking Commission authorization to use internal models to compute market and credit risk charges would apply under the existing provisions of Appendix E to Rule 15c3–1, which apply to ANC broker-dealers. *See* 17 CFR 240.15c3–1e.

[831] *See* 17 CFR 240.15c3–1e(a) and paragraph (d) of proposed Rule 18a–1. Consequently, the Commission is using the current collection of information for Appendix E to Rule 15c3–1 as a basis for this new collection of information.

[832] The requirements that would be imposed on paragraphs (d) and (e) of proposed Rule 18a–1 are consistent with the requirements of Appendix E to Rule 15c3–1.

[833] *See* sections II.A.2.b.iii., II.A.2.c., and II.A.2.d. of this release (describing requirements for VaR models and other requirements under proposed Rule 18a–1 for stand-alone SBSDs).

[834] *See OTC Derivatives Dealers,* 62 FR 67940; *OTC Derivatives Dealers,* 63 FR 59362; *Alternative Net Capital Requirements Adopting Release,* 69 FR at 34452.

[835] This estimate is based on the current hour burdens under Appendix E to Rule 15c3–1.

[836] *Id. See also OTC Derivatives Dealers,* 62 FR 67940; *Alternative Net Capital Requirements Adopting Release,* 69 FR at 34452.

[837] 6 stand-alone SBSDs × 1,000 hours = 6,000 hours.

[838] The internal hours likely would be performed by an in-house attorney (1,500 hours), a risk management specialist (1,500 hours), and compliance manager (1,500 hours). Therefore, the estimated internal costs for this hour burden would be calculated as follows: ((in-house attorney for

Continued

remaining 25% (1,500 hours) to external burden to hire outside professionals to assist in preparing and reviewing the stand-alone SBSD's application for submission to the Commission.[839] The Commission staff estimates $400 per hour for external costs for retaining outside consultants, resulting in a one-time industry-wide external cost of $600,000.[840]

The Commission staff estimates that a stand-alone SBSD approved to use internal models would spend approximately 5,600 hours per year to review and update the models and approximately 160 hours each quarter, or approximately 640 hours per year, to backtest the models.[841] Consequently, the Commission staff estimates that the total burden associated with reviewing and back-testing the models for the 6 stand-alone SBSDs would result in an industry-wide annual hour burden of approximately 37,440 hours per year.[842] In addition, the Commission staff has allocated 75% (28,080) [843] of these burden hours to internal burden and the remaining 25% (9,360) to external burden to hire outside professionals to assist in reviewing, updating and backtesting the models.[844] The Commission staff estimates $400 per hour for external costs for retaining outside professionals, resulting in an industry-wide external cost of $3.7 million annually.[845]

Stand-alone SBSDs electing to file an application with the Commission to use a VaR model will incur start-up costs including information technology costs to comply with proposed Rule 18a–1. Because each stand-alone SBSD's information technology systems may be in varying stages of readiness to enable these firms to meet the requirements of the proposed rules, the cost of modifying their information technology systems could vary significantly. Based on the estimates for the ANC broker-dealers,[846] it is expected that a stand-alone SBSD would incur an average of approximately $8.0 million to modify its information technology systems to meet the VaR requirements of the proposed new Rule 18a–1, for a total one-time industry-wide cost of $48 million.[847]

Second, under paragraph (f) of proposed Rule 18a–1 and proposed new paragraph (f) of Rule 15c3–1, stand-alone SBSDs that are approved to use models to compute deductions for market and credit risk under Rule 18a–1 and ANC broker-dealers would be subject to liquidity stress test requirements. The Commission staff estimates that the proposed requirements resulting from these provisions would result in a one-time burden to applicable stand-alone SBSDs and ANC broker-dealers as they would need to develop models for the liquidity stress test, document the results of the test to provide to senior management, document differences in the assumptions used in the liquidity stress test of the firm from those used in a consolidated entity of which the firm is a part, and develop a written contingency funding plan.[848] Based on experience supervising ANC broker-dealers,[849] the Commission staff estimates that each of the 6 stand-alone SBSDs and 10 ANC broker-dealers would spend an average of approximately 200 hours to comply with these requirements, resulting in an average industry-wide one-time internal hour burden of approximately 3,200 hours.[850]

In terms of annual hour burden, the Commission staff estimates that a stand-alone SBSD or ANC broker-dealer would spend an average of approximately 50 hours [851] per month testing and documenting the results of its liquidity stress test and reviewing its contingency funding plan, resulting in a total industry-wide annual hour burden of approximately 9,600 hours.[852]

Third, under paragraph (g) of proposed new Rule 18a–1, a stand-alone SBSD would be required to comply with Rule 15c3–4 (except for certain provisions of that rule) as if it were an OTC derivatives dealer.[853] ANC broker-dealers currently are required to comply with Rule 15c3–4.[854] Nonbank SBSDs would be required to comply with Rule 15c3–4, which requires the establishment of a risk management

1,500 hours at $378 per hour) + (risk management specialist for 1,500 hours at $259 per hour) + (compliance manager for 1,500 hours at $279 per hour)) = $1,374,000. The hourly rates use for internal professionals used throughout this section IV. of the release are taken from SIFMA's *Management & Professional Earnings in the Securities Industry 2011,* modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[839] 6,000 hours × .75 = 4,500 hours; 6,000 hours × .25 = 1,500 hours. This allocation is based on the Commission's experience in implementing the ANC rules for broker-dealers. Larger firms tend to perform these tasks in-house due to the proprietary nature of these models as well as the high fixed-costs in hiring an outside consultant. However, smaller firms may need to hire an outside consultant to perform certain of these tasks.

[840] 1,500 hours × $400 per hour = $600,000. *See* PRA Analysis in *Product Definitions Adopting Release,* 77 FR at 48334 (providing an estimate of $400 an hour to engage an outside attorney). *See also Nationally Recognized Statistical Rating Organizations,* Exchange Act Release No. 64514 (May 18, 2011) 76 FR 33430, 33504 (June 8, 2012) (providing estimate of $400 per hour to engage outside attorneys and outside professionals).

[841] These hour burdens are consistent with the current hour burdens under Appendix E to Rule 15c3–1 for ANC broker-dealers.

[842] 6 Stand-alone SBSDs × [5,600 hours + 640 hours] = 37,440 hours.

[843] These functions likely would be performed by a risk management specialist (14,040 hours) and a senior compliance examiner (14,040 hours). Therefore, the estimated internal costs for this hour burden would be calculated as follows: ((risk management specialist for 14,040 hours at $259 per hour) + (senior compliance examiner for 14,040 hours at $230 per hour)) = $6,865,560.

[844] 37,440 hours × .75 = 28,080; 37,440 hours × .25 = 9,360 hours. This allocation is based on the Commission's experience in implementing the ANC rules for broker-dealers. Larger firms tend to perform these tasks in-house due to the proprietary nature of these models as well as the high fixed-costs in hiring an outside consultant. However, smaller firms may need to hire an outside consultant to perform these tasks.

[845] 9,360 hours × $400 per hour = $3,744,000. *See* PRA Analysis in *Product Definitions Adopting Release,* 77 FR 48334 (providing an estimate of $400 an hour to engage an outside attorney). *See also Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504 (providing estimate of $400 per hour to engage outside attorneys and outside professionals).

[846] *Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[847] 6 stand-alone SBSDs × $8 million = $48 million.

[848] *See* section II.A.2.d. of this release (discussing liquidity stress test and written contingency funding plan).

[849] Based on Commission staff experience supervising the ANC broker-dealers, all of the ANC broker-dealers that are part of a holding company generally have a written contingency funding plan, generally at the holding company level. This proposed rule would require that each ANC broker-dealer and stand-alone SBSD using internal models maintain a written contingency funding plan at the entity level (in addition to any holding company plan). Therefore, the proposed hour burdens are averages for all firms, including the ANC broker-dealers, which may already conduct these activities within their organizations, and smaller firms, including stand-alone broker-dealers which may not currently undertake these proposed activities.

[850] [10 ANC broker-dealers + 6 stand-alone SBSDs] × 200 hours = 3,200 hours. Based on Commission staff experience supervising the ANC broker-dealers, the Commission staff expects that these functions would likely be performed internally by an in-house attorney (1,600 hours) and a risk management specialist (1,600). Therefore, the estimated internal costs for this hour burden would be calculated as follows: ((in-house attorney for 1,600 hours at $378 per hour) + (risk management specialist for 1,600 hours at $259 per hour)) = $1,019,200.

[851] This PRA estimate is based, in part, on the 160 hours per quarter it would take an ANC broker-dealer to review and backtest its models under the current collection of information in Rule 15c3–1. *See Alternative Net Capital Requirements Adopting Release,* 69 FR at 34452.

[852] [6 Stand-alone SBSDs + 10 ANC broker-dealers] × 50 hours × 12 months = 9,600 hours. These functions would be performed by a senior compliance examiner (4,800 hours) and a risk management specialist (4,800 hours). Therefore, the estimated internal costs for this hour burden would be calculated as follows: ((senior compliance examiner for 4,800 hours at $230 per hour) + (risk management specialist for 4,800 hours at $259 per hour)) = $2,347,200.

[853] *See* paragraph (g) to proposed new Rule 18a–1.

[854] 17 CFR 240.15c3–1(a)(7)(iii).

control system.[855] The Commission adopted Rule 15c3–4 in 1998 as part of the OTC derivatives dealer oversight program.[856] The rule requires an OTC derivatives dealer to establish, document, and maintain a system of internal risk management controls to assist in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.[857] It also requires OTC derivatives dealers to establish, document, and maintain procedures designed to prevent the firm from engaging in securities activities that are not permitted by OTC derivatives dealers pursuant to Rule 15a–1.[858] Rule 15c3–4 identifies a number of elements that must be part of an OTC derivatives dealer's internal risk management control system.[859] These include, for example, that the system have:

- A risk control unit that reports directly to senior management and is independent from business trading units; [860]
- Separation of duties between personnel responsible for entering into a transaction and those responsible for recording the transaction in the books and records of the OTC derivatives dealer; [861]
- Periodic reviews (which may be performed by internal audit staff) and annual reviews (which must be conducted by independent certified public accountants) of the OTC derivatives dealer's risk management systems; [862] and
- Definitions of risk, risk monitoring, and risk management.[863]

Rule 15c3–4 further provides that the elements of the internal risk management control system must include written guidelines, approved by the OTC derivatives dealer's governing body, that discuss a number of matters, including for example:

- Quantitative guidelines for managing the OTC derivatives dealer's overall risk exposure; [864]
- The type, scope, and frequency of reporting by management on risk exposures; [865]
- The procedures for and the timing of the governing body's periodic review of the risk monitoring and risk management written guidelines, systems, and processes; [866]
- The process for monitoring risk independent of the business or trading units whose activities create the risks being monitored; [867]
- The performance of the risk management function by persons independent from or senior to the business or trading units whose activities create the risks; [868]
- The authority and resources of the groups or persons performing the risk monitoring and risk management functions; [869]
- The appropriate response by management when internal risk management guidelines have been exceeded; [870]
- The procedures to monitor and address the risk that an OTC derivatives transaction contract will be unenforceable; [871]
- The procedures requiring the documentation of the principal terms of OTC derivatives transactions and other relevant information regarding such transactions; [872] and
- The procedures authorizing specified employees to commit the OTC derivatives dealer to particular types of transactions.[873]

Rule 15c3–4 also requires management to periodically review, in accordance with the written procedures, the business activities of the OTC derivatives dealer for consistency with risk management guidelines.[874]

Based on the nature of the written guidelines described above, the Commission staff estimates that the requirement to comply with Rule 15c3–4 would result in one-time and annual hour burdens to nonbank SBSDs. The Commission staff estimates that the average amount of time a firm would spend implementing its risk management control system would be 2,000 hours,[875] resulting in an industry-wide one-time hour burden of 30,000 hours across the 15 nonbank SBSDs not already subject to Rule 15c3–4.[876]

The proposed rule would require a nonbank SBSD to consider a number of issues affecting its business environment when creating its risk management control system. For example, a nonbank SBSD would need to consider, among other things, the sophistication and experience of relevant trading, risk management, and internal audit personnel, as well as the separation of duties among these personnel, when designing and implementing its internal control system's guidelines, policies, and procedures. This would help to ensure that the control system that is implemented would adequately address the risks posed by the firm's business and the environment in which it is being conducted. In addition, this would enable a nonbank SBSD derivatives dealer to implement specific policies and procedures unique to its circumstances.

In implementing its policies and procedures, a nonbank SBSD would be required to document and record its system of internal risk management controls. In particular, a nonbank SBSD would be required to document its consideration of certain issues affecting its business when designing its internal controls. A nonbank SBSD would also be required to prepare and maintain written guidelines that discuss its internal control system, including procedures for determining the scope of authorized activities. The Commission staff estimates that each of these 15 nonbank SBSDs [877] would spend approximately 250 hours per year reviewing and updating their risk management control systems to comply with Rule 15c3–4, resulting in an industry-wide annual hour burden of approximately 3,750 hours.[878]

[855] *See* proposed new paragraph (a)(10)(ii) of Rule 15c3–1 (17 CFR 240.15c3–1); paragraph (g) of proposed new Rule 18a–1. *See also* 17 CFR 240.15c3–4.

[856] *See* 17 CFR 240.15c3–4; *OTC Derivatives Dealers,* 63 FR 59362.

[857] *See* 17 CFR 240.15c3–4.

[858] *See* 17 CFR 240.15c3–4; 17 CFR 240.15a–1.

[859] *See* 17 CFR 240.15c3–4(c).

[860] *See* 17 CFR 240.15c3–4(c)(1).

[861] *See* 17 CFR 240.15c3–4(c)(2).

[862] *See* 17 CFR 240.15c3–4(c)(3).

[863] *See* 17 CFR 240.15c3–4(c)(4).

[864] *See* 17 CFR 240.15c3–4(c)(5)(iii).

[865] *See* 17 CFR 240.15c3–4(c)(5)(iv).

[866] *See* 17 CFR 240.15c3–4(c)(5)(v).

[867] *See* 17 CFR 240.15c3–4(c)(5)(vi).

[868] *See* 17 CFR 240.15c3–4(c)(5)(vii).

[869] *See* 17 CFR 240.15c3–4(c)(5)(viii).

[870] *See* 17 CFR 240.15c3–4(c)(5)(ix).

[871] *See* 17 CFR 240.15c3–4(c)(5)(x).

[872] *See* 17 CFR 240.15c3–4(c)(5)(xi).

[873] *See* 17 CFR 240.15c3–4(c)(5)(xii).

[874] *See* 17 CFR 240.15c3–4(d).

[875] This estimates is based on the one-time burden estimated for an OTC derivatives dealer to implement is controls under Rule 15c3–1. *See OTC Derivatives Dealers,* 62 FR 67940. This also is included in the current PRA estimate for Rule 15c3–4.

[876] 25 nonbank SBSDs—10 ANC broker-dealer SBSDs = 15 nonbank SBSDs. 15 nonbank SBSDs × 2,000 hours = 30,000 hours. This number is incremental to the current collection of information for Rule 15c3–1 with regard to complying with the provisions of Rule 15c3–4 and, therefore, excludes the 10 respondents included in the collection of information for that rule. These hours would likely be performed by a combination of an in-house attorney (10,000 hours), a risk management specialist (10,000 hours), and an operations specialist (10,000 hours). Therefore, the estimated internal costs for this hour burden would be calculated as follows: ((in-house attorney for 10,000 hours at $378 per hour) + (risk management specialist for 10,000 hours at $259 per hour) + (operations specialist for 10,000 hours at $117 per hour)) = $7,540,000.

[877] 25 nonbank SBSDs − 10 ANC broker-dealer/SBSDs = 15 nonbank SBSDs.

[878] 15 nonbank SBSDs × 250 hours = 3,750 hours. These hour burden estimates are consistent with similar collections of information under Appendix

Continued

Nonbank SBSDs may incur start-up costs to comply with the provisions of Rule 15c3–4 incorporated into proposed Rule 18a–1, including information technology costs. The information technology systems of nonbank SBSDs may be in varying stages of readiness to enable these firms to meet the requirements of the proposed rules so the cost of modifying their information technology systems could vary significantly. Based on the estimates for similar collections of information,[879] it is expected that a nonbank SBSDs would incur an average of approximately $16,000 for initial hardware and software expenses, while the average ongoing cost would be approximately $20,500 per nonbank SBSD to meet the requirements of the proposed new Rule 18a–1, for a total industry-wide initial cost of $240,000 and ongoing cost of $307,500 per year.[880]

Fourth, proposed paragraph (c)(2)(vi)(O)(*1*)(*iii*) of Rule 15c3–1 and paragraph (c)(1)(vi)(A)(*3*)(*i*) of proposed new Rule 18a–1, broker-dealer SBSDs and stand-alone SBSDs not using models would be required to use an industry sector classification system that is documented and reasonable in terms of grouping types of companies with similar business activities and risk characteristics used for credit default swap reference obligors for purposes of calculating ''haircuts'' on security-based swaps under applicable net capital rules.

As discussed above, the Commission staff estimates that 6 broker-dealer SBSDs and 3 nonbank SBSDs not using models would utilize the credit default swap haircut provisions under the proposed amendments to Rule 15c3–1 and proposed new Rule 18a–1, respectively. Consequently, these firms would use an industry sector classification system that is documented for the credit default swap reference obligors. The Commission expects that these firms would utilize external classifications systems because of reduced costs and ease of use as a result of the common usage of several of these classification systems in the financial services industry. The Commission staff estimates that nonbank SBSDs not using models would spend approximately 1 hour per year documenting these industry sectors, for a total annual hour burden of 9 hours.[881]

Fifth, under paragraph (i) of proposed new Rule 18a–1, a nonbank SBSD would be required to file certain notices with the Commission relating to the withdrawal of equity capital.[882] Broker-dealers—which would include broker-dealer SBSDs—currently are required to file these notices under paragraph (e) of Rule 15c3–1.[883] The Commission staff estimates that the notice requirements would result in annual hour burdens to stand-alone SBSDs. The Commission staff estimates that each of the 9 stand-alone SBSDs would file approximately 2 notices annually with the Commission.[884] In addition, the Commission staff estimates that it would take a stand-alone SBSD approximately 30 minutes to file these notices, resulting in an industry-wide annual hour burden of 4.5 hours.[885]

Finally, under Appendix D to proposed new Rule 18a–1, a nonbank SBSD would be required to file a proposed subordinated loan agreement with the Commission (including nonconforming subordinated loan agreements).[886] Broker-dealers—which would include broker-dealer SBSDs—currently are subject to such a requirement. The Commission staff estimates this proposed requirement would result in one-time and annual hour burdens for stand-alone SBSDs. Based on staff experience with Rule 15c3–1, the Commission staff estimates that each of the 9 stand-alone SBSDs would spend approximately 20 hours of internal employee resources drafting or updating its subordinated loan agreement template to comply with the proposed requirement, resulting in an industry-wide one-time hour burden of approximately 180 hours.[887] In addition, based on staff experience with Rule 15c3–1, the Commission staff estimates that each stand-alone SBSD would file 1 proposed subordinated loan agreement with the Commission per year and that it would take a firm approximately 10 hours to prepare and file the agreement, resulting in an industry-wide annual hour burden of approximately 90 hours.[888]

2. Proposed Rule 18a–2

Proposed new Rule 18a–2 would establish capital requirements for nonbank MSBSPs.[889] In particular, a nonbank MSBSP would be required at all times to have and maintain positive tangible net worth.[890] Because MSBSPs, by definition, will be entities that engage in a substantial security-based swap business, under the proposed rules, they would be required to comply with Rule 15c3–4,[891] which requires OTC derivatives dealers and ANC broker-dealers to establish, document, and maintain a system of internal risk management controls to assist in managing the risks associated with their business activities, including market, credit, leverage, liquidity, legal, and operational risks.[892] The Commission staff estimates that the requirement to comply with Rule 15c3–4 would result in one-time and annual hour burdens to nonbank MSBSPs. The Commission staff estimates that the average amount of time a firm would spend implementing its risk management control system would be 2,000 hours,[893] resulting in an industry-wide one-time hour burden of 10,000 hours.[894]

E to Rule 15c3–1. These hours likely would be performed by a risk management specialist. Therefore, the estimated internal costs for this hour burden would be calculated as follows: Risk management specialist for 3,750 hours at $259 per hour = $971,250.

[879] *Risk Management Controls for Brokers or Dealers with Market Access,* Exchange Act Release No. 63421 (Nov. 3, 2010), 75 FR 69792, 69814 (Nov. 15, 2010).

[880] 15 nonbank SBSDs × $16,000 = $240,000; 15 nonbank SBSDs × $20,500 =$307,500.

[881] (3 nonbank SBSDs not using models × 1 hour) + (6 broker-dealer SBSDs × 1 hour) = 9 hours. This function would likely be performed by an internal compliance attorney. Therefore, the estimated internal costs for this hour burden would be calculated as follows: Internal compliance attorney for 9 hours at $322 per hour = $2,898.

[882] *See* proposed new Rule 18a–1(i).

[883] 17 CFR 240.15c3–1(e).

[884] This estimate is based on the number of notices currently filed by broker-dealers under the current collection of information under Rule 15c3–1.

[885] [9 stand-alone SBSDs × 2 notices] × 30 minutes = 4.5 hours. This estimate is based on the 30 minutes it is estimated to take a broker-dealer to file a similar notice under Rule 15c3–1. The Commission believes the stand-alone SBSDs would likely perform these functions internally using an internal compliance attorney. Therefore, the estimated internal costs for this hour burden would be calculated as follows: Internal compliance attorney for 4.5 hours at $322 per hour = $1,449.

[886] *See* proposed new paragraph (c)(5) to proposed Rule 18a–1. Broker-dealer SBSDs would be subject to the provisions of Appendix D to Rule 15c3–1. 17 CFR 240.15c3–1d.

[887] 9 stand-alone SBSDs × 20 hours = 180 hours. This function would likely be performed by an in-house attorney. Therefore, the estimated internal costs for this hour burden would be calculated as follows: in-house attorney for 180 hours at $378 per hour = $68,040.

[888] 9 stand-alone SBSDs × 1 loan agreement × 10 hours = 90 hours. This function would likely be performed by an in-house attorney. Therefore, the estimated internal costs for this hour burden would be calculated as follows: In-house attorney for 90 hours at $378 per hour = $34,020.

[889] *See* proposed new Rule 18a–2.

[890] *See* paragraph (a) of proposed new Rule 18a–2.

[891] *See* paragraph (c) of proposed new Rule 18a–2.

[892] *See* 17 CFR 240.15c3–4.

[893] This estimate is based on the one-time burden estimated for an OTC derivatives dealer to implement is controls under Rule 15c3–1. *OTC Derivatives Dealers,* 62 FR 67940. This also is included in the current PRA estimate for Rule 15c3–4.

[894] 5 MSBSPs × 2,000 hours = 10,000 hours. These hours would likely be performed by a combination of an internal compliance attorney (3,333.33 hours), a risk management specialist (3,333.33 hours), and an operations specialist

The proposed rule would require a nonbank MSBSP to consider a number of issues affecting its business environment when creating its risk management control system. For example, a nonbank MSBSP would need to consider, among other things, the sophistication and experience of relevant trading, risk management, and internal audit personnel, as well as the separation of duties among these personnel, when designing and implementing its internal control system's guidelines, policies, and procedures. This would help to ensure that the control system that is implemented would adequately address the risks posed by the firm's business and the environment in which it is being conducted. In addition, this would enable a nonbank MSBSP to implement specific policies and procedures unique to its circumstances.

In implementing its policies and procedures, a nonbank MSBSP would be required to document and record its system of internal risk management controls. In particular, a nonbank MSBSP would be required to document its consideration of certain issues affecting its business when designing its internal controls. A nonbank MSBSP would also be required to prepare and maintain written guidelines that discuss its internal control system, including procedures for determining the scope of authorized activities. The Commission staff estimates that each of the 5 MSBSPs would spend approximately 250 hours per year reviewing and updating their risk management control systems to comply with Rule 15c3–4, resulting in an industry-wide annual hour burden of approximately 1,250 hours.[895]

Because nonbank MSBSPs may not initially have the systems or expertise internally to meet the risk management requirements of proposed new Rule 18a–2, these firms would likely hire an outside risk management consultant to assist them in implementing their risk management systems. The Commission staff estimates that a nonbank MSBSP may hire an outside management consultant for approximately 200 hours to assist the firm for a total start-up cost to the nonbank MSBSP of $80,000 per MSBSP, or a total of $400,000 for all nonbank MSBSPs.[896]

Nonbank MSBSPs may incur start-up costs to comply with proposed Rule 18a–2, including information technology costs. The information technology systems of a nonbank MSBSP may be in varying stages of readiness to enable these firms to meet the requirements of the proposed rules so the cost of modifying their information technology systems could vary significantly. Based on the estimates for similar collections of information,[897] the Commission staff expects that a nonbank MSBSP would incur an average of approximately $16,000 for initial hardware and software expenses, while the average ongoing cost would be approximately $20,500 per nonbank MSBSP to meet the requirements of the proposed new Rule 18a–2, for a total industry-wide initial cost of $80,000 and ongoing cost of $102,500.[898]

3. Proposed Rule 18a–3

Proposed paragraph (e) of new Rule 18a–3 would require a nonbank SBSD to establish and implement risk monitoring procedures with respect to counterparty accounts.[899] Therefore, paragraph (e) to proposed Rule 18a–3 would result in one-time and annual hour burdens for nonbank SBSDs. In this regard, nonbank SBSDs would need to develop a comprehensive written risk analysis methodology for assessing the potential risk to the firm over a specified range of possible market movements over a specified time period that would meet the requirements of the rule.

Because these firms would already be required to comply with Rule 15c3–4,[900] the Commission staff estimates that each of the 25 nonbank SBSDs would spend an average of approximately 210 hours establishing the written risk analysis methodology, resulting in an industry-wide one-time hour burden of approximately 5,250 hours.[901] In addition, based on staff experience, the Commission staff estimates that a nonbank SBSD would spend an average of approximately 60 hours per year reviewing the written risk analysis methodology and updating it as necessary, resulting in an average industry-wide annual hour burden of approximately 1,500 hours.[902]

The 25 respondents subject to the collection of information may incur start-up costs in order to comply with this collection of information. These costs may vary depending on the size and complexity of the nonbank SBSD. In addition, the start-up costs may be less for the 16 nonbank SBSD respondents also registered as broker-dealers because these firms may already be subject to similar requirements with respect to other margin rules.[903] For the remaining 9 nonbank SBSDs, because these written procedures may be novel undertakings for these firms, the Commission staff assumes these nonbank SBSDs would have their written risk analysis methodology reviewed by outside counsel. As a result, the Commission staff estimates that these nonbank SBSDs would likely incur $2,000 in legal costs, or $18,000 in the aggregate initial burden to review and comment on these materials.[904]

4. Proposed Rule 18a–4

Under proposed new Rule 18a–4, SBSDs would be required to establish special accounts with banks and obtain written acknowledgements from, and

(3,333.33 hours). Therefore, the estimated internal costs for this hour burden would be calculated as follows: ((internal compliance attorney for 3,333.33 hours at $322 per hour) + (risk management specialist for 3,333.33 hours at $259 per hour) + (operations specialist for 3,333.33 hours at $117 per hour)) = $2,326,664.34.

[895] 5 MSBSPs × 250 hours = 1,250 hours. These hour burden estimates are consistent with similar collections of information under Appendix E to Rule 15c3–1. These hours would likely be performed by a risk management specialist. Therefore, the estimated internal cost for this hour burden would be calculated as follows: Risk management specialist for 1,250 hours at $259 per hour = $323,750.

[896] 5 nonbank MSBSPs × $80,000 = $400,000. *See also* PRA Analysis in *Product Definitions Adopting Release,* 77 FR at 48344 (providing an estimate of $400 an hour to engage an outside attorney); *Nationally Recognized Statistical Rating Organizations,* 76 FR at 33504 (providing estimate of $400 per hour to engage outside attorneys and outside professionals).

[897] *Risk Management Controls for Brokers or Dealers with Market Access,* 75 FR at 69814.

[898] 5 nonbank MSBSPs × $16,000 = $80,000; 5 nonbank MSBSPs × $20,500 = $102,500.

[899] *See* paragraph (e) of proposed new Rule 18a–3.

[900] *See* section II.A.2.c. of this release (describing risk management provisions of Rule 15c3–4).

[901] 25 nonbank SBSDs × 210 hours = 5,250 hours. *See generally Clearing Agency Standards for Operation and Governance,* 76 FR at 14510 (estimating 210 one-time burden hours and 60 annual hours to implement policies and procedures reasonably designed to use margin requirements to limit a clearing agency's credit exposures to participants in normal market conditions and use risk-based models and parameters to set and review margin requirements.). These hours would likely be performed internally by an assistant general counsel (1,750 hours), a compliance attorney (1,750 hours), and a risk management specialist (1,750 hours). Therefore, the estimated internal cost for this hour burden would be calculated as follows: ((assistant general counsel for 1,750 hours at $407 per hour) + (risk management specialist for 1,750 hours at $259 per hour) + (compliance attorney for 1,750 hours at $322 per hour)) = $1,729,000.

[902] 25 stand-alone SBSDs × 60 hours = 1,500 hours. These hours would likely be performed by a compliance attorney. Therefore, the estimated internal cost for this hour burden would be calculated as follows: Compliance attorney for 1,500 hours at $322 per hour = $483,000.

[903] *See, e.g.,* FINRA Rule 4210 and 4240. *See also Business Conduct Release,* 76 FR at 42445 (noting burden for paragraph (g) of proposed Rule 15Fh–3 is based on existing FINRA rules).

[904] The Commission staff estimates the review of the written risk analysis methodology would require 5 hours of outside counsel time at a cost of $400 per hour. *See also Business Conduct Release,* 76 FR at 42445.

enter into written contracts with, the banks. These special accounts would include: (1) The qualified clearing agency account under paragraph (a)(3); (2) the qualified SDSD account under paragraph (a)(4); and the special account for the exclusive benefit of security-based swap customers under paragraph (a)(7) of proposed new Rule 18a–4, (collectively, the ''special accounts''). Based on staff experience with Rule 15c3–3, the Commission staff estimates that each of the 50 SBSDs would establish six special accounts at banks (two for each type of special account). Further, based on staff experience with Rule 15c3–3, the Commission staff estimates that each SBSD would spend approximately 30 hours to draft and obtain the written acknowledgement and agreement for each account, resulting in an industry-wide one-time hour burden of approximately 9,000 hours.[905] The Commission staff estimates that 25% [906] of the 50 SBSDs or approximately 13 would establish a new special account each year because, for example, they change their banking relationship, for each type of special account. Therefore, the Commission staff estimates an industry-wide annual hour burden of approximately 1,170 hours.[907]

Paragraph (c)(1) of proposed new Rule 18a–4 would provide that the SBSD must at all times maintain in a special account, through deposits into the account, cash and/or qualified securities in amounts computed in accordance with the formula set forth in Exhibit A to Rule 18a–4,[908] modeled on the formula in Appendix A to Rule 15c3–3. Paragraph (c)(3) of proposed new Rule 18a–4 would provide that the computations necessary to determine the amount required to be maintained in the special bank account must be made on a daily basis. Variation in size and complexity between these SBSDs would make it very difficult to develop a meaningful figure for the amount of time required to calculate each reserve computation. Based on experience with the Rule 15c3–3 reserve computation PRA burden hours and with the OTC derivatives industry, the Commission staff estimates that it would take between one and five hours to compute each reserve computation, and that the average time spent across all the SBSDs would be approximately 2.5 hours. Accordingly, the Commission staff estimates that the resulting annual hour burden for paragraph (c)(3) of proposed new Rule 18a–3 would be approximately 31,250 hours.[909]

Under paragraph (d)(1) of proposed new Rule 18a–4, an SBSD or an MSBSP would be required to provide a notice to a counterparty pursuant to section 3E(f) of the Exchange Act prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the effective date of the proposed rule.[910] All 50 SBSDs and 5 MSBSPs would be required to provide these notices to their counterparties. The Commission staff estimates that these 55 entities would engage outside counsel to draft and review the notice at a cost of $400 per hour for an average of 10 hours per respondent, resulting in a one-time cost burden of $220,000 for all of these 55 entities.[911]

The number of notices sent in the first year the rule is effective would depend on the number of counterparties with which each SBSD and MSBSP engages in security-based swap transactions. The number of counterparties an SBSD and MSBSP would have would vary depending on the size and complexity of the firm and its operations. The Commission staff estimates that each of the 50 SBSDs and 5 MSBSPs would have approximately 1,000 counterparties at any given time.[912] Therefore, the Commission staff estimates that approximately 55,000 notices would be sent in the first year the rule is effective.[913] The Commission staff estimates that the each of the 50 SBSDs and 5 MSBSPs would spend approximately 10 minutes sending out the notice, resulting in an industry-wide one-time hour burden of approximately 9,167 hours.[914] The Commission staff further estimates that the 50 SBSDs and 5 MSBSPs would establish account relationships with 200 new counterparties per year. Therefore, the Commission staff estimates that approximately 11,000 notices would be sent annually,[915] resulting in an industry-wide annual hour burden of approximately 1,833 hours.[916]

Under proposed new Rule 18a–4(d)(2), an SBSD would be required to obtain agreements from counterparties that do not choose to require segregation of funds or other property pursuant to Section 3E(f) of the Exchange Act or paragraph (c)(3) of Rule 18a–4 in which the counterparty agrees to subordinate all of its claims against the SBSD to the claims of security-based swap customers of the SBSD.[917] The Commission staff estimates that an SBSD would spend, on average, approximately 200 hours to draft and prepare standard subordination agreements, resulting in an industry-wide one-time hour burden of 10,000 hours.[918] Because the SBSD would enter into these agreements with

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[905] 50 SBSDs × 6 special accounts × 30 hours = 9,000 hours. A compliance attorney would likely perform this function. Therefore, the estimated internal cost for this hour burden would be calculated as follows: Compliance attorney for 9,000 hours at $322 per hour = $2,898,000.

[906] This number is based on the currently approved PRA collection for Rule 15c3–3.

[907] 13 SBSDs × 3 types of special accounts × 30 hours = 1,170 hours. A compliance attorney would likely perform this function. Therefore, the estimated internal cost for this hour burden would be calculated as follows: Compliance attorney for 1,170 hours at $322 per hour = $376,740.

[908] *See* paragraph (c)(1) of proposed new Rule 18a–4 and Exhibit A to proposed new Rule 18a–4.

[909] 50 SBSDs × 250 business days × 2.5 hours/day = 31,250 hours. This task would likely be performed by a financial reporting manager. Therefore, the estimated internal cost for this hour burden would be calculated as follows: Financial reporting manager for 31,250 hours at $309 per hour = $9,656,250.

[910] *See* paragraph (d)(1) of proposed new Rule 18a–4.

[911] [50 SBSDs + 5 MSBSPs] × $400 per hour × 10 hours = $220,000. The Commission expects that these functions would likely be performed by outside counsel with an expertise in financial services law to help ensure that counterparties are receiving the proper notice under the statutory requirement.

[912] The Commission previously estimated that there are approximately 8,500 market participants in security-based swap transactions. *See Business Conduct Release,* 76 FR at 42443. Based on the 8,500 market participants and Commission staff experience relative to the securities and OTC derivatives industry, the Commission staff estimates that each SBSD and MSBSP would have 1,000 counterparties at any given time. The number of counterparties may widely vary depending on the size of the SBSD or MSBSP. A large firm may have thousands or counterparties at one time, while a smaller firm may have substantially less than 1,000. The Commission staff also estimates, based on staff experience, that these entities would establish account relationships with approximately 200 new counterparties a year, or approximately 20% of a firm's existing counterparties.

[913] [50 SBSDs + 5 MSBSPs] × 1,000 counterparties = 55,000 notices.

[914] (55,000 notices × 10 minutes)/60 minutes = 9,167 hours. A compliance clerk would likely send these notices. Therefore, the estimated internal cost for this hour burden would be calculated as follows: Compliance clerk for 9,167 hours at $60 per hour = $550,020. The hourly rates use for internal office employees used throughout this section are taken from SIFMA's Office Salaries in the Securities Industry 2011, modified by the Commission staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead.

[915] [50 SBSDs + 5 MSBSPs] × 200 counterparties = 11,000 notices.

[916] (11,000 notices × 10 minutes)/60 minutes = 1,833 hours. A compliance clerk would likely send these notices. Therefore, the estimated internal cost for this hour burden would be calculated as follows: compliance clerk for 1,833 hours at $60 per hour = $109,980.

[917] *See* paragraph (d)(2) of proposed new Rule 18a–4.

[918] 200 hours × 50 SBSDs = 10,000 hours. An in-house attorney would likely draft these agreements because the Commission staff expects that drafting contracts would be one of the typical job functions of an in-house attorney. Therefore, the estimated internal cost for this hour burden would be calculated as follows: In-house attorney for 10,000 hours at $378 per hour = $3,780,000.

security-based swap customers, after the SBSD prepares a standard subordination agreement in-house, the Commission staff also estimates that an SBSD would have outside counsel a review the standard subordination agreements and that the review would take approximately 20 hours at a cost of approximately $400 per hour. As a result, the Commission staff estimates that each SBSD would incur one-time costs of approximately $8,000,[919] resulting in an industry-wide one-time cost of approximately $400,000.[920]

As discussed above, the Commission staff estimates that each of the 50 SBSDs would have approximately 1,000 counterparties at any given time. The Commission staff further estimates that approximately 50% of these counterparties would either elect individual segregation or waive segregation altogether.[921] The Commission staff estimates that an SBSD would spend 20 hours per counterparty to enter into a written subordination agreement, resulting in an industry-wide one-time hour burden of approximately 500,000 hours.[922] Further, as discussed the Commission staff estimates that each of the 50 SBSDs would establish account relationships with 200 new counterparties per year. The Commission staff further estimates that 50% or 100 of these counterparties would either elect individual segregation or waive segregation altogether. Therefore, the Commission staff estimates an industry-wide annual hour burden of approximately 100,000 hours.[923]

[919] $400 × 20 hours = $8,000.

[920] $8,000 × 50 = $400,000.

[921] Based on discussions with market participants, the Commission staff understands that many large buy-side financial end users currently ask for individual segregation and the Commission staff assumes that many of these end users will continue to do so. However, Commission staff believes that some smaller end users may not choose to incur additional cost that may come with individual segregation. Therefore, the Commission staff estimates that approximately 50% of counterparties will either elect individual segregation or waiver segregation altogether.

[922] 50 SBSDs × 500 counterparties × 20 hours = 500,000 hours. These functions would likely be performed by a compliance attorney (250,000 hours) and a compliance clerk (250,000 hours). Therefore, the estimated internal cost for this hour burden would be calculated as follows: ((compliance attorney for 250,000 hours at $322 per hour) + (compliance clerk for 250,000 hours at $60 per hour)) = $95,500,000.

[923] 50 SBSDs × 100 counterparties × 20 hours = 100,000 hours. These functions would likely be performed by a compliance attorney (50,000 hours) and a compliance clerk 50,000 hours). Therefore, the estimated internal cost for this hour burden would be calculated as follows: ((compliance attorney for 50,000 hours at $322 per hour) + (compliance clerk for 50,000 hours at $60 per hour)) = $19,100,000.

E. Collection of Information Is Mandatory

The collections of information pursuant to the proposed amendments and new rules are mandatory, as applicable, for ANC broker-dealers, SBSDs, and MSBSPs.

F. Confidentiality

The Commission expects to receive confidential information in connection with the proposed collections of information. To the extent that the Commission receives confidential information pursuant to these collections of information, the Commission is committed to protecting the confidentiality of such information to the extent permitted by law.[924]

G. Retention Period for Recordkeeping Requirements

ANC broker-dealers are required to preserve for a period of not less than three years, the first two years in an easily accessible place, certain records required under Rule 15c3–4 and certain records under Appendix E to Rule 15c3–1.[925] Rule 17a–4 specifies the required retention periods for a broker-dealer.[926] Many of a broker-dealer's records must be retained for three years; certain other records must be retained for longer periods.[927]

As noted above, the recordkeeping burdens with respect to some requirements in proposed new Rules 18a–1 through 18a–4 will be addressed in the SBSD and MSBSP recordkeeping requirements, which will the subject of a separate release.

H. Request for Comment

Pursuant to 44 U.S.C. 3306(c)(2)(B), the Commission requests comment on the proposed collections of information in order to:

• Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

• Evaluate the accuracy of the Commission's estimates of the burden of the proposed collections of information;

• Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

• Evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct their comments to the Office of Management and Budget, 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 Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090, and refer to File No. S7–08–12. 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. 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. S7–08–12, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street NE., Washington, DC 20549.

[924] *See, e.g.,* 15 U.S.C. 78 × (governing the public availability of information obtained by the Commission); 5 U.S.C. 552 *et seq.* (Freedom of Information Act—''FOIA''). *See also* paragraph (d)(1) of proposed new Rule 18a–1(d). FOIA provides at least two pertinent exemptions under which the Commission has authority to withhold certain information. FOIA Exemption 4 provides an exemption for ''trade secrets and commercial or financial information obtained from a person and privileged or confidential.'' *5 U.S.C. 552(b)(4).* FOIA Exemption 8 provides an exemption for matters that are ''contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.'' *5 U.S.C. 552(b)(8).*

[925] *See* 17 CFR 17a–4(b)(9), (10), and (12).

[926] 17 CFR 240.17a–4.

[927] *Id.*

V. Economic Analysis

The Commission is sensitive to the costs and benefits of its rules. Some of these costs and benefits stem from statutory mandates, while others are affected by the discretion exercised in implementing the mandates. The following economic analysis seeks to identify and consider the benefits and costs—including the effects on efficiency, competition, and capital formation—that would result from the proposed capital, margin, and segregation rules for SBSDs and MSBSPs and from the proposed amendments to Rule 15c3–1. The costs and benefits considered in proposing these new rules and amendments are discussed below and have informed the policy choices described throughout this release.

The Commission discusses below a baseline against which the rules may be evaluated. For the purposes of this economic analysis, the baseline is the OTC derivatives markets as they exist today prior to the effectiveness of the statutory and regulatory provisions that will govern these markets in the future pursuant to the Dodd-Frank Act. With respect to the proposed amendments to Rule 15c3–1, the baseline for purposes of this economic analysis is the current capital regime for broker-dealers under Rule 15c3–1.[928]

While the Commission does not have comprehensive information on the U.S. OTC derivatives markets, the Commission is using the limited data currently available in considering in this economic analysis the effects of the proposals, including their intended benefits and anticipated possible costs.[929] Additionally, the Commission requests that commenters identify sources of data and information as well as provide data and information to assist the Commission in analyzing the economic consequences of the proposed rules. More generally, the Commission requests comment on all aspects of this initial economic analysis, including on whether the analysis has: (1) Identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (2) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (3) identified and considered reasonable alternatives to the proposed new rules and rule amendments.

If these proposed rules and rule amendments are adopted, their benefits and costs would affect competition, efficiency, and capital formation in the security-based swap market broadly, with the impact not being limited to SBSDs and MSBSPs. Section 3(f) of the Exchange Act provides that whenever the Commission engages in rulemaking under the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[930] In addition, section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the effect such rules would have on competition.[931] Section 23(a)(2) of the Exchange Act also 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.[932]

As discussed more fully in section II. above, the Commission is proposing: (1) Rules 18a–1 and 18a–2, and amendments to Rule 15c3–1, to establish capital requirements for nonbank SBSDs and nonbank MSBSPs; (2) Rule 18a–3 to establish customer margin requirements applicable to nonbank SBSDs and nonbank MSBSPs for non-cleared security-based swaps; and (3) Rule 18a–4 to establish segregation requirements for SBSDs and notification requirements with respect to segregation for SBSDs and MSBSPs.[933] Some of the proposed amendments to Rule 15c3–1 would apply to broker-dealers that are not registered as SBSDs or MSBSPs to the extent that they hold positions in security-based swaps and swaps. The Commission also is proposing to amend Rule 15c3–1 to increase the minimum capital requirements for ANC broker-dealers. Finally, the Commission is proposing a liquidity requirement for ANC broker-dealers and for nonbank stand-alone SBSDs that use internal models to compute net capital.

The sections below present an overview of the OTC derivatives markets, a discussion of the general costs and benefits of the proposed financial responsibility requirements, and a discussion of the costs and benefits of each proposed amendment and new rule. The sections that follow also incorporate a consideration of the potential effects of the proposed amendments and new rules on competition, efficiency, and capital formation.

A. Baseline of Economic Analysis

1. Overview of the OTC Derivatives Markets—Baseline for Proposed Rules 18a–1 Through 18a–4

As stated above, to assess the costs and benefits of these rules, a baseline must be established against which the rules may be evaluated. For the purposes of this economic analysis, the baseline is the OTC derivatives markets[934] as they exist today prior to the effectiveness of the statutory and regulatory provisions that will govern these markets in the future pursuant to the Dodd-Frank Act.[935] The markets as they exist today are dominated, both globally and domestically, by a small number of firms, generally entities affiliated with or within large commercial banks.[936]

The OTC derivatives markets have been described as opaque because, for example, transaction-level data about OTC derivatives trading generally is not publicly available.[937] This economic analysis is supported, where possible, by data currently available to the Commission from The Depository Trust & Clearing Corporation Trade Information Warehouse (''DTCC–TIW''). This evaluation takes into account data regarding the security-based swap market and especially data regarding the activity—including activity that may be suggestive of dealing behavior—of participants in the single-name credit default swap market.[938] While a large segment of the security-based swap market is comprised of single-name credit default swaps, these derivatives do not comprise the entire security-based swap market.[939] Moreover, credit

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[928] 17 CFR 240.15c3–1.

[929] Information that is available for the purposes of this economic analysis includes an analysis of the market for single-name credit default swaps performed by the Commission's Division of Risk, Strategy, and Financial Innovation. *See CDS Data Analysis.*

[930] 15 U.S.C. 78c(f).

[931] 15 U.S.C. 78w(a)(2).

[932] *Id.*

[933] The Commission is also proposing a conforming amendment to Rule 15c3–3 to clarify that broker-dealer SBSDs must comply with Rule 15c3–3 and Rule 18a–4, as applicable.

[934] OTC derivatives may include forwards, swaps and options on foreign exchange, and interest rate, equity and commodity derivatives.

[935] The baseline, however, for amendments to Rule 15c3–1 is the current financial responsibility regime for broker-dealers under this rule.

[936] *See, e.g., ISDA Margin Survey 2012.*

[937] *See* Orice M. Williams, GAO, *Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps* at 2, 5, 27. *See also* Robert E. Litan, The Brookings Institution, *The Derivatives Dealers' Club and Derivatives Market Reform: A Guide for Policy Makers, Citizens and Other Interested Parties* 15–20 (Apr. 7, 2010), available at *http://www.brookings.edu/~/media/research/files/papers/2010/4/07%20derivatives%20litan/0407_derivatives_litan.pdf; Security-Based Swap Data Repository Registration, Duties, and Core Principles,* Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306, 77354 (Dec. 10, 2010); IOSCO, *The Credit Default Swap Market,* Report FR05/12, (June 2012), available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD385.pdf* (stating although the amount of public information on CDS has increased over recent years, the CDS market is still quite opaque).

[938] The *CDS Data Analysis* provides reasonably comprehensive information regarding the credit default swap activities and positions of U.S. market participants, but the Commission notes that the data does not encompass those credit default swaps that both: (i) Do not involve U.S. counterparties; and (ii) are based on non-U.S. reference entities. Reliance on this data should not be interpreted to indicate our views as to the nature or extent of the application of Title VII to non-U.S. persons; instead, it is anticipated that issues regarding the extraterritorial application of Title VII will be addressed in a separate release.

[939] In addition, it is reasonable to believe that the implementation of Title VII itself will change the security-based swap market, and, with the full implementation of Title VII—which in part is

default swaps are a small percentage of the overall OTC derivatives market, which, in addition to security-based swaps, includes foreign currency swaps and interest rate swaps.

Available information about the global OTC derivatives markets suggests that swap transactions, in contrast to security-based swap transactions, dominate trading activities, notional amounts, and market values.[940] For example, the BIS estimates that the total notional amounts outstanding and gross market value of global OTC derivatives were over $648 trillion and $27.2 trillion, respectively, as of the end of 2011.[941] Of these totals, the BIS estimates that foreign exchange contracts, interest rate contracts, and commodity contracts comprised approximately 88% of the total notional amount and 84% of the gross market value.[942] Credit default swaps, including index credit default swaps, comprised approximately 4.4% of the total notional amount and 5.8% of the gross market value. Equity-linked contracts, including forwards, swaps and options, comprised approximately an additional 1.0% of the total notional amount and 2.5% of the gross market value.[943]

Because the financial responsibility program for SBSDs and MSBSPs would apply to dealers and participants in the security-based swap markets, they are expected to affect a substantially smaller portion of the U.S. OTC derivatives markets than the proposed financial responsibility rules for swap dealers and major swap participants proposed by the CFTC and prudential regulators.[944] In addition, though the proposed capital, segregation and margin rules apply to all security-based swaps, not just single-name credit default swaps, the data on single-name credit default swaps are currently sufficiently representative of the market to help inform this economic analysis because currently an estimated 95% of all security-based swap transactions appear likely to be single-name credit default swaps.[945] The majority of these single-name credit default swaps, both in terms of aggregate total notional amount and total volume by product type, are based on corporate and sovereign reference entities.[946]

While the number of transactions is larger in single-name credit default swaps than in index credit default swaps, the aggregate total notional amount of the latter exceeds that of single-name credit default swaps.[947] For example, the total aggregate notional amount for single-name credit default swaps was $6.2 trillion, while the aggregate total notional amount for index credit default swaps was $16.8 trillion over the sample period of January 1, 2011 to December 31, 2011. For the same sample period, however, single-name credit default swaps totaled 69% of transactional volume, while index credit default swaps comprised 31% of the total transactional volume.[948] The majority of trades in both notional amount and volume for both single-name and index credit default swaps over the 2011 sample period were new trades in contrast to assignments, increases, terminations or exits.[949] The analysis of the 2011 data further shows that by total notional amount and total volume the majority of single-name and index credit default contracts have a tenor of 5 years.[950] In addition, the data from the sample period indicates that the geographical distribution of counterparties' parent country domiciles in single name contracts are concentrated in the United States, United Kingdom, and Switzerland.[951]

As described more fully in the *CDS Data Analysis,*[952] based on 2011 transaction data, Commission staff identified entities currently transacting in the credit default swap market that may register as SBSDs by analyzing various criteria of their dealing activity. The results suggest that there is currently a high degree of concentration of potential dealing activity in the single-name credit default swap market. For example, using the criterion that dealers are likely to transact with many counterparties who themselves are not dealers, the analysis of the 2011 data show that only 28 out of 1,084 market participants have three or more counterparties that themselves are not recognized as dealers by ISDA.[953] In addition, the analysis suggests that dealers appear, based on the percentage of trades between buyer and seller principals, in the majority of all trades on either one or both sides in single-name and index credit default swaps.[954]

This concentration to a large extent appears to reflect the fact that those larger entities are well-capitalized and therefore possess competitive advantages in engaging in OTC security-based swap dealing activities by providing potential counterparties with adequate assurances of financial performance.[955] As such, it is

conditioned on the implementation of the proposed financial responsibility program—more information will be available for this analysis.

[940] *See* BIS, *Statistical Release: OTC derivatives statistics at end-December 2011,* 5 (May 2012), available at *http://www.bis.org/publ/otc_hy1205.pdf* (reflecting data reported by central banks in 14 countries: Belgium, Canada, France, Germany, England, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, the United States, Australia, and Spain).

[941] *Id.* at 12 (''Nominal or notional amounts outstanding are defined as the gross nominal or notional value of all deals concluded and not yet settled on the reporting date * * * Gross market values are defined as the sums of the absolute values of all open contracts with either positive or negative replacement values evaluated at market prices prevailing on the reporting date * * * gross market values supply information about the potential scale of market risk in derivatives transactions. Furthermore, gross market value at current market prices provides a measure of economic significance that is readily comparable across markets and products.'').

[942] *Id.*

[943] *Id.* Similarly, the OCC has found that interest rate products comprised 81% of the total notional amount of OTC derivatives held by bank dealers whereas credit derivative contracts comprised 6.4% and equity contracts comprised 1% of that notional amount. *See* OCC, *Quarterly Report on Bank Trading and Derivatives Activities, Fourth Quarter 2011,* available at *http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq411.pdf.*

[944] *See CFTC Margin Proposing Release,* 76 FR 27802; *Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564.

[945] *See Entity Definitions Adopting Release,* 77 FR at 30636. *See also Product Definitions Adopting Release,* 77 FR 48205 (defining the term *security-based swap*).

[946] Data compiled by the Commission's Division of Risk, Strategy, and Financial Innovation on credit default transactions from the DTCC–TIW between January 1, 2011 and December 31, 2011.

[947] *Id.* This data also shows the average mean and median single-name and index credit default swap notional transaction size in millions is 6.47 and 4.12, and 39.22 and 14.25, respectively.

[948] *Id.*

[949] *Id.*

[950] *Id.*

[951] *Id.*

[952] *See CDS Data Analysis.*

[953] *Id.* at Table 3c. The analysis of this transaction data is imperfect as a tool for identifying dealing activity, given that the presence or absence of dealing activity ultimately turns upon the relevant facts and circumstances of an entity's security-based swap transactions, as informed by the dealer-trader distinction. Criteria based on the number of an entity's counterparties that are not recognized as dealers nonetheless appear to be useful for identifying apparent dealing activity in the absence of full analysis of the relevant facts and circumstances, given that engaging in security-based swap transactions with non-dealers would be consistent with the conduct of seeking to profit by providing liquidity to others, as anticipated by the dealer-trader distinction.

[954] Data compiled by the Commission's Division of Risk, Strategy, and Financial Innovation on credit default transactions from the DTCC–TIW between January 1, 2011 and December 31, 2011. Additionally, according to the OCC, at the end of the first quarter of 2012, derivatives activity in the U.S. banking system continues to be dominated by a small group of large financial institutions. Four large commercial banks represent 93% of the total banking industry notional amounts and 81% of industry net current credit exposure. *See* OCC, *Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2012,* available at *http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq112.pdf.*

[955] *See, e.g.,* Craig Pirrong, *Rocket Science, Default Risk and The Organization of Derivatives*

Continued

reasonable to conclude that currently there likely are high barriers to entry in terms of capitalization in connection with security-based swap dealing activity.[956]

Other than OTC derivatives dealers, which are subject to significant limitations on their activities, broker-dealers historically have not participated in a significant way in security-based swap trading for at least two reasons. First, because the Exchange Act has not previously defined security-based swaps as ''securities,'' they have not been required to be traded through registered broker-dealers.[957] And second, a broker-dealer engaging in security-based swap activities is currently subject to existing regulatory requirements with respect to those activities, including capital, margin, segregation, and recordkeeping requirements. Specifically, the existing broker-dealer capital requirements make it relatively costly to conduct these activities in broker-dealers, as discussed in section II.A.2. of this release. As a result, security-based swap activities are currently mostly concentrated in entities that are affiliated with the parent companies of broker-dealers, but not in broker-dealers themselves.[958]

End users enter into OTC derivatives transactions to take investment positions or to hedge commercial and financial risk. These non-dealer end users of OTC derivatives are, for example, commercial companies, governmental entities, financial institutions, investment vehicles, and individuals. Available data suggests that the largest end users of credit default swaps are, in descending order, hedge funds, asset managers, and banks, which may have a commercial need to hedge their credit exposures to a wide variety of entities or may take an active view on credit risk.[959] Based on the available data, the Commission further estimates that *commercial end users* currently participate in the security-based swap markets on a very limited basis.[960]

Finally, this baseline for proposed new Rules 18a–1 through 18a–4 will be further discussed in the applicable sections of the release below.

Request for Comment

The Commission generally requests comment about its preliminary estimates of the scale and composition of the OTC derivatives market, including the relative size of the security-based swap segment of that market. In addition, the Commission requests that commenters provide data and sources of data to quantify:

1. The average daily and annual volume of OTC derivatives transactions;

2. The volume of transactions in each class of OTC derivatives (*e.g.,* interest rate swaps, index credit default swaps, single-name credit default swaps, currency swaps, commodity swaps, and equity-based swaps);

3. The total notional amount of all pending swap transactions;

4. The total current exposure of all pending swap transactions;

5. The total notional amount of all pending security-based swap transactions;

6. The total current exposure of all pending security-based swap transactions;

7. The types and numbers of dealers in OTC derivatives (*e.g.,* banks, broker-dealers, unregulated entities);

8. The capital levels of dealers, particularly those not subject to regulatory capital requirements;

9. The types and numbers of dealers in OTC derivatives dealers that engage in both a swap and security-based swap business;

10. The types and numbers of dealers in OTC derivatives that engage only in a swap business;

11. The types and numbers of dealers in OTC derivatives that engage only in a security-based swaps business;

12. The classes of end users (*e.g., commercial end users,* financial end users, and others) and the number of end users in each class;

13. The types of OTC derivatives transactions that each class of end user commonly engages in;

14. The amount of assets posted for OTC derivatives to collateralize current exposure;

15. The amount of assets posted for OTC derivatives to collateralize potential future exposure;

16. The type of assets used as collateral; and

17. The amount of assets that are held under the different types of collateral arrangements (*e.g.,* held by the dealer but not segregated, held by the dealer in omnibus segregation, held by a third-party custodian).

2. Baseline for Amendments to Rule 15c3–1

As discussed in more detail above, the Commission is proposing amendments to Rule 15c3–1.[961] These amendments would establish minimum net capital requirements for broker-dealers that register as SBSDs, increase the minimum net capital requirements for ANC broker-dealers, narrow the current treatment of credit risk charges for ANC broker-dealers to apply only to uncollateralized receivables from *commercial end users* arising from security-based swaps, and establish liquidity requirements for ANC broker-dealers and nonbank SBSDs using internal models. Some of those proposed amendments to Rule 15c3–1 would also apply to broker-dealers not registering as SBSDs or MSBSPs to the extent they hold security-based swap positions or non-security-based swap positions.

As discussed in section II.A.1. of this release, the existing broker-dealer capital requirements are contained in Rule 15c3–1 [962] and seven appendices to Rule 15c3–1.[963] The baseline for this economic analysis with respect to the proposed amendments to Rule 15c3–1 is

Markets, Working Paper 17–18 (2006), available at *http://www.cba.uh.edu/spirrong/Derivorg1.pdf* (noting that counterparties seek to reduce risk of default by engaging in credit derivative transactions with well-capitalized firms). *See also Entity Definitions Adopting Release,* 77 FR at 30739–30742.

[956] *See id.* at 18–19 (noting lack of success among new entrants into derivatives dealing market due to perception that AAA rating for subsidiary is less desirable than a slightly lower rating for a larger entity, and suggesting that there are ''economies of scale in bearing default risk'' that may induce ''substantial concentration in dealer activities''). *See also Entity Definitions Adopting Release,* 77 FR at 30739–30742.

[957] *See* definition of ''security'' in section 3(a)(10) of the Exchange Act and ''security-based swap'' in section 3(a)(68) of the Exchange Act.

[958] *See ISDA Margin Survey 2012.*

[959] This information is based on available market data from DTCC–TIW compiled by the Commission's Division of Risk, Strategy, and Financial Innovation. For example, data compiled by the Commission's Division of Risk, Strategy, and Financial Innovation on credit default transactions from the DTCC–TIW between January 1, 2011 and December 31, 2011 suggests that for single-name credit default swap transactions, dealer to dealer transactions composed 68.26% of trades between buyer and seller principals over the sample period.

[960] For example, data compiled by the Commission's Division of Risk, Strategy, and Financial Innovation on credit default transactions from the DTCC–TIW between January 1, 2011 and December 31, 2011 suggest that the total percentage of trades between buyer and seller principals over the sample period for single-name credit default swaps was only 0.03% of the total trade counterparty distribution for non-financial end users, which are composed of non-financial companies and family trusts.

[961] *See* section II.B. of this release.

[962] 17 CFR 240.15c3–1.

[963] 17 CFR 240.15c3–1a (Options); 17 CFR 240.15c3–1b (Adjustments to net worth and aggregate indebtedness for certain commodities transactions); 17 CFR 240.15c3–1c (Consolidated computations of net capital and aggregate indebtedness for certain subsidiaries and affiliates; 17 CFR 240.15c3–1d (Satisfactory subordination agreements); 17 CFR 240.15c3–1e (Deductions for market and credit risk for certain brokers or dealers); 17 CFR 240.15c3–1f (Optional market and credit risk requirements for OTC derivatives dealers); 17 CFR 240.15c3–1g (Conditions for ultimate holding companies of certain brokers or dealers).

the broker-dealer capital regime as it exists today.

Specifically, current Rule 15c3–1 requires broker-dealers to maintain a minimum level of net capital (meaning highly liquid capital) at all times.[964] The rule requires that a broker-dealer perform two calculations: (1) A computation of the minimum amount of net capital the broker-dealer must maintain; [965] and (2) a computation of the amount of net capital the broker-dealer is maintaining.[966] The minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying one of two financial ratios: the 15-to-1 aggregate indebtedness to net capital ratio or the 2% of aggregate debit items ratio.[967]

In computing net capital, the broker-dealer must, among other things, make certain adjustments to net worth such as deducting illiquid assets and taking other capital charges and adding qualifying subordinated loans.[968] ''Tentative net capital'' is defined as the amount remaining after these deductions.[969] The final step in computing net capital is to deduct from the mark-to-market values of the proprietary positions (*e.g.* in securities, money market instruments, and commodities) that are included in its tentative net capital prescribed percentages (''standardized haircuts'').[970] The standardized haircuts are designed to account for the market risk inherent in these proprietary positions and to create a buffer of liquidity to protect against other risks associated with the securities business.[971] With Commission approval, ANC broker-dealers and OTC derivative dealers are permitted to calculate deductions for market risk and credit risk from tentative net capital using internal models in lieu of the standardized haircuts.[972] Because the use of internal models to compute net capital generally can substantially reduce the deductions for proprietary positions compared to standardized haircuts and only certain risks are addressed by these internal models, current Rule 15c3–1 imposes substantially higher minimum capital requirements for ANC broker-dealers and OTC derivatives dealers as compared to other types of broker-dealers.[973] For example, under current Rule 15c3–1, ANC broker-dealers are required to at all times maintain tentative net capital of not less than $1 billion and net capital of not less than $500,000,[974] and they are required to provide notice to the Commission if their tentative net capital falls below $5 billion.[975] The current rule requires that a broker-dealer must ensure that its net capital exceeds its minimum net capital requirement at all times.[976]

Finally, the baseline of the current capital regime will be further discussed in the applicable sections of the release below.

B. Analysis of the Proposals and Alternatives

1. Overview—The Proposed Financial Responsibility Program

Generally, the financial responsibility requirements the Commission is proposing today are intended to enhance the financial integrity of SBSDs and MSBSPs. As discussed more fully below, in proposing these requirements, the Commission is seeking to appropriately consider both the potential benefits of minimizing the risk that the failure of one firm will cause financial distress to other firms and disrupt financial markets and the U.S. financial system and the potential costs to that firm, the financial markets, and the U.S. financial system if SBSDs and MSBPs are required to comply with overly restrictive capital, margin and segregation requirements. This introductory section reviews at a general level certain considerations regarding the economic analysis of the proposed rules that is set forth in greater detail below.

As discussed in section I. of the release, the current broker-dealer financial responsibility requirements serve as the template for the proposals for several reasons. First, the financial markets in which SBSDs and MSBSPs are expected to operate are similar to the financial markets in which broker-dealers operate in the sense that they are driven in significant part by dealers that buy and sell on a regular basis and that take principal risk. Second, like nonbank dealers in securities but unlike bank SBSDs, nonbank SBSDs will not be able to rely on a backstop provider of liquidity but rather need to be able to liquidate assets quickly in the event of a counterparty default. Third, the broker-dealer financial responsibility requirements have existed for many years and have facilitated the prudent operation of broker-dealers.[977] Fourth, some broker-dealers likely will be registered as nonbank SBSDs so as to be able to offer customers a broader range of services than would be permitted as a stand-alone SBSD. Therefore, establishing consistent financial responsibility requirements would avoid potential competitive disparities between stand-alone SBSDs and broker-dealer SBSDs. And fifth, by placing an emphasis on maintaining liquid assets and requiring the segregation of customer funds, the current broker-dealer financial responsibility requirements have generally been successful in limiting losses to customers due to broker-dealer defaults.[978] Consequently, the current broker-dealer financial responsibility requirements provide a reasonable template for building a financial responsibility program for SBSDs and MSBSPs.

However, the Commission recognizes that there may be other appropriate

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[964] *See* 17 CFR 240.15c3–1.

[965] *See* 17 CFR 240.15c3–1(a).

[966] *See* 17 CFR 240.15c3–1(c)(2). The computation of net capital is based on the definition of ''net capital'' in paragraph (c)(2) of Rule 15c3–1. *Id.*

[967] *See* 17 CFR 240.15c3–1(a).

[968] *See* 17 CFR 240.15c3–1(c)(2)(i)–(xiii).

[969] *See* 17 CFR 240.15c3–1(c)(15).

[970] *See* 17 CFR 240.15c3–1(c)(2)(vi).

[971] *See, e.g., Uniform Net Capital Rule,* 42 FR 31778 (''[Haircuts] are intended to enable net capital computations to reflect the market risk inherent in the positioning of the particular types of securities enumerated in [the rule]'').

[972] *See* 17 CFR 240.15c3–1(a)(5) and (a)(7); 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f. As part of the application to use internal models, an entity seeking to become an ANC broker-dealer or an OTC derivatives dealer must identify the types of positions it intends to include in its model calculation. *See* 17 CFR 240.15c3–3e(a)(1)(iii); 17 CFR 240.15c3–1f(a)(1)(ii). After approval, the ANC broker-dealer or OTC derivatives dealer must obtain Commission approval to make a material change to the model, including a change to the types of positions included in the model. *See* 17 CFR 240.15c3–1e(a)(8); 17 CFR 240.15c3–f(a)(3).

[973] *See* 17 CFR 240.15c3–1(a)(5) and (a)(7).

[974] 17 CFR 240.15c3–1(a)(7)(i).

[975] 17 CFR 240.15c3–1(a)(7)(ii).

[976] 17 CFR 240.15c3–1(a).

[977] For example, one of the objectives of the broker-dealer financial responsibility requirements is to protect customers from the consequences of the financial failure of a broker-dealer in terms of safeguarding customer securities and funds held by the broker-dealer. In this regard, SIPC, since its inception in 1971, has initiated customer protection proceedings for only 324 broker-dealers, which is less than 1% of the approximately 39,200 broker-dealers that have been members of SIPC during that timeframe. During the same period, only $1.1 billion of the $117.5 billion of cash and securities distributed for accounts of customers came from the SIPC fund rather than debtors' estates. *See SIPC 2011 Annual Report.*

[978] For example, of the more than 625,200 claims satisfied in completed or substantially completed cases since SIPC's inception in 1971, as of December 31, 2011, a total of 351 were for cash and securities whose value was greater than the limits of protection afforded by SIPA. The 351 claims, unchanged during 2011, represent less than one-tenth of one percent of all claims satisfied. The unsatisfied portion of claims, $47.2 million, is unchanged in 2011. These remaining claims approximate three-tenths of one percent of the total value of securities and cash distributed for accounts of customers in those cases. *See SIPC 2011 Annual Report.* These figures do not include the SIPA liquidations of Bernard L. Madoff Investment Securities LLC and Lehman Brothers Inc., which are not complete.

approaches to establishing financial responsibility requirements—including, for example, requirements based on the Basel Standard in the case of entities that are part of a bank holding company, as has been proposed by the CFTC.[979] Generally, the bank capital model requires the holding of specified levels of capital as a percentage of ''risk weighted assets.'' [980] In general, it does not require a full capital deduction for unsecured receivables, given that banks, as lending entities, are in the business of extending credit to a range of counterparties.

This approach could promote a consistent view and management of capital within a bank holding company structure. However, it would not be a net liquid assets standard. In addition, applying capital rules designed for banks to a non-bank entity would raise various practical and policy issues that are not directly implicated by the proposed approach. First, it would need to be clear whether a regulator with primary responsibility for the non-bank entity would defer to bank regulators with respect to the interpretation of Basel standards as applied to the entity, or instead develop its own interpretation of those standards. Further, it would need to be clear how trading and other risks of the non-bank entity and its bank affiliate or affiliates would be expected to be managed, whether such risks would be managed holistically at the holding company level or separately at the entity level, and what limitations, if any, would apply to transfers of risks from a bank to its non-bank entity affiliate, or vice versa. In addition, to the extent that bank capital standards would permit the non-bank entity to hold more illiquid assets as regulatory capital, an additional liquidity standard might be required at the entity level in order to assure that the entity maintained sufficient liquidity to support its trading activity. Similarly, if the non-bank entity were an SBSD that held assets for customers, the impact of any reduced liquidity associated with the application of bank capital standards on the ability of the entity to quickly wind down operations and distribute assets to customers would need to be considered. The Commission specifically seeks comment as to whether to adapt Basel capital standards to non-bank affiliates of banks, and how such a regime would work in practice—including how it would address the issues described above and similar challenges.

The Commission also recognizes that in determining appropriate financial responsibility requirements—whether based on current broker-dealer rules or other alternative approaches described above—it must assess and consider a number of different costs and benefits, and the determinations it ultimately makes can have a variety of economic consequences for the relevant firms, markets, and the financial system as a whole. On the one hand, the capital and margin requirements in particular are broadly intended to work in tandem to strengthen the financial system by reducing the potential for default to an acceptable level and limiting the amount of leverage that can be employed by SBSDs and other market participants. Requiring particular firms to hold more capital or exchange more margin may reduce the risk of default by one or more market participants and reduce the amount of leverage employed in the system generally, which in turn may have a number of important benefits. The failure of an SBSD could result in immediate financial loss to its counterparties or customers, particularly those that are not able to avoid losses by liquidating collateral or those that have delivered assets for custody by the SBSD. Since the primary benefit of the capital and margin requirements is to reduce the probability of a SBSD failure, potential counterparties may be more willing to transact when they have greater assurance that they will be paid following a credit event. Depending on the size of the SBSD and its interconnectedness with other market participants, such a default also could have adverse spillover or contagion effects that could create instability for the financial markets more generally, such as limiting the willingness of healthy market participants to extend credit to each other, and thus substantially reduce liquidity and valuations for particular types of financial instruments.[981] Further, to the extent that market participants generally perceive that the prudential requirements are sufficient to protect them from losses due to a counterparty's default, the security-based swap market may experience increased trading activity, reduced transaction costs, improved liquidity, enhanced capital formation, and an improved ability to manage risk.

On the other hand, as described below, higher financial responsibility requirements for individual firms also give rise to direct costs for the firms involved and potentially significant collective costs for the markets and the financial system as a whole. For example, overly restrictive requirements that increase the cost of trading by individual firms could reduce their willingness to engage in such trading, adversely affecting liquidity in the security-based swaps markets and increasing transaction costs for market participants. Similarly, capital requirements that are set high enough to limit or restrict the willingness or ability of new firms to enter the market may impair or reduce competition in the markets, which in turn could also adversely affect liquidity and price discovery and increase transaction costs. Any such reduction in liquidity or price discovery, or increase in transaction costs, could adversely affect efficiency and impose direct costs on those market participants who rely on security-based swaps to manage or hedge the risks arising from their business activities that may support or promote capital formation. Even if the cost of overly restrictive financial responsibility requirements were shouldered only by those market participants that are subject to them, the excess amount of capital or margin tied up as a result of those requirements would not be available for potentially more efficient uses, which thereby could impair effective capital allocation and formation.

Although, in establishing appropriate financial responsibility requirements that are neither insufficient nor excessive, the Commission must seek to consider these and other potential benefits and costs, the Commission notes that it is difficult to quantify such benefits and costs. For example, although the adverse spillover effects of defaults on liquidity and valuations were evident during the financial crisis,[982] it is difficult to quantify the

[979] *CFTC Capital Proposing Release,* 76 FR 27802.

[980] The prudential regulators also have proposed capital rules that would require a covered swap entity to comply with the regulatory capital rules already made applicable to that covered swap entity as part of its prudential regulatory regime. *Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27568. The prudential regulators note that they have ''had risk-based capital rules in place for banks to address over-the-counter derivatives since 1989 when the banking agencies implemented their risk-based capital adequacy standards * * * based on the first Basel Accord.'' *Id.*

[981] *See, e.g.,* Markus K. Brunnermeier and Lasse Heje Pedersen, *Market Liquidity and Funding Liquidity, Review of Financial Studies,* 22 Review of Financial Studies 2201 (2009); Denis Gromb and Dimitri Vayanos, *A Model of Financial Market Liquidity Based on Intermediary Capital,* 8 Journal of the European Economic Association 456 (2010).

[982] *See* aggregate derivatives claims on Lehman Brothers Special Finance initially filed by the top 30 financial institution counterparties was estimated to be approximately $22 billion, available at *http://chapter11.epiqsystems.com/LBH/document/GetDocument.aspx?DocumentId=1386611* and

effects of measures intended to reduce the default probability of the individual intermediary, the ensuing prevention of contagion, and the adverse effects on liquidity and valuation. More broadly, it is difficult to quantify the costs and benefits that may be associated with steps to mitigate or avoid a future financial crisis. Similarly, although capital, margin, or segregation requirements may, among other things, affect liquidity and transaction costs in the security-based swap markets, and result in a different allocation of capital than may otherwise occur, it is difficult to quantify the extent of these effects, or the resulting effect on the financial system more generally.

These difficulties are further aggravated by the fact that only limited public data related to the security-based swap market, in general, and to security-based swap market participants in particular, exist, all of which could assist in quantifying certain benefits and costs. It also is difficult to demonstrate empirically that the customer protections associated with the proposed financial responsibility requirements would alter the likelihood that any specific market participant would suffer injury, or the degree to which the participant would suffer injury, from participating in an under- or over-regulated security-based swap market.

In light of these challenges, much of the discussion of the proposed rules in this economic analysis will remain qualitative in nature, although where possible the economic analysis attempts to quantify these benefits and costs. The inability to quantify these benefits and costs, however, does not mean that the benefits and costs of the proposals are any less significant. In addition, as noted above, the proposed rules include a number of specific quantitative requirements—such as numerical thresholds, limits, deductions and ratios. The Commission recognizes that the specificity of each such quantitative requirement could be read by some to imply a definitive conclusion based on quantitative analysis of that requirement and its alternatives. These quantitative requirements have not been derived directly from econometric or mathematical models. Instead, they reflect a preliminary assessment by the Commission, based on qualitative analysis, regarding the appropriate financial standard for an identified issue, drawing (as noted above) from the Commission's long-term experience in administering its existing broker-dealer financial responsibility regime as well as its general experience in regulating broker-dealers and markets and from comparable quantitative requirements in its own rules and those of other regulators. Accordingly, the discussion generally describes in a qualitative way the primary costs, benefits and other economic effects that the Commission has identified and taken into account in developing these specific quantitative requirements. The Commission emphasizes that it invites comment, including relevant data and analysis, regarding all aspects of the various quantitative requirements reflected in the proposed rules.

Finally, the Commission notes that the proposals ultimately adopted, like other requirements under the Dodd-Frank Act, could have a substantial impact on international commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions. U.S. or foreign firms could be advantaged or disadvantaged depending on how the rules ultimately adopted by the Commission compare with corresponding requirements in other jurisdictions. Such differences could in turn affect cross-border capital flows and the ability of global firms to most efficiently allocate capital among legal entities to meet the demands of their counterparties. The Commission intends to address the potential international implications of the proposed capital, margin and segregation requirements, together with the full spectrum of other issues relating to the application of Title VII to cross-border security-based swap transactions, in a separate proposal.

a. Nonbank SBSDs

In addition to fulfilling a statutory requirement, it is expected that the proposed capital, margin and segregation rules should be beneficial to market participants by advancing market transparency, risk reduction and counterparty protection as Title VII of the Dodd-Frank Act intended.[983] It can be further expected that these benefits manifest themselves over the long-term and benefit the market as a whole. To the extent that the proposed rules increase the safety and soundness of entities that register as nonbank SBSDs and not just codify current practice, the proposals should specifically reduce the likelihood of default by an intermediary with substantial positions in security-based swaps and possible negative spillover effects. This would further imply that without the proposed rules in place, such an event could result in significant losses to counterparties whose exposures to the defaulting dealer are not sufficiently secured, which, depending on the size of individual counterparty exposures, could lead to defaults of those counterparties. Such events could then deter intermediaries from entering into financing transactions,[984] even with creditworthy counterparties, which could ultimately adversely affect valuation and liquidity in the broader financial markets.[985]

Apart from the positive impact on the safety and soundness of the security-based swap market, the proposed new rules and rule amendments could create the potential for regulatory arbitrage to the extent that they differ from corresponding rules other regulators adopt. As noted above in section I. of this release, the Commission is proposing capital and margin requirements for nonbank SBSDs that differ in some respects from the prudential regulators' proposed capital and margin requirements for bank SBSDs.[986] Depending on the final rules the Commission adopts, the financial responsibility requirements could make it more or less costly to conduct security-based swaps trading in banks as compared to nonbank SBSDs. For example, if the application of the proposed 8% margin risk factor substantially increases capital requirements for nonbank SBSDs compared to the risk-based capital requirements imposed by the prudential regulators on the same activity, bank holding companies could be incentivized to conduct these activities in their bank affiliates.[987] On the other hand, if the Commission does not require nonbank SBSDs to collect initial margin in their transactions with each other, as is generally current market practice,[988] while the prudential regulators require the collection of initial margin for the same trades as their proposed rules suggest, intermediaries could have an incentive

http://chapter11.epiqsystems.com/LBH/document/GetDocument.aspx?DocumentId=1430484.

[983] *See* section I. of this release.

[984] *See, e.g.,* Markus K. Brunnermeier and Lasse Heje Pedersen, *Market Liquidity and Funding Liquidity, Review of Financial Studies* at 22; Denis Gromb and Dimitri Vayanos, *A Model of Financial Market Liquidity Based on Intermediary Capital* at 8.

[985] *See* aggregate derivatives claims on Lehman Brothers Special Finance initially filed by the top 30 financial institution counterparties was estimated to be approximately $22 billion, available at *http://chapter11.epiqsystems.com/LBH/document/GetDocument.aspx?DocumentId=1386611* and *http://chapter11.epiqsystems.com/LBH/document/GetDocument.aspx?DocumentId=1430484.*

[986] *See* section I. of this release.

[987] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564.

[988] *See generally ISDA Margin Survey 2011.*

to conduct business through nonbank entities.[989] These differences could create competitive inequalities and affect the allocation of trading activities within a holding company structure.

The proposed financial responsibility requirements for SBSDs would also result in costs to individual market participants and may affect the amount of capital available to support security-based swap transactions generally.[990] As described in section V.B.1 immediately above, if SBSDs are required to maintain an excessive amount of capital, that amount may result in certain costs for the markets and the financial system, including the potential for the reduced availability of security-based swaps for market participants who would otherwise use such transactions to hedge the risks of their business, or engage in other activities that would promote capital formation. In addition, in some cases, these costs may include costs to financial conglomerates to restructure their security-based swap activities or move them into affiliates that register as SBSDs.[991] Nonbank SBSDs as well as other market participants would also incur costs to hire compliance personnel and to establish internal systems, procedures and controls designed to ensure compliance with the new requirements. Some of these costs were discussed in the PRA analysis in section IV of this release. Finally, the full cost impact of the proposed financial responsibility requirements will depend to some extent on other rules related to SBSDs (*e.g.,* registration) that the Commission has not yet adopted.[992]

Costs related to specific sections of the proposed new rules and rule amendments are discussed below. Some of these costs may be largely fixed in nature; other costs (such as minimum capital requirements and margin costs) may be variable as they reflect the level of the nonbank SBSD's security-based swap activity. End users also may incur increased transaction costs in connection with the proposals as SBSDs are likely to pass on the financial burden of any increased capital, margin or segregation requirements to customers.[993]

This economic analysis considers the overall benefits and costs of the proposed new rules and amendments, keeping in mind that the benefits may be distributed across market participants, accrue over the long-term, and are difficult to quantify or to measure as easily as certain costs.

Request for Comment

The Commission generally requests comment about its analysis of the general costs and benefits of the proposed rules. The Commission requests data to quantify and estimates of the costs and the value of the benefits of the proposals described above. The Commission also requests data to quantify the impact of the proposals against the baseline. In addition, the Commission requests comment in response to the following questions:

1. In general terms, how effectively would the proposed rules limit systemic risk arising from security-based swap transactions? Please explain.

2. In general, how would the proposed rules and rule amendments impact the capital of entities that would need to register as nonbank SBSDs? For example, would they require these entities to hold more capital? If so, what would be the impact of the availability of sources of funding to these entities?

3. How important is parity of treatment between nonbank SBSDs and bank SBSDs in terms of regulatory requirements, and how should parity be understood? For example, should nonbank SBSDs and bank SBSDs be required to hold the same amounts of capital to support a certain level of security-based swaps business?

4. To what extent would the proposed regulatory requirements impact the amount of liquidity provided for or required by security-based swap market participants, and to what extent will that affect the funding cost for the financial sector in particular and the economy in general? Please quantify.

b. Nonbank MSBSPs

As with their application to nonbank SBSDs, in addition to fulfilling a statutory requirement, it is expected that the proposed capital, margin and notification requirements under the segregation rules for MSBSPs will advance market transparency, risk reduction and counterparty protection as Title VII of the Dodd-Frank Act intended.[994] However, in contrast to capital and margin requirements for nonbank SBSDs, the proposed rules for nonbank MSBSPs are intended to limit the impact on counterparties of a potential default by a nonbank MSBSP, rather than to create prudential standards that would render the possibility of its failure more remote. Capital standards of the type that would apply to SBSDs[995] may not be practical for nonbank MSBSPs, depending on their individual business models and whether they are subject to any other prudential requirements. Accordingly, the proposals are intended to ensure that nonbank MSBSPs meet a minimum capital standard by maintaining a positive tangible net worth,[996] collateralize their current exposures to end users, and post collateral to counterparties that covers at least the amount of the current exposure of those counterparties to them.[997]

These proposed requirements are expected to have a relatively smaller aggregate effect than the proposed financial responsibility requirements for nonbank SBSDs because they are likely to affect relatively fewer entities. The Commission expects that only 5 or fewer entities will register as nonbank MSBSPs with the Commission.[998] Another approach, discussed further below, would subject MSBSPs to a capital regime similar to that proposed for nonbank SBSDs.

The proposed financial responsibility requirements for MSBSPs would also result in costs to individual market participants and may affect the amount of capital available to support security-based swap transactions overall and the financial markets generally. To the extent that the proposed capital and margin requirements are too restrictive, it could limit capital formation and the use of security-based swaps to hedge risks associated with the MSBSP's business activities.[999]

The proposed requirements may also impose more limited compliance burdens on MSBSPs. For example, nonbank MSBSPs as well as other market participants would also incur costs to hire compliance personnel and to establish internal systems, procedures and controls designed to ensure compliance with the new requirements.[1000] Some of these costs are discussed in the PRA analysis in section IV. of this release. Finally, the full cost impact of the proposed financial responsibility requirements will depend to some extent on other rules related to MSBSPs (*e.g.,* registration) that the Commission has not yet adopted.[1001]

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[989] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564.

[990] *See* section II. of this release.

[991] *See SBSD Registration Proposing Release,* 76 FR 65784.

[992] *Id.*

[993] If the rules succeed in improving competition among dealers in the security-based swap market rules this pass-through behavior should be less of a concern.

[994] *See* section I. of this release.

[995] *See* proposed new Rule 18a–1.

[996] *See* proposed new Rule 18a–2.

[997] *See* proposed new Rule 18a–3.

[998] *See* section IV.C. of this release.

[999] *See* section II. of this release.

[1000] *See* section V.C. of this release.

[1001] *See SBSD Registration Proposing Release,* 76 FR 65784.

Costs related to specific sections of the proposed new rules and rule amendments are discussed below. Some of these costs may be largely fixed in nature; other costs (such as minimum capital requirements and margin costs) may be variable as they reflect the level of the nonbank MSBSP's security-based swap activity.

Request for Comment

The Commission generally requests comment about its analysis of the general costs and benefits of the proposed rules on MSBSPs. The Commission requests data to quantify and estimates of the costs and the value of the benefits of the proposals for MSBSPs described above.

2. The Proposed Capital Rules

a. Nonbank SBSDs and ANC Broker-Dealers

As discussed above in section II.A. of this release, proposed new Rule 18a–1 would prescribe capital requirements for stand-alone SBSDs, and proposed amendments to Rule 15c3–1 would prescribe capital requirements for broker-dealer SBSDs and increase existing capital requirements for ANC broker-dealers.[1002] The proposed amendments to Rule 15c3–1 would apply to broker-dealers that are not registered as SBSDs to the extent they hold positions in security-based swaps and swaps. In addition, the Commission is proposing liquidity requirements for ANC broker-dealers and stand-alone SBSDs that use internal models to compute net capital.[1003] Finally, the Commission is proposing to require that all nonbank SBSDs comply with Rule 15c3–4, which requires the establishment of a risk management control system.[1004]

As described above, the capital and other financial responsibility requirements for broker-dealers generally provide a reasonable template for crafting the corresponding requirements for nonbank SBSDs. For example, among other considerations, the objectives of capital standards for both types of entities are similar. Rule 15c3–1 is a net liquid assets test that is designed to require a broker-dealer to maintain sufficient liquid assets to meet all obligations to customers and counterparties and have adequate additional resources to wind-down its business in an orderly manner without the need for a formal proceeding if it fails financially. The objective of the proposed capital standards for nonbank SBSDs is the same.

In addition, as discussed in section II.A.1. above, the Dodd-Frank Act divided responsibility for SBSDs and MSBSPs by providing the prudential regulators with authority to prescribe the capital and margin requirements for bank SBSDs and the Commission with authority to prescribe capital and margin requirements for nonbank SBSDs.[1005] This division also suggests it may be appropriate to model the capital requirements for nonbank SBSDs on the capital standards for broker-dealers, while the capital requirements for bank SBSDs are modeled on capital standards for banks (as reflected in the proposal by the prudential regulators).[1006]

As discussed in section II.A.1. above, certain differences in the activities of securities firms, banks, and commodities firms, differences in the products at issue, or the balancing of relevant policy choices and considerations, appear to support this distinction between nonbank SBSDs and bank SBSDs. First, based on the Commission staff's understanding of the activities of nonbank dealers in OTC derivatives, nonbank SBSDs are expected to engage in a securities business with respect to security-based swaps that is more similar to the dealer activities of broker-dealers than to the activities of banks; indeed, some broker-dealers likely will be registered as nonbank SBSDs.[1007] Second, existing capital standards for banks and broker-dealers reflect, in part, differences in their funding models and access to certain types of financial support, and those same differences also will exist between bank SBSDs and nonbank SBSDs. For example, banks obtain funding through customer deposits and can obtain liquidity through the Federal Reserve's discount window; whereas broker-dealers do not—and nonbank SBSDs will not—have access to these sources of funding and liquidity. Third, Rule 15c3–1 currently contains provisions designed to address dealing in OTC derivatives by broker-dealers and, therefore, to some extent already can accommodate this type of activity (although, as discussed below, proposed amendments to Rule 15c3–1 would be designed to more specifically address the risks of security-based swaps and the potential for increased involvement of broker-dealers in the security-based swaps markets).[1008] For these reasons, the proposed capital standard for nonbank SBSDs is a net liquid assets test modeled on the broker-dealer capital standard in Rule 15c3–1.

The net liquid assets test is designed to allow a broker-dealer to engage in activities that are part of conducting a securities business (*e.g.,* taking securities into inventory) but in a manner that places the firm in the position of holding at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities (*e.g.,* money owed to customers, counterparties, and creditors). For example, Rule 15c3–1 allows securities positions to count as allowable net capital, subject to standardized or internal model-based haircuts.[1009] The rule, however, does not permit most unsecured receivables to count as allowable net capital.[1010]

This aspect of the rule severely limits the ability of broker-dealers to engage in activities, such as unsecured lending, that generate unsecured receivables. The rule also does not permit fixed assets or other illiquid assets to count as allowable net capital, which creates disincentives for broker-dealers to own real estate and other fixed assets that cannot be readily converted into cash. For these reasons, Rule 15c3–1 incentivizes broker-dealers to confine their business activities and devote capital to activities such as underwriting, market making, and advising on and facilitating customer securities transactions.

Proposed new Rule 18a–1 and the proposed amendments to Rule 15c3–1 would provide a number of benefits, as well as impose certain costs on nonbank SBSDs, broker-dealer SBSDs, and broker-dealers, which are described below. In considering costs, in cases where the Commission is proposing amendments to Rule 15c3–1, the baseline is the current broker-dealer capital regime under Rule 15c3–1.[1011] The proposed rule also will have possible effects on competition, efficiency, and capital formation, which will be discussed further below.

[1002] *See* proposed new Rule 18a–1.

[1003] *See* proposed paragraph (f) to Rule 15c3–1; paragraph (f) of proposed new Rule 18a–1.

[1004] *See* proposed new paragraph (a)(10)(ii) of Rule 15c3–1; paragraph (g) of proposed new Rule 18a–1. *See also* 17 CFR 240.15c3–4.

[1005] *See* 15 U.S.C. 78o–10, in general; 15 U.S.C. 78o–10(e)(2)(A)–(B), in particular.

[1006] The prudential regulators have proposed capital requirements for bank SBSDs and bank swap dealers that are based on the capital requirements for banks. *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27582.

[1007] *Id.*

[1008] *See* 17 CFR 240.15c3–1f and 17 CFR 240.15c3–1e. *See also Alternative Net Capital Requirements Adopting Release,* 69 FR 34428; *OTC Derivatives Dealers,* 63 FR 59362.

[1009] *See* 17 CFR 240.15c3–1(c)(2)(vi); 17 CFR 240.15c3–1e; 17 CFR 240.15c3–1f.

[1010] *See* 17 CFR 240.15c3–1(c)(2)(iv).

[1011] 17 CFR 240.15c3–1.

i. Minimum Capital Requirements

The following table provides a summary of the proposed minimum capital requirements under the proposed new Rule 18a–1 and proposed amendments to Rule 15c3–1:

Proposed Minimum Capital Requirements

Type of Registrant	Tentative Net Capital	Net Capital	
		Fixed Dollar	Financial Ratio
Stand-alone SBSD (not using internal models)	N/A	$20 million	8% margin factor
Stand-alone SBSD (using internal models)	$100 million	$20 million	8% margin factor
Broker-dealer SBSD (not using internal models)	N/A	$20 million	8% margin factor+ Rule 15c3-1 ratio
Broker-dealer SBSD (using internal models)	$5 billion	$1 billion	8% margin factor+ Rule 15c3-1 ratio

Stand-alone SBSDs and broker-dealer SBSDs that are not approved to use internal models, that is, are neither ANC broker-dealers nor OTC derivatives dealers, would be required to maintain net capital of the larger of $20 million or 8% of the firm's margin factor. The proposed $20 million fixed-dollar minimum requirement would be consistent with the fixed-dollar minimum requirement applicable to OTC derivatives dealers and already familiar to existing market participants.[1012] OTC derivatives dealers are limited purpose broker-dealers that are authorized to trade in certain derivatives, including security-based swaps, use internal models to calculate net capital, and they are required to maintain minimum tentative net capital of $100 million and minimum net capital of $20 million.[1013] These current fixed-dollar minimums have been the minimum capital standards for OTC derivative dealers for over a decade and to date, there have been no indications that these minimums are not adequately meeting the objective of requiring OTC derivatives dealers to maintain sufficient levels of regulatory capital to account for the risks inherent in their activities.

However, the proposed $20 million fixed-dollar minimum requirement for stand-alone SBSDs not using internal models to calculate net capital would be substantially higher than the fixed-dollar minimums in Rule 15c3–1 currently applicable to broker-dealers that do not use internal models.[1014] The proposed more stringent minimum capital requirement of $20 million for stand-alone SBSDs not approved to use models reflects the facts that these firms: (1) Unlike broker-dealers, will be able to deal in security-based swaps, which, in general, pose risks that are different from, and in some respects greater than, those arising from dealing in securities; but (2) unlike OTC derivative dealers have direct customer relationships and have custody of customer funds.[1015] Therefore, without the increased requirements, a failure of a stand-alone SBSD would, ceteris paribus, be more likely than a failure of an OTC derivatives dealer and, as a consequence of the relationships with customers, would have a broader adverse impact on a larger number of market participants, including customers and counterparties.[1016] Consequently, these heightened requirements should enhance the safety and soundness of the nonbank SBSDs, and thereby reduce systemic risk, as well as increase market participants' confidence in the security-based swap markets. Stand-alone SBSDs not approved to use internal models would not, however, be subject to a minimum tentative net capital requirement, which is applied to only firms that use internal models to account for risks not fully captured by the models.[1017]

Stand-alone SBSDs using models would be required to maintain minimum net capital of the higher of $20 million or the 8% margin factor, as well as a minimum tentative net capital of $100 million, a requirement that also applies to OTC derivatives dealers. Models to calculate deductions from tentative net capital for proprietary positions take only market and credit risk into account and therefore generally lead to lower deductions and higher levels of net capital.[1018] The minimum

[1012] *See* 17 CFR 240.15c3–1(a)(5). The CFTC proposed a $20 million fixed-dollar minimum net capital requirement for FCMs that are registered as swap dealers, regardless of whether the firm is approved to use internal models to compute regulatory capital. *See CFTC Capital Proposing Release,* 76 FR 27802. Further, the CFTC proposed a $20 million fixed-dollar ''tangible net equity'' minimum requirement for swap dealers and major swap participants that are not FCMs *and are not* affiliated with a U.S. bank holding company. Finally, the CFTC proposed a $20 million fixed-dollar Tier 1 capital minimum requirement for swap dealers and major swap participants that are not FCMs *and are* affiliated with a U.S. bank holding company (the term ''Tier 1 capital'' refers to the regulatory capital requirement for U.S. banking institutions). *Id.*

[1013] *See* 17 CFR 240.15c3–1(a)(5).

[1014] For example, a broker-dealer that carries customer accounts has a fixed-dollar minimum requirement of $250,000; a broker-dealer that does not carry customer accounts but engages in proprietary securities trading (defined as more than ten trades a year) has a fixed-dollar minimum requirement of $100,000; and a broker-dealer that does not carry accounts for customers or otherwise receive or hold securities and cash for customers, and does not engage in proprietary trading activities, has a fixed-dollar minimum requirement of $5,000. *See* 17 CFR 240.15c3–1(a)(2).

[1015] *See* 17 CFR 240.3b–12; 17 CFR 240.15a–1.

[1016] The proposal is consistent with the CFTC's proposed capital requirements for nonbank swap dealers, which impose $20 million fixed-dollar minimum requirements regardless of whether the firm is approved to use internal models to compute regulatory capital. *See CFTC Capital Proposing Release,* 76 FR 27802.

[1017] OTC derivatives dealers are subject to a $100 million minimum tentative net capital requirement. ANC broker-dealers are currently subject to a $1 billion minimum tentative net capital requirement. The minimum tentative net capital requirements are designed to address risks that may not be captured when using internal models rather than standardized haircuts to compute net capital. *See OTC Derivatives Dealers,* 63 FR at 59384; *Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities; Proposed Rule,* Exchange Act Release No. 48690 (Oct. 24, 2003), 68 FR 62872, 62875 (Nov. 6, 2003).

[1018] *See, e.g., Alternative Net Capital Requirements Adopting Release,* 69 FR at 34455 (describing benefits of alternative net capital requirements for broker-dealers using models stating a ''major benefit for the broker-dealer will be lower deductions from net capital for market and credit risk that we expect will result from the use of the alternative method.''). Therefore, it is likely

tentative net capital requirement for firms using models is intended to provide an additional assurance of adequate capital to reflect this concern.

However, because the tentative net capital calculation does not take account of market risk deductions, the minimum $100 million tentative net capital requirement might be a less effective standard in cases where a dealer maintains a substantial amount of less liquid positions that require relatively large deductions for market risk. As an alternative, the Commission could impose a minimum requirement that increases according to the nature and size of the positions held, for example, 25% of the market risk deductions that are required to be taken in determining actual net capital. This approach could better scale the tentative net capital requirement according to the risk of the proprietary positions held by an SBSD. On the other hand, a variable tentative net capital test would not serve as an accurate measure of risk if the model did not appropriately capture all material risks of the positions or the assumptions underlying the use of the model were no longer appropriate. The variable tentative net capital test also could increase the tentative net capital requirement in some cases to a level that could limit or discourage the entry of firms that do not presently compete in the security-based swap markets. Further, as noted above, the minimum net capital requirement in each case would increase in accordance with an increase in the amount of business conducted as a result of the 8% margin factor. The Commission is specifically seeking comment on this alternative in section II.A.1. of this release.

Under the proposed amendments to Rule 15c3–1, ANC broker-dealers would be required to maintain: (1) Tentative net capital of not less than $5 billion; and (2) net capital of not less than the greater of $1 billion or the financial ratio amount required pursuant to paragraph (a)(1) of Rule 15c3–1 *plus* the 8% margin factor.[1019] These relatively high minimum capital requirements for ANC dealers (as compared with the requirements for other types of broker-dealers) reflect the substantial and diverse range of business activities engaged in by ANC broker-dealers and their importance as intermediaries in the securities markets.[1020] Further, the heightened capital requirements reflect the fact that, as noted above, VaR models are more risk sensitive but also generally permit substantially reduced deductions to tentative net capital as compared to the standardized haircuts as well as the fact that VaR models may not capture all risks.[1021]

Based on financial information reported by the ANC broker-dealers in their monthly FOCUS Reports filed with the Commission, the six current ANC broker-dealers maintain capital levels in excess of these proposed increased minimum requirements. For example, at the end of 2011, the interquartile range of net capital and tentative net capital levels among the six ANC broker-dealers were from $1.11 billion to $7.77 billion and from $1.32 billion to $9.69 billion, respectively. Further, ANC broker-dealers are currently required to notify the Commission if their tentative net capital falls below $5 billion.[1022] This notification provision is used by the Commission to trigger increased supervision of the firm's operations and to take any necessary corrective action and is similar to corollary ''early warning'' requirements for OTC derivatives dealers.[1023] Consequently, this $5 billion ''early warning'' level currently acts as the de facto minimum tentative net capital requirement since the ANC broker-dealers seek to avoid providing this regulatory notice that their tentative net capital has fallen below the early warning level.[1024]

Although increases to minimum tentative and minimum net capital requirements are being proposed, the proposals may not present a material cost to the current ANC broker-dealers, because they already hold more than the proposed minimum requirements in the amendments to Rule 15c3–1. The more relevant number is the proposed increase in the early warning notification threshold from $5 billion to $6 billion. The existing early warning requirement for OTC derivatives dealers triggers a notice when the firm's tentative net capital falls below an amount that is 120% of the firm's required minimum tentative net capital amount of $100 million ($120 million = $1.2 \times \$100$ million).[1025] The proposed new ''early warning'' threshold for ANC broker-dealers of $6 billion (= $1.2 \times \$5$ billion) in tentative net capital is modeled on this requirement. In general, because the amount of actual net capital is subject to volatility commensurate with market volatility in proprietary instruments, the Commission expects ANC broker-dealers to maintain a reasonable cushion in excess of the minimum. Since, based on the Commission staff's supervision of the ANC broker-dealers, the current ANC broker-dealers report tentative net capital levels generally well in excess of $6 billion, the costs to the ANC broker-dealers to comply with this new requirement are not expected to be material.[1026] However, these costs may be prohibitive to new entrants that wish to register as broker-dealer SBSDs using internal models if they currently do not, or cannot, maintain these proposed capital levels. As noted below, such barriers to entry may prevent or reduce competition among SBSDs, which in turn can lead to higher transaction costs and less liquidity than would otherwise exist.

In addition to the proposed minimum fixed tentative and minimum net capital requirements, the proposed 8% margin factor would be part of determining a nonbank SBSD's minimum net capital requirement.[1027] The 8% margin factor is intended to establish a minimum capital requirement that scales with the level of a nonbank SBSD's security-based swap activity and to limit the amount of leverage a nonbank SBSD can employ by requiring an increase in capital commensurate with the amount of leverage extended.

The 8% margin factor ratio requirement also is similar to an existing requirement in the CFTC's net capital rule for FCMs,[1028] and the CFTC has proposed a similar requirement for swap dealers and major swap participants registered as FCMs.[1029]

that for new entrants to capture substantial volume in security-based swaps they will need to use VaR models. *See also OTC Derivatives Dealer Release,* 63 FR 59362 (discussing benefits of minimum capital requirements as an additional measure of protection).

[1019] *See* proposed amendments to paragraph (a)(7)(i) of Rule 15c3–1.

[1020] As noted above, the six ANC broker-dealers collectively hold in excess of one trillion dollars' worth of customer securities.

[1021] *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[1022] 17 CFR 240.15c3–1(a)(ii).

[1023] OTC derivatives dealers are required to provide notification promptly (but within 24 hours) if their tentative net capital falls below 120% of the firm's required minimum tentative net capital amount. *See* 17 CFR 240.17a–11(c)(3). Rule 17a–11 also requires ANC broker-dealers and OTC derivatives dealers to provide same day notification if their tentative net capital falls below required minimums. *See* 17 CFR 240.17a–11(b)(2).

[1024] *See* 17 CFR 240.15c3–1(a)(7)(i).

[1025] *See* 17 CFR 240.17a–11(c)(3).

[1026] *Id.*

[1027] Since the 8% margin factor would be additive to the minimum capital requirements for ANC broker-dealers conducting a security-based swap business, the cost impact to an ANC broker-dealer using its current minimum capital requirements under Rule 15c3–1 and 15c3–1e as a baseline, would at minimum, increase by the 8% margin factor.

[1028] *See* 17 CFR 1.17(a)(1)(i)(B).

[1029] *See CFTC Capital Proposing Release,* 76 FR 27802. The 8% calculation under the CFTC's proposal relates to cleared swaps or futures transactions, whereas the 8% margin factor

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Under the CFTC's proposal, an FCM would be required to maintain adjusted net capital [1030] that is equal to or greater than 8% of the risk margin required for customer and non-customer exchange-traded futures and swaps positions that are cleared by a DCO.[1031] Because exchange-traded futures, however, are generally more liquid and give rise to lower margins than non-cleared security-based swaps with the same notional amount, the proposed 8% margin factor (which includes margin for both cleared and non-cleared swaps) would require allocating substantially more capital to support a non-cleared security-based swap contract compared to a futures contract. Requiring such additional capital could impose the types of costs on these firms and the markets more generally that are described above in section V.B.1. of this release. On the other hand, applying the 8% margin factor to non-cleared security-based swaps (rather than just cleared security-based swaps) would permit the nonbank SBSD's minimum capital requirement to vary based on this aspect of its business, which can entail similar leverage and present greater credit risk than cleared security-based swaps. This would have the benefit of further promoting the goals of the financial responsibility rules described above in section V.B.1. of this release.

Based on FOCUS Report information as of year-end 2011, approximately ten broker-dealers, including the current ANC broker-dealers, maintain tentative net capital in excess of $5 billion,[1032] approximately 31 broker-dealers maintain net capital in excess of $1 billion, approximately 145 broker-dealers maintain tentative net capital in excess of $100 million, and approximately 270 broker-dealers maintain net capital in excess of $20 million.

Although the proposed increase in minimum capital and early warning requirements for ANC broker-dealers will not affect firms that already have this classification, it would reduce the number of additional firms (from 31 to 4, according to FOCUS Report data) that would currently qualify for this designation and hence represents a significant potential cost for additional registrants. As noted above, these costs may be prohibitive to new entrants that wish to register as ANC broker-dealer SBSDs using internal models. If these additional costs were not imposed or were lower, there might be greater opportunities for more competition in the security-based swap markets, which in turn could lower transaction costs and increase liquidity in these markets. However, setting capital levels that allow new entrants that do not have sufficient capital to engage in the diverse business of ANC broker dealers could be disruptive to the market. In addition, to the extent that potential new entrants are able to operate effectively in these markets as stand-alone SBSDs (i.e., swap dealers that are not registered as broker-dealers), they would be eligible for lower minimum capital requirements and competition could further increase without compromising the heightened requirements for ANC broker-dealers.

With respect to the derivatives markets in particular, it is difficult to quantify the impact of the proposed capital requirements against the baseline of the OTC derivatives markets as they exist today because prior to the adoption of Title VII, swaps and security-based swaps were by and large unregulated.[1033] As discussed above in section V.A. of this release, however, most trading in security-based swaps and other derivatives is currently conducted by large banks and their affiliates. Among these entities are the current ANC broker-dealers. Other broker-dealers affiliated with firms presently conducting business in security-based swaps may be among the 270 broker-dealers that maintain net capital in excess of $20 million. Consequently, broker-dealers presently trading in security-based swaps may not need to raise significant new amounts of capital in order to register as nonbank SBSDs. At the same time, the proposed minimum capital requirements could discourage entry by entities other than the approximately 270 broker-dealers that already have capital in excess of the required minimums.

As discussed above in section II.A.1. of this release, the Commission is seeking comment on possible modifications to the capital requirements in ways that may lessen potential compliance costs. First, to the extent that a nonbank SBSD that is approved to use models may be required to register as a broker-dealer solely to conduct certain brokerage activity, *e.g.,* sending customer orders for execution to a security-based swap execution facility, the Commission could modify the capital requirements by setting lower minimum capital requirements for such firms than apply to ANC broker-dealers. Further, the requirements for OTC derivatives dealers could be amended to allow these firms to conduct a broader range of activities. This modification could increase the ability of firms that are not capitalized at minimum capital requirements proposed for the ANC firms to use models and compete for business in security-based swaps.

The Commission also could consider modifications that would increase the flexibility for a broader group of firms to conduct a derivatives business that extends beyond security-based swaps. For example, the Commission could determine to allow a firm to register jointly as an OTC derivatives dealer and SBSD. This modification could allow the registrant to conduct a broader range of derivatives activities than dealing only in security-based swaps, and to be able to use internal models for capital purposes without being subject to much higher capital requirements that apply to ANC broker-dealers. On the other hand, there could be practical difficulties in merging the registration regimes. For example, because OTC derivatives dealers are prohibited from having custody of customers' assets, while nonbank SBSDs would be

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proposed in new Rule 18a–1 would be based on cleared and non-cleared security-based swaps.

[1030] The CFTC has proposed that swap dealers and major swap participants that are also FCMs would be required to meet the existing FCM requirement to hold minimum levels of adjusted net capital, and also would be required to calculate the required minimum level as the greatest of the following: (1) A fixed dollar amount which under the CFTC's proposed rules would be $20 million; (2) the amount required for FCMs that also act as retail foreign exchange dealers; (3) 8% of the proposed risk margin; (4) the amount required by a registered futures association of which the FCM is a member; or (4) for an FCM, that is also a broker-dealer, the amount required by Commission rules. *See CFTC Capital Proposing Release,* 76 FR 27802.

[1031] *See CFTC Capital Proposing Release,* 76 FR 27802. The CFTC's proposed 8% margin requirement is intended to establish a minimum capital requirement that corresponds to the level of risk arising from the FCM's swap activity. *Id.* at 27807. One commenter objected to the inclusion of the 8% test in the CFTC's capital proposal, noting that margin and capital are complementary concepts in that both incorporate counterparty risk, and accordingly, the higher the initial margin requirement for a particular swap, the less regulatory capital a swap dealer should need to carry the client's position. The commenter believed that the CFTC's 8% charge would lead to allocations of dealer and client funding and capital to client portfolios in amounts disproportionately large in comparison to the risks of the relevant transactions. This commenter recommended to the CFTC that the CFTC defer incorporating swaps into the 8% margin multiplier for capital until after margin and capital requirements are finalized and the CFTC and market participants have had an opportunity to evaluate margin levels and the interrelationship between swap margin and capital. Letter from John M. Damgard, President, Futures Industry Association, Robert G. Pickel, Chief Executive Officer, ISDA and Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, SIFMA, to the CFTC (July 7, 2011) (*''FIA/ISDA/SIFMA Comment Letter to the CFTC''*).

[1032] These 10 broker-dealers also maintain tentative net capital in excess of $6.0 billion based on FOCUS Report information as of year-end 2011.

[1033] *See Product Definitions Adopting Release,* 77 FR 48207.

permitted to do so, subject to compliance with new Rule 18a–4, dual registrants could be required to maintain separate sets of compliance processes and procedures, based on product type.

Alternatively, the Commission could provide conditional relief on a case-by-case basis to allow a firm that is registered as an SBSD to conduct dealing activity in derivatives other than security-based swaps. This also could provide a means for an entity to do business in a broad set of derivative instruments, subject to the basic capital standards that would apply to SBSDs. This approach also could allow the Commission to fashion exemptive relief on a case-by-case basis, pending further consideration of how and whether to reconcile the SBSD and OTC derivatives dealer regimes. On the other hand, allowing SBSDs to deal in products that OTC derivatives dealers can deal in, without the restrictions that apply to their activities, could undermine the purpose for the restrictions. The Commission is specifically soliciting comment on these potential approaches above in section II.A.1.

ii. Standardized Haircuts

As discussed in section II.A.2.b.ii. of this release, under proposed new Rule 18a–1 and the amendments to Rule 15c3–1, a nonbank SBSD would be required to apply standardized haircuts to its proprietary positions, unless the Commission approved it to use internal models for specific positions. In general, all haircut regimes are intended to be conservative estimates of risk as they tend to overcompensate for the actual risks and hence generally impose higher costs in terms of capital compared to VaR models.[1034]

As discussed in section II.A.2.b.ii. of this release, for positions that are not security-based swaps, broker-dealer SBSDs and stand-alone SBSDs also would be required to apply the standardized haircuts currently set forth in Rule 15c3–1.[1035] Standardized ''haircuts'' for credit default swaps would be based on a maturity grid approach. Modeled after similar ''haircut'' approaches currently employed under Rule 15c3–1, the proposed approach for credit default swaps is designed to be more risk-sensitive than a haircut approach that determines market deductions based on the type of each position without recognizing offsets among securities with similar risk characteristics (the proposed rules also permit firms to reduce the required haircut for certain netted positions). The number of maturity and spread categories in the proposed grid for credit default swaps is based on staff experience with the maturity grids for other securities in Rule 15c3–1 and, in part, on FINRA Rule 4240.[1036] While the haircut grid design takes into account that positions in credit defaults swaps with larger spreads or longer tenors are riskier and hence should be supported by larger haircuts, the Commission is specifically seeking comment on the design of the grid and particularly whether the haircuts appropriately reflect the risk inherent in long and short positions of credit defaults swaps across the spread and tenor spectrum.

Security-based swaps that are not credit default swaps can be divided into two broad categories: Those that reference equity securities and those that reference debt instruments. Since each type of security-based swap can be viewed as being equivalent to a highly-levered synthetic position in the referenced instrument and therefore has the same price volatility as the referenced instrument, the standardized haircut for these categories of security-based swaps would be the deduction currently prescribed in Rule 15c3–1 applicable to the instrument referenced by the security-based swap multiplied by the contract's notional amount.[1037] It is likely that a nonbank SBSD that maintains substantial positions in such instruments would maintain portfolios of multiple instruments in such categories with offsetting long and short positions to hedge its risk.

Under the Commission's proposed standardized haircuts for these categories of security-based swaps, nonbank SBSDs would also be able to recognize the offsets currently permitted under Rule 15c3–1.[1038] In particular, as discussed below, nonbank SBSDs would be permitted to treat equity security-based swaps under the provisions of Appendix A to Rule 15c3–1, which produces a single haircut for portfolios of equity options and related positions.[1039] This method would permit a nonbank SBSD to compute deductions for a portfolio of equity security-based swaps using a comprehensive risk perspective by accounting for the risk of the entire portfolio, rather than the risk of each position within the portfolio.[1040] Appendix A provides a relatively less costly mechanism for a nonbank SBSD to calculate haircuts (in contrast to the standardized haircuts) since it is used for other equity derivatives and generally may reduce haircuts for a nonbank SBSD by allowing a swap referencing an equity security to be considered as part of a related portfolio. This, in turn, may permit a nonbank SBSD to more efficiently deploy this capital savings in other areas of its operations, as well as enhance operational efficiencies.

Similarly, nonbank SBSDs would be permitted to treat a debt security-based swap in the same manner as debt instruments are treated in the Rule 15c3–1 grids in terms of allowing offsets between long and short positions where the instruments are in the same maturity categories, subcategories, and in some cases, adjacent categories.[1041] Consequently, nonbank SBSDs could recognize the offsets and hedges that those provisions permit to reduce the deductions on portfolios of debt security-based swaps, and thereby reduce their capital costs. This, in turn, may permit a nonbank SBSD to more efficiently deploy this capital savings in other areas of its operations.

The proposed approaches, like other types of standardized haircuts, likely will require a higher amount of capital to conduct security-based swaps

[1034] Commenters to the proposed CFTC capital rule for swap dealers stated that they believe that model-based approaches are generally superior to grid-based approaches. One commenter argued that grid-based approaches are generally insufficiently risk sensitive, are not part of integrated risk management systems, and are hard to keep up-to-date to include innovative product and trading strategies. *FIA/ISDA/SIFMA Comment Letter to the CFTC.* Grid-based approaches, however, provide alternatives to firms that are unable to or chose not to use models.

[1035] *See* 17 CFR 240.15c3–1(c)(2)(vi); paragraph (c)(1)(vii) of proposed new Rule 18a–1. *See also* section II.A.2.b.vi. of this release (discussing the treatment of swaps).

[1036] *See Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Amend FINRA Rule 4240 (Margin Requirements for Credit Default Swaps),* Exchange Act Release No. 66527 (Mar. 7, 2012) (File No. SR–FINRA–2012–015) (in which FINRA amended the maturity grid in Rule 4240 in the interest of regulatory clarity and efficiency, and based upon FINRA's experience in the administration of the rule). While FINRA Rule 4240 is one reference point, the maturity grid it specifies does not appear to have been widely used by market participants, in part because a significant amount of business in the current credit default swap market is conducted by entities that are not members of FINRA.

[1037] *See* proposed new paragraph (c)(2)(vi)(O)(*2*) of Rule 15c3–1; paragraph (c)(1)(vi)(B) of proposed new Rule 18a–1. For example, if a dealer maintained a position in a security-based swap with a notional amount of $1 million that provided the dealer with long exposure to a nonconvertible debt security maturing in 2½ years (assuming no offsetting short positions), the dealer would look to Rule 15c3–1(c)(2)(vi)(F) to find the applicable haircut percentage (5%) and the firm would be required to take a capital deduction of $50,000.

[1038] *See* proposed new paragraph (c)(2)(vi)(O)(*2*) of Rule 15c3–1; paragraph (c)(1)(vi)(B) of proposed new Rule 18a–1.

[1039] *See* 17 CFR 240.15c3–1a; Appendix A to proposed new Rule 18a–1.

[1040] *See* section II.A.2.b.ii. of this release.

[1041] *See* 17 CFR 240.15c3–1(c)(2)(vi).

business, in contrast to a VaR model. While the standardized haircuts and proposed CDS grid recognize certain offsets, standardized haircuts generally result in higher costs of capital because the standardized approaches do not recognize other ways in which a nonbank SBSD may mitigate its exposures, including unwinding unprofitable trades, entering into certain hedges that would not be recognized under the proposed capital rules, and portfolio diversification. The higher amounts that may result from using the standardized haircut and a grid-based approach [1042] may be acceptable for nonbank SBSDs that occasionally trade in security-based swaps but not in a substantial enough volume to justify the initial and ongoing systems and personnel costs to develop, implement, and monitor the performance of internal models. On the other hand, firms that conduct a substantial business in securities-based swaps in general will need to use the more cost-efficient models to measure and manage the risks of their positions over time.

The benefit of the standardized haircut approach of measuring market risk, besides its inherent simplicity, is that it may reduce the likelihood of default or failure by nonbank SBSDs that have not demonstrated that they have the risk management capabilities, of which VaR models are an integral part, or capital levels to support the use of VaR models. Therefore, the standardized haircut approach, in turn, may improve customer protections and reduce systemic risk. In addition, a standardized haircut approach may reduce costs for the nonbank SBSD related to the risk of failing to observe or correct a problem with the use of VaR models that could adversely impact the firm's financial condition, because the use of VaR models would require the allocation by the nonbank SBSD of additional firm resources and personnel.

Conversely, if the proposed standardized haircuts are too conservative, they could make the conduct of security-based swaps business too costly, preventing or impairing the ability of firms to engage in security-based swaps, increasing transaction costs, reducing liquidity, and reducing the availability of security-based swaps for risk mitigation by end users.

iii. Capital Charge in Lieu of Margin Collateral

As discussed in section II.A.2.b.v. of this release, the Commission is proposing certain capital charges in lieu of margin. Generally, margin collateral is designed to serve as a buffer to account for a decrease in the market value of the counterparty's positions between the time of default and liquidation. If the amount of the margin collateral is insufficient to make up the difference, the nonbank SBSD will incur losses. The proposal requires the nonbank SBSD to hold sufficient net capital to enable it to, first, withstand such losses and to cover counterparty exposures that are not sufficiently secured with liquid collateral, and, second, to create a strong incentive for dealers to collateralize these exposures. Consequently, this proposed capital charge may serve as an alternative to margin collateral, enhance the financial soundness of the nonbank SBSD and, in turn, ultimately reduce systemic risk.

With respect to cleared security-based swaps, the rules would impose a capital charge if a nonbank SBSD collects margin collateral from a counterparty in an amount that is less than the deduction that would apply to the security-based swap if it were a proprietary position of the nonbank SBSD (*i.e.,* less than an amount determined by using the standardized haircuts in Rule 15c3–1, as proposed to be amended, and in proposed new Rule 18a–1 or a VaR model, as applicable).[1043] As discussed in section II.A.2.b.v. of this release, the proposed capital charge, therefore, is designed to protect the nonbank SBSDs against this risk, and thereby, serves to increase the safety and soundness of the nonbank SBSD.

This proposed charge, however, could impose additional capital costs on cleared transactions where the amount of the additional costs would depend on the differences between amounts required under Rule 18a–1 and margin amounts the clearing agency sets. It is difficult to estimate the cost impact of this proposal because there is currently a lack of trading for customers in cleared security-based swaps that could be used for comparative purposes.[1044] In addition, requiring nonbank SBSDs to take a capital charge equal to the difference between the haircut amount and the clearing agency margin could reduce incentives to use cleared security-based swap contracts, which would be inconsistent with the goal of reducing systemic risk. However, incentives to clear security-based swaps will be substantially affected by a variety of other factors, including the amount of margin required for non-cleared contracts, and clearing volume will also be affected by mandatory clearing determinations by the Commission under Section 763(a) of the Dodd-Frank Act. In general, it is unclear whether the additional costs to conduct business on a cleared basis would materially affect the volume of business that SBSDs conduct on an uncleared basis when they have the choice to do so.

As discussed in section II.A.2.b.v. of the release, with respect to non-cleared security-based swaps, the Commission is proposing capital charges to address three exceptions in proposed new Rule 18a–3 (nonbank SBSD margin rule), including margin not collected from *commercial end users,* margin collateral collected but segregated pursuant to section 3E(f) of the Exchange Act, and margin that has not been collected for a legacy swap.[1045] The rule is designed to reduce systemic risk by requiring capital to cover counterparty exposures, because the capital levels will serve in lieu of margin as a buffer in case of counterparty defaults. If the nonbank SBSD did not hold capital in lieu of margin, a counterparty default could lead to the default of the nonbank SBSD itself. This capital charge should have the benefit of reducing the likelihood of default of the nonbank SBSD due to under-margined counterparty exposure. Conversely it will increase the cost of capital for nonbank SBSDs that engage in non-cleared security-based swaps because they must use their own capital to support the counterparty's transaction, which in turn could reduce the liquidity of such security-based swaps. However, the proposed rule imposes a charge only if a firm fails to collect margin under Rule 18a–3, and thus no additional costs would be imposed on a nonbank SBSDs that

[1042] *See* section II.A.2.b.2. of this release.

[1043] *See* proposed paragraph (c)(2)(xiv)(A) of Rule 15c3–1; paragraph (c)(1)(viii)(A) of proposed Rule 18a–1.

[1044] *See Process for Submissions of Security-Based Swaps,* 77 FR 41602 (although the volume of interdealer CDS cleared to date is quite large, many security-based swap transactions are still ineligible for central clearing, and many transactions in security-based swaps eligible for clearing at a CCP continue to settle bilaterally. Voluntary clearing of security-based swaps in the U.S. is currently limited to CDS products. Central clearing of security-based swaps began in March 2009 for index CDS products, in December 2009 for single-name corporate CDS products, and in November 2011 for single-name sovereign CDS products. At present, there is no central clearing in the U.S. for security-based swaps that are not CDS products, such as those based on equity securities.). *Id.*

[1045] This proposed rule also provides the nonbank SBSDs certain flexibility in determining whether to collect margin from certain counterparties exempt from certain requirements of proposed Rule 18a–3 and thus attempts to appropriately consider both the concerns of *commercial end users* and other entities/transactions exempt from proposed new Rule 18a–3 and the need to enhance the financial soundness of the nonbank SBSD.

collects margin. Therefore, the proposed rule is designed to create a strong incentive for nonbank SBSDs to collect margin and collateralize counterparty exposures.

The charge for collateral segregated in individual accounts under Section 3E(f) of the Exchange Act reflects the potential that collateral collected by an SBSD but held in a third-party custodian account may not be readily liquidated immediately following a counterparty's default. Accordingly, this aspect of the rule would create an additional capital cost to SBSDs that hold collateral in independent third-party accounts.[1046] If these costs are passed on to counterparties electing an independent segregation option, they could deter counterparties from electing the option and reduce their flexibility in determining the optimal way to hold their collateral.

The third proposed capital charge would apply to margin not collected in the case of legacy non-cleared security-based swaps. This proposal should benefit nonbank SBSDs and their counterparties in that it is designed to avoid the difficulties of requiring a nonbank SBSD to renegotiate security-based swap contracts to come into compliance with the new margin collateral requirements, which would be a complex and costly task. Based on discussions with market participants, this proposal, however, may impose substantial costs in the form of capital charges on firms that have legacy contracts.[1047] Because broker-dealers, however, currently do not conduct significant business in security-based swaps, and any newly-registered SBSDs may not enter into security-based swap transactions before the effectiveness of these proposed rules and, therefore, not have any legacy security-based swaps, this cost of capital may be immaterial. However, the costs could be significant if legacy security-based swaps are assigned to a security-based swap dealer.

iv. Credit Risk Charge

As discussed in section II.A.2.b.iv. of this release, consistent with existing rules affecting broker-dealers,[1048] proposed Rule 18a–1 and the amendments to Rule 15c3–1 rule would require firms to take a 100% charge for the amount of any unsecured receivable, including any uncollateralized receivable currently owed under a security-based swap. As an alternative to taking this capital charge in lieu of margin to a *commercial end user,* as discussed in section II.A.2.b.iv. of the release, ANC broker-dealers and stand-alone SBSDs using internal models would be permitted instead to take a credit risk charge using a methodology in Appendix E to Rule 15c3–1 for uncollateralized receivables arising from security-based swaps with (and only with) *commercial end users* in lieu of the 100% deduction otherwise required by the rules.[1049]

The proposed rule is designed to provide an alternative, less costly way (in lieu of the 100% deduction otherwise required by the rules) to recognize credit exposure incurred in transactions with *commercial end users* for those nonbank SBSDs approved to use internal models. Nonbank SBSDs would be permitted to use this approach because they are required to implement processes for analyzing credit risk to OTC derivative counterparties and to develop mathematical models for estimating credit exposures arising from OTC derivatives transactions and determining risk-based capital charges for those exposures.[1050]

The rule, however, will increase costs [1051] for nonbank SBSDs that do substantial trading with *commercial end users* and do not collect margin for transactions in non-cleared security-based swaps from them. Available data suggests that *commercial end users* presently do not conduct substantial trading in non-cleared security-based swaps.[1052] Therefore, the proposed credit risk charge may not have an immediate cost impact on nonbank SBSDs when compared to the baseline of the OTC derivatives markets as they exist today. However, costs, in terms of higher capital charges and opportunity costs, could become significant if *commercial end users* begin to trade security-based swaps in greater volume and exposures to the nonbank SBSDs remain uncollateralized.

To the extent that *commercial end users* do trade in security-based swaps, the ability of a nonbank SBSD to use internal models likely would give it a significant cost advantage over nonbank SBSDs not using models once the initial infrastructure investment to use the models has been made. In addition, ANC broker-dealers currently are permitted to add back to net worth uncollateralized receivables from counterparties arising from OTC derivatives transactions (*i.e.,* they can add back the amount of the uncollateralized current exposure).[1053] This treatment would be narrowed under the proposed capital requirements for nonbank SBSDs as well as for ANC broker-dealers to the extent that it would apply only to uncollateralized receivables from *commercial end users* arising from security-based swaps. In contrast, uncollateralized receivables from other types of counterparties would be subject to a 100% deduction from net worth to limit the potential that the rules would permit a substantial amount of unsecured exposures for ANC broker-dealers and nonbank SBSDs.[1054]

According to FOCUS Reports and staff experience supervising the ANC broker-dealers, ANC broker-dealers have not engaged in a large volume of OTC derivatives transactions since the rules were adopted in 2004. Therefore, they have not had significant amounts of unsecured receivables that would be subject to the credit risk charge provisions in Appendix E to Rule 15c3–1. However, when the Dodd-Frank OTC derivatives reforms are implemented, ANC broker-dealers could significantly increase their holdings of OTC derivatives. An increase in derivatives exposure that is uncollateralized would increase the exposure of the ANC broker-dealers to their derivatives counterparties. In turn, however, this proposed amendment should strengthen the capital position of the ANC broker-

[1046] *See* discussion above in section II.A.2.b.v. of this release. *See also* discussion above in section V.B.1. of this release (discussing quantification of costs).

[1047] As discussed above in section II.B.2. of this release, this exception would be designed to address the impracticality of renegotiating contracts governing security-based swap transactions that predate the effectiveness of proposed new Rule 18a–3 in order to come into compliance with the account *equity* requirements in the rule. *See* discussion above in section V.A.1. of this release (discussing quantification of costs).

[1048] *See* 17 CFR 240.15c3–1(c)(2)(iv)(B)–(D); proposed new Rule 18a–1(c)(1)(iii)(B)–(D).

[1049] *See* paragraph (e)(2) of proposed new Rule 18a–1. Paragraph (c)(1) of Appendix E to Rule 15c3–1 requires an ANC broker-dealer to take a counterparty exposure charge in an amount equal to: (i) The net replacement value in the account of each counterparty that is insolvent, or in bankruptcy, or that has senior unsecured long-term debt in default; and (ii) for a counterparty not otherwise described in paragraph (c)(1)(i) of Appendix E, the credit equivalent amount of the broker's or dealer's exposure to the counterparty, as defined in paragraph (c)(4)(i) of this Appendix E, multiplied by the credit risk weight of the counterparty, as defined in paragraph (c)(4)(vi) of Appendix E, multiplied by 8%. 17 CFR 240.15c3–1e(c)(1).

[1050] *See* Appendix E to Rule 15c3–1 and proposed new Rule 18a–1.

[1051] *See* section V.B.1. of this release (discussing quantification of costs).

[1052] *See generally CDS Data Analysis; ISDA Margin Survey 2012.*

[1053] *See* 17 CFR 240.15c3–1e(c). OTC derivatives dealers are permitted to treat such uncollateralized receivables in a similar manner. *See* 17 CFR 240.15c3–1f.

[1054] *See* proposed amendments to paragraphs (a) and (c) of Rule 15c3–1e. *See* section II.A.2.b.iv. of this release (discussing credit risk charges).

dealers, and thereby reduce the likelihood of default of one of these entities. Because ANC broker-dealers currently do not trade in significant amounts of OTC derivatives, and therefore, do not currently have significant amounts of unsecured receivables related to OTC derivatives transactions, the cost impact as compared to the baseline of the current capital regime for broker-dealers should not be material for these firms.

v. Funding Liquidity Stress Test Requirement

As discussed in section II.A.2.d. of this release, the Commission is proposing a funding liquidity stress requirement [1055] to be conducted by the ANC broker-dealers and stand-alone SBSDs that use internal models at least monthly that takes into account certain assumed conditions lasting for 30 consecutive days. These required assumed conditions would be:

- A stress event that includes a decline in creditworthiness of the firm severe enough to trigger contractual credit-related commitment provisions of counterparty agreements; [1056]
- The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding, including intercompany advances and unfunded committed lines of credit;
- The potential for a material net loss of secured funding;
- The loss of the ability to procure repurchase agreement financing for less liquid assets;
- The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;
- A material increase in collateral required to be maintained at registered clearing agencies of which the firm is a member; and
- The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the firm, including those related to customer businesses of the firm.[1057]

These proposed minimum elements are designed to ensure that ANC broker-dealers and stand-alone SBSDs using internal models employ a stress test that is severe enough to produce an estimate of a potential funding loss of a magnitude that might be expected in a severely stressed market.

The benefit of the proposed liquidity stress test requirement is an additional level of protection against disruptions in the ability to obtain funding for a firm with significant proprietary positions in securities or derivatives.[1058] The proposed liquidity requirement is intended to increase the likelihood that a firm could withstand a general loss of confidence in the firm itself, or the markets more generally and stay solvent for up to 30 days, during which time it could either regain the ability to obtain funding in the ordinary course or else better position itself for resolution, with less collateral impact on other market participants and the financial system. As such, this proposal may reduce the likelihood and severity of a fire sale and, therefore, mitigate spillover effects and lower systemic risk.[1059] This, in turn, may increase confidence in the security-based swap markets and may lead to an increase in trading in this market.

This proposal, however, would impose additional opportunity costs of capital, and other costs on ANC broker-dealers and nonbank SBSDs directly related to the amount of the required liquidity reserve because a nonbank SBSD would be unable to deploy the assets that are maintained for the liquidity reserve in other, potentially more efficient ways.

In addition, smaller firms may incur more implementation costs, because, in general, large firms already run stress tests and maintain a liquidity reserve based on those tests.[1060] In addition, the required assumed conditions are designed to be consistent with the liquidity stress tests performed by ANC broker-dealers (based on staff experience in supervising the ANC broker-dealers) and to address the types of outflows experienced by ANC broker-dealers and other broker-dealers in times of stress. Therefore, while the opportunity cost of the liquidity requirements might be substantial, they are not expected to impose liquidity standards that are materially different from what is observed now among the ANC broker-dealers and thus should not represent an undue burden at this time.

Finally, under the proposals, an ANC broker-dealer and a stand-alone SBSD using internal models would be required to establish a written contingency funding plan. The plan would need to clearly set out the strategies for addressing liquidity shortfalls in emergency situations,[1061] and would need to address the policies, roles, and responsibilities for meeting the liquidity needs of the firm and communicating with the public and other market participants during a liquidity stress event.[1062]

This proposal may reduce the likelihood of default of a nonbank SBSD that uses internal models or an ANC broker-dealer, and thus, in turn, reduce systemic risk. Based on staff experience supervising ANC broker-dealers and monitoring the ultimate holding companies of these firms, most of these entities have a written contingency funding plan, generally, at the holding company level. To the extent that these firms are required to implement a written contingency funding plan at the nonbank SBSD level or ANC level, these firms may incur personnel, technology or other operational costs to develop and implement such a plan.[1063]

vi. Risk Management Procedures

As discussed in section II.A.2.c. above, nonbank SBSDs would be required to comply with the risk management provisions of Rule 15c3–4, as if they were OTC derivatives dealers, because the risks of trading by nonbank SBSDs in security-based swaps,

[1055] *Compare* BCBS, *Basel III: International framework for liquidity risk measurement, standards and monitoring* (Dec. 2010), available at *http://www.bis.org/publ/bcbs188.pdf*.

[1056] *See Federal Reserve Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,* 77 FR 594, 608 (Jan. 5, 2012) (noting that effective liquidity stress testing should be conducted over a variety of time horizons to adequately capture rapidly developing events, and other conditions and outcomes that may materialize in the near or long term).

[1057] *See* proposed new paragraph (f)(1) to Rule 15c3–1 and paragraph (f)(1) of proposed new Rule 18a–1.

[1058] *See* letter from Christopher Cox, Chairman, Commission, to Dr. Nout Wellink, Chairman, BCBS (Mar. 20, 2008), available at *http://www.sec.gov/news/press/2008/2008–48_letter.pdf* (highlighting importance of liquidity management in meeting obligations during stressful market conditions). *See also Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies,* 77 FR 594, 608 (Jan. 5, 2012) (proposing that liquidity stress testing must be tailored to reflect a covered company's capital structure, risk profile, complexity, activities, size and other appropriate risk-related factors stating that stress testing will be directly tied to the covered company's business profile and the regulatory environment in which it operates.). The minimum factors described above are intended to specifically address factors relevant to the regulatory environment in which ANC broker-dealers and stand-alone SBSD using internal models operate.

[1059] *See* Andrei Shleifer and Robert Vishny, *Fire Sales in Finance and Macroeconomics,* 25 Journal of Economic Perspectives 29–48 (Winter 2011) (surveying literature on fire sales, which implies that if financial institutions are not liquidity restraints during fire sales, price and liquidity spirals should less likely occur).

[1060] *See* 17 CFR 240.15c3–4.

[1061] *See* proposed new paragraph (f)(4) of Rule 15c3–1; paragraph (f)(4) of proposed Rule 18a–1.

[1062] *See* proposed new paragraph (f)(4) of Rule 15c3–1; paragraph (f)(4) of proposed Rule 18a–1.

[1063] *See* section V.C. of this release.

including market, credit, operational, and legal risks, are similar to the risks faced by OTC derivatives dealers in trading other types of OTC derivatives.[1064] These requirements may reduce the risk of significant losses by nonbank SBSDs. The internal risk management control system requirements also should reduce the risk that the problems of one firm will spread because each nonbank SBSD should have a better understanding of the nonbank's exposures and the risks of those exposures. The nonbank SBSDs may incur costs in better modifying documents and their information technology systems to meet these requirements, but these costs could vary significantly among nonbank SBSDs depending on the degree to which their risk management systems are documented and on size of each firm and the types of business it engages in.[1065]

b. Capital Requirements for MSBSPs

As discussed in section II.A.3. of the release, proposed new Rule 18a–2 would require nonbank MSBSPs to have and maintain positive tangible net worth at all times.[1066] Entities that may need to register as MSBSPs may engage in a diverse range of business activities very different from, and broader than, the securities activities conducted by broker-dealers (otherwise they would be required to register as an SBSD and/or broker-dealer). Because nonbank MSBSPs, by definition, will be entities that have substantial exposure to security-based swaps, they would also be required to comply with Rule 15c3–4,[1067] which requires OTC derivatives dealers and ANC broker-dealers to establish, document, and maintain a system of internal risk management.[1068] This proposal is designed to promote sound risk management practices with respect to the risks associated with trading in OTC derivatives. Nonbank MSBSPs may incur implementation costs, such as technology costs to comply with the risk management practices proposed by the rule. These are discussed in section V.C. below.

Risk management controls at nonbank MSBSPs may promote the stability of these firms and, consequently, the stability of the entire financial system. This, in turn, may protect the financial industry from systemic risk.

The Commission could instead impose capital requirements that are the same as, or modeled on, those that are being proposed for nonbank SBSDs, which could more effectively reduce the risk of failure of MSBSPs and thereby reduce systemic risk. In general, nonbank SBSDs and MSBSPs can be expected to differ in terms of the range and types of their counterparty relationships and, by definition, MSBSPs will not maintain two-sided exposure to a range of instruments that is characteristic of dealer activity. The systemic impact of the failure of an MSBSP will depend on various factors, including the ability of its counterparties to readily liquidate assets posted by the MSBSP as collateral, without suffering a loss. Although the Commission is proposing to require MSBSPs to post collateral to eliminate their current exposure to counterparties in security-based swaps, the collateral may not be sufficient to avoid losses during a period of market volatility. At the same time, imposing a capital regime on MSBSPs that is based on a net liquid assets test could impact the ability of an MSBSP to pursue business activities and strategies unrelated to its activities involving financial instruments. For example, these entities may engage in commercial activities that require them to have substantial fixed assets to support manufacturing and/or result in them having significant assets comprised of unsecured receivables. Requiring them to adhere to a net liquid assets test could result in their having to obtain significant additional capital or engage in costly restructurings. The Commission is specifically seeking comment on this approach in section II.A.3. of this release.

As stated above, at present, entities that may be required to be registered as MSBSPs are expected to be companies that engage in a diverse range of business. For these reasons, it would be difficult to quantify how much additional capital, if any, or costs the capital requirements under proposed new Rule 18a–3 would require these entities to maintain or incur and compare these amounts against the current baseline of the OTC derivatives market as it exists today.[1069] Given that proposed new Rule 18a–2 would only require that a nonbank MSBSP maintain a positive tangible net worth at all times, and 5 or fewer entities are expected to register as nonbank MSBSPs,[1070] these costs are not expected to be material because it is not expected that these firms would have to alter their existing business practice in any substantial way to comply with the proposed positive tangible net worth test.

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

The proposed financial responsibility requirements should reduce the risk of a failure of any major market participant in the security-based swap market, which in turn reduces the possibility of a general market failure, and thus promotes confidence for market participants to transact in security-based swaps for investment and hedging purposes. The proposed capital requirements are designed to promote confidence in nonbank SBSDs among customers, counterparties, and the entities that provide financing to nonbank SBSDs and, thereby, lessen the potential that these market participants may seek to rapidly withdraw assets and financing from SBSDs during a time of market stress. This heightened confidence is expected to increase trading activity and promote competition among dealers. The proposed financial responsibility requirements, in significant part, will affect efficiency and capital formation through their impact on competition.[1071] Specifically, markets that are competitive can, ceteris paribus, be expected to promote a more efficient allocation of capital.

Any new entrant will increase the number of competing entities, and the extent to which competition increases will depend on the number of additional entrants and their success in attracting business from established market participants. As discussed in section IV. of this release, the Commission expects up to 50 entities to register as SBSDs. The number of registered firms will depend, among other factors, on whether potential new entrants determine that the cost impact of the proposed financial responsibility requirements would allow them to compete effectively for business. To the extent that costs associated with the proposed rules are high however, they

[1064] For example, individually negotiated OTC derivative products, including security-based swaps, generally are not very liquid. Market participants face risks associated with the financial and legal ability of counterparties to perform under the terms of specific transactions. The additional exposure to credit risk, liquidity risk, and other risks makes it necessary for OTC derivatives market participants to implement a risk management control system.

[1065] *See* section V.C. of this release.

[1066] *See* paragraph (a) of proposed new Rule 18a–2.

[1067] *See* paragraph (c) of proposed new Rule 18a–2.

[1068] *See* 17 CFR 240.15c3–4.

[1069] *See* section V.A.1. of this release.

[1070] *See* section IV. of this release.

[1071] *See also Entity Definitions Adopting Release,* 77 FR at 30742.

may negatively affect competition within the security-based swap markets. This may, for example, lead smaller dealers or entities for whom dealing is not a core business to exit the market because compliance with the proposed minimum capital requirements is not feasible because of cost considerations. The same costs might also deter the entry of new SBSDs or MSBSPs into the market, and if sufficiently high, increase concentration among nonbank SBSDs.

The possibility of using VaR to calculate haircuts may permit a nonbank SBSD to more efficiently deploy capital in other parts of its operations (because VaR models could reduce capital charges and thereby could make additional capital available), which should be a factor in the decision to enter the security-based swap markets in general and through which type of registrant in particular. Because of the reduced charges for market and credit risk, a nonbank SBSD may be able to reallocate capital from the nonbank SBSD to affiliates that may receive a higher return than the nonbank SBSD.[1072] Therefore, the success of new entrants in competing for security-based swap business also will likely depend on the extent to which they obtain the Commission's approval to use a VaR model.[1073] Hence, the Commission expects a positive impact on competition especially among SBSDs that use internal models, whether they are stand-alone SBSDs or ANC broker-dealers.

However, some of the entities that presently compete in the market may opt to conduct these activities in registered broker-dealer affiliates; this development would not increase the number of competitors. But other firms that currently do not deal in security-based swaps or do not do so in any significant degree, may choose to compete either as a stand-alone SBSD or as a broker-dealer SBSD. This may increase the number of competing firms.

The proposals ultimately adopted, like other requirements established under the Dodd-Frank Act, could have a substantial impact on international commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions. In particular, intermediaries operating in the U.S. and in other jurisdictions could be advantaged or disadvantaged if corresponding requirements are not established in other jurisdictions or if the Commission's rules are substantially more or less stringent than corresponding requirements in other jurisdictions. This could, among other potential impacts, affect the ability of intermediaries and other market participants based in the U.S. to participate in non-U.S. markets, the ability of non-U.S.-based intermediaries and other market participants to participate in U.S. markets, and whether and how international firms make use of global ''booking entities'' to centralize risks related to security-based swaps. As discussed in section I. of this release, these issues have been the focus of numerous comments to the Commission and other regulators, Congressional inquiries, and other public dialogue.

Accordingly, substantial differences between the U.S. and foreign jurisdictions in the costs of complying with the financial responsibility requirements for security-based swaps between U.S. and foreign jurisdictions could reduce cross-border capital flows and hinder the ability of global firms to most efficiently allocate capital among legal entities to meet the demands of their counterparties. As discussed in section I. of this release, the potential international implications of the proposed capital, margin, and segregation requirements warrant further consideration.[1074] The Commission intends to publish a comprehensive release seeking public comment on the full spectrum of issues relating to the application of Title VII to cross-border security-based swap transactions and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act.

The willingness of end users to trade with a nonbank SBSD dealer will depend on their evaluation of the risks of trading with that particular firm compared to more established firms, and their ability to negotiate favorable price and other terms. As discussed in section V.A. of this release, end users of security-based swaps are mostly comprised of hedge funds and other asset management and financial firms. Many of these entities are sophisticated participants that trade in substantial volume and generally post collateral for their security-based swap positions.[1075] These end users are relatively well-positioned to negotiate price and other terms with competing dealers and to take advantage of greater choice of nonbank SBSD counterparties. These same participants, when transacting in the securities markets, often trade with a variety of competing dealers, including through prime brokerage relationships. To the extent that the proposals result in increased competition, participants in the security-based swap markets should be able to take advantage of this increased competition and negotiate improved terms, resulting generally in narrower spreads and better prices.

In addition, benefits may be expected to also arise from the ability of nonbank SBSDs, which now conduct substantial business in security-based swaps, to consolidate those operations within their affiliated U.S. broker-dealers. This flexibility may yield efficiencies for clients conducting business in securities and security-based swaps, including netting benefits,[1076] a reduction in the number of account relationships required with affiliated entities, and a reduction in the number of governing agreements. These potential benefits are at some tension with benefits from an increase in the number of competitors, to the extent that netting benefits will be maximized by holding a large portfolio of positions at the same entity,[1077] rather than trading with a variety of competing dealers. Further, because the proposals would permit the conduct of a security-based swap business in an entity jointly registered as a broker-dealer SBSD,[1078] they would facilitate the potential for those firms to offer portfolio margin for a variety of positions. From the standpoint of a holding company with multiple financial affiliates, aggregating security-based swaps business in a single entity,

[1072] *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[1073] *See, e.g., Alternative Net Capital Requirements Adopting Release,* 69 FR at 34455 (describing benefits of alternative net capital requirements for broker-dealers using models stating a ''major benefit for the broker-dealer will be lower deductions from net capital for market and credit risk that we expect will result from the use of the alternative method.'') Therefore, it is likely that for new entrants to capture substantial volume in security-based swaps they will need to use VaR models. *See also OTC Derivatives Dealer Release,* 63 FR 59362 (discussing benefits of minimum capital requirements as an additional measure of protection).

[1074] *See* BCBS, IOSCO, *Margin Requirements for Non-centrally-cleared Derivatives* (July 2012), available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD387.pdf* (consultative document seeking comment on a paper on margin requirements for non-centrally-cleared derivatives).

[1075] *See, e.g., Independent Amounts* at 6.

[1076] *See, e.g.,* paragraph (c)(5) of proposed new Rule 18a–3(c)(5). *See* letter from Stuart J. Kaswell, Executive Vice President, Managing Director and General Counsel, Managed Funds Association, to David A. Stawick, Secretary of the CFTC (July 11, 2011) (''Effective netting agreements lower systemic risk by reducing both the aggregate requirement to deliver margin and trading costs for market participants.'').

[1077] *See* Darrell Duffie and Haoxiang Zhu, *Does a Central Clearing Party Reduce Counterparty Risk,* Stanford University Working Paper (Mar. 6, 2010) (showing that netting in the context of CCPs results in significant reductions in counterparty exposures).

[1078] *See, e.g.,* amendments to Rule 15c3–1 (proposing minimum net capital requirements for broker-dealers engaging in a security-based swap business).

such as a broker-dealer SBSD, could help to simplify and streamline risk management, allow more efficient use of capital, as well as operational efficiencies, and avoid the need for multiple netting and other agreements.

While these arguments generally suggest the possibility of positive effects of the proposed rules on competition, efficiency and capital formation, financial responsibility requirements that impose too many competitive burdens pose the risk of imposing excessive regulatory costs that could deter the efficient allocation of capital. Such rules also may be expected to reduce the capital formation benefits that otherwise would be associated with security-based swaps. Specifically, financial responsibility requirements that are overly stringent may prevent entries in the security-based swap markets and thereby may either increase spreads and trading costs or even reduce the availability of security-based swaps. In both instances, end users would face higher cost to meet their business needs.

Apart from their impact on the extent of dealer competition and efficiencies for end users, the proposed new rules and rule amendments could create the potential for regulatory arbitrage to the extent that they differ from corresponding rules other regulators adopt. As noted above in section I. of this release, the proposals of the prudential regulators and the CFTC were considered in developing the Commission's proposed capital, margin, and segregation requirements for SBSDs and MSBSPs. The Commission's proposals differ in some respects from proposals of the prudential regulators and the CFTC. While some differences are based on differences in the activities of securities firms, banks, and commodities firms, or differences in the products at issue, other differences may reflect an alternative approach to balancing the relevant policy choices and considerations. Depending on the final rules the Commission adopts, the financial responsibility requirements could make it more or less costly to conduct security-based swaps trading in banks as compared to nonbank SBSDs. For example, high capital requirements may discourage certain entities from participating in the security-based swap markets, particularly if the regulatory costs for nonbank SBSDs are high. Likewise, if the application of the proposed 8% margin risk factor substantially increases capital requirements for nonbank SBSDs compared to risk-based capital requirements imposed by the prudential regulators on the same activity, bank holding companies could be incentivized to conduct these activities in their bank affiliates.[1079] These differences could create competitive inequalities and affect the allocation of trading activities within a holding company structure.

Finally, in significant part, the effect of the proposals for nonbank MSBSPs on efficiency and capital formation will also be linked to the effect of these requirements on competition,[1080] as competitive markets, ceteris paribus, can be expected to promote a more efficient allocation of capital.

Conversely, if the proposals for MSBSPs are accompanied by too many competitive burdens, the proposals risk the imposition of excessive regulatory costs that could deter the efficient allocation of capital. Such rules also may be expected to reduce the capital formation benefits that otherwise would be associated with security-based swaps. Requirements for nonbank MSBSPs that are overly stringent may prevent entries in the security-based swap markets and thereby may reduce the availability of security-based swaps, forcing end users to use less effective financial instruments to meet their business needs.

Request for Comment

The Commission generally requests comment about its analysis of the general costs and benefits of the proposed capital rules for SBSDs and MSBSPs. In addition, the Commission requests comment in response to the following questions:

1. Would the minimum capital requirements represent a barrier to entry to firms that may otherwise seek to trade security-based swaps as SBSDs? If so, which types of firms would be foreclosed?

2. Is it correct to assume that firms that have the risk management capability to act as a dealer in security-based swaps generally would also meet or be readily able to meet the proposed capital minimums?

3. To what extent will firms that receive approval to use VaR models be able to dominate trading in security-based swaps, whether because of costs to other firms in applying a haircut methodology to security-based swaps or for other reasons?

4. What would be the impact of market concentration on reduction in systemic risk? For example, would concentration of positions in a relatively few firms exacerbate systemic risk by exaggerating the impact of the failure of a single firm? Conversely, would high capital requirements better protect against systemic risk by reducing the risk of failure of a nonbank SBSD?

5. Do the proposed capital requirements for nonbank SBSDs proportionately reflect the increased risk associated with the use of internal models and trading in a portfolio of instruments, including securities, security-based swaps, and other derivatives?

6. The Commission requests comment on how much additional capital would be required, if any, as a result of the proposed 8% margin factor based on a sample portfolio of security-based swaps and how the result compares to the amount these firms currently hold against the same risk.

7. Under the proposed 8% margin factor, the relation between exposure and capital is linear. Is this type of formal approach appropriate for risks associated with security-based swaps? Should the risk margin factor be increased at higher levels of exposure, or should it increase on some other basis?

8. How would firms' current risk management practices for calculating their exposures to counterparties compare to the proposed 8% margin factor, if nonbank SBSDs were only required to comply with a fixed minimum net capital standard?

9. From a systemic risk perspective, should the proposed capital rules for nonbank SBSDs encourage the conduct of security-based swaps trading outside of broker-dealer affiliates?

10. From a systemic risk perspective, are the proposed increases in the minimum net capital (from $500 million to $1 billion) and minimum tentative net capital ($1 billion to $5 billion) requirements for ANC broker-dealers adequate? From a systematic risk perspective, is the proposed increase in the ''early warning'' level from $5 billion to $6 billion for ANC broker-dealers adequate?

11. Would the proposed CDS grid impose any additional costs on nonbank SBSDs in comparison to the current haircut charges for similar debt securities under Rule 15c3–1?

12. Would a nonbank SBSD incur additional costs resulting from the proposed liquidity stress test based on current practice? The Commission requests that commenters quantify the extent of the additional cost the proposed stress test would yield based on hypothetical firm portfolios, and provide the Commission with such data.

13. Are the factors proposed in the liquidity funding stress test adequate? If

[1079] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564.

[1080] *See also Entity Definitions Adopting Release,* 77 FR at 30742.

not, are there other factors that should be included?

14. How would proposed new Rule 18a–2 impact entities that may be required to register as MSBSPs?

15. Would proposed new Rule 18a–2 require nonbank MSBSPs to hold additional capital, in comparison to current capital levels maintained at these firms? If yes, please quantify the amount.

16. What additional costs, if any, would a nonbank MSBSP incur in making adjustments to risk management practices to conform to the specific provisions of Rule 15c3–4?

17. If stand-alone SBSDs would not be able to claim flow-through capital benefits for consolidated subsidiaries or affiliates under Rule 18a–1c, in contrast to Appendix C of existing Rule 15c3–1, would stand-alone SBSDs be competitively disadvantaged? If yes, please explain.

18. Would the Commission's proposals lead to greater competition among intermediaries for security-based swaps business, greater concentration, or neither? How important are the goals of reduction in systemic risk versus promotion of competition in crafting rules in this area, and to what extent are they competing goals? If they are not competing goals, how should the achievement of both goals inform the Commission's overall approach?

19. Will the Commission's proposals affect the competitive position of U.S. firms in the global security-based swaps market? How in general would they impact global trading in these products? How could the Commission best address any anti-competitive effects? For example, should the Commission permit U.S. firms trading with off-shore counterparties to collect margin based on the rules of the jurisdiction where the counterparty is located, provided the Commission determines that those rules are comparable to the U.S. regime? How would comparability be determined?

20. The Commission specifically requests comment on the potential impact of interagency differences in specific aspects of capital and margin requirements. Which specific aspects of the proposed rules could have the most impact in determining the type of legal entity in which trading is conducted? What would be the market or economic effects?

3. The Proposed Margin Rule—Rule 18a–3

As discussed in section II.B. of this release, pursuant to section 15F(e) of the Exchange Act, proposed new Rule 18a–3 would establish margin requirements for nonbank SBSDs and nonbank MSBSPs with respect to transactions with counterparties in non-cleared security-based swaps.[1081] As discussed in more detail below, the proposed rule would require nonbank SBSDs to collect collateral from their counterparties to non-cleared security-based swaps to cover both current exposure and potential future exposure to the counterparty (*i.e.,* the rule would require the account to have prescribed minimum levels of *equity*); however, there would be exceptions to these requirements for certain types of counterparties. Proposed new Rule 18a–3 would have a number of benefits as well as impose certain costs on nonbank SBSDs, nonbank MSBSPs, as well as other market participants, including *commercial end users.* The proposed rule also would have possible effects on competition, efficiency, and capital formation, which will be discussed further below.

The two types of credit exposure arising from OTC derivatives are current exposure and potential future exposure. The current exposure is the amount that the counterparty would be obligated to pay the dealer if all the OTC derivatives contracts with the counterparty were terminated (*i.e.,* it is the amount of the current receivable from the counterparty). This form of credit risk arises from the potential that the counterparty may default on the obligation to pay the current receivable. The potential future exposure is the amount that the current exposure may increase in the favor of the dealer in the future. This form of credit risk arises from the potential that the counterparty may default before providing the dealer with additional collateral to cover the incremental increase in the current exposure or the current exposure will increase after a default when the counterparty has ceased to provide additional collateral to cover such increases and before the dealer can liquidate the position.

Rule 18a–3 is intended to support a goal of the Dodd-Frank Act by promoting centralized clearing of sufficiently standardized products,[1082] which, in turn, may help to mitigate credit risk.[1083] Specifically, Rule 18a–3, by creating stringent margin requirements for non-cleared contracts, is meant to create incentives for participants to clear security-based swaps, where available and appropriate for their needs.[1084] Central clearing can provide systemic benefits by limiting systemic leverage and aggregating and managing risks by a central counterparty.[1085] At the same time, realization of these benefits assumes that central counterparties are appropriately capitalized and sufficiently collateralize their exposures to their clearing members. Under the proposed rule, the market will benefit from the required collateralization of non-cleared security-based swaps. Specifically, the required collateralization should improve counterparty risk management, reduce the risk of contagion from a defaulting counterparty, and ultimately reduce systemic risk.

While available data suggests that clearing of security-based swaps has been increasing, significant segments of the security-based swap markets remain uncleared, even where a CCP is available to clear the product in question on a voluntary basis.[1086] The mandatory clearing determinations made pursuant to Exchange Act section 3C(a)(1) will alter current clearing practices at the time such determinations are made. The Commission has not yet made any mandatory clearing determinations under the authority of section 3C(a)(1) of the Exchange Act and cannot estimate

[1081] *See* proposed new Rule 18a–3.

[1082] The Dodd-Frank Act seeks to ensure that, wherever possible and appropriate, derivatives contracts formerly traded exclusively in the OTC market be cleared. *See, e.g.,* Senate Committee on Banking, Housing, and Urban Affairs, *The Restoring American Financial Stability Act of 2010,* S. Rep. No. 111–176, 34 (stating that ''[s]ome parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, non-cleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible.'').

[1083] For example, when an OTC derivatives contract between two counterparties that are members of a CCP is executed and submitted for clearing, it is typically replaced by two new contracts—separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties are no longer counterparties to each other. Instead, each acquires the CCP as its counterparty, and the CCP assumes the counterparty credit risk of each of the original counterparties that are members of the CCP. *See* Stephen Cecchetti, Jacob Gyntelberg, and Mark Hollanders, *Central counterparties for over-the-counter derivatives,* BIS Quarterly Review (Sept. 2009), available at *http://www.bis.org/publ/qtrpdf/r_qt0909f.pdf.* Structured and operated appropriately, CCPs may improve the management of counterparty risk and may provide additional benefits such as multilateral netting of trades. *See also Process for Submissions of Security-Based Swaps,* 77 FR at 41603.

[1084] *See* Daniel Heller and Nicholas Vause, *Expansion of Central Clearing,* BIS Quarterly Review (June 2011) (arguing expansion of central clearing within or across segments of the derivatives markets could economize both on margin and non-margin resources).

[1085] *See Process for Submissions of Security-Based Swaps,* 77 FR 41602.

[1086] *See Process for Submissions of Security-Based Swaps,* 77 FR 41602.

at this time how much of the security-based swap markets may ultimately be subject to such determinations.

Other costs resulting from proposed new Rule 18a–3 may result from reducing the availability of liquid assets for purposes other than posting collateral. Data available to the Commission suggests that existing collateral practices vary widely by type of market participant and counterparty.[1087] For example, the *ISDA Margin Survey 2012,* which provides global estimates regarding the use of collateral in the OTC derivatives business based on a survey of ISDA members as of the end of 2011,[1088] stated that 71% of all OTC derivatives transactions were subject to collateral agreements; the average percentage was 96% for the largest dealers responding to the survey.[1089] The percent of trades subject to collateral agreements was higher, however, for credit derivatives (93.4% of all trades) and about the same as the general average for equity derivatives (72.7%).[1090]

The *ISDA Margin Survey 2011* reported on the extent of collateralization (percentage of net exposures) by type of counterparty.[1091] The amount reported for all counterparties and all OTC derivatives was 73.1%.[1092] The *ISDA Margin Survey 2011* also indicates that the collateralization levels by large dealers of their net exposures to their bank and broker-dealer dealer counterparties was 88.6%.[1093] For hedge funds, the average collateralization levels were 178%, reflecting a greater tendency to collect initial margin from those participants.[1094] Finally, exposures to non-financial corporations (37.3%) and sovereign governments (17.6%) had much lower levels of coverage.[1095]

The data from the *ISDA Margin Survey 2011* and the *ISDA Margin Survey 2012* support the premises that margin practices widely vary, that larger dealers tend to collateralize their net exposures, that exposures to financial end users tend to be collateralized with both variation (current exposure) and initial margin (potential future exposure), and that much of the exposure to non-financial end users generally is not collateralized.[1096]

Rule 18a–3 is generally modeled on the broker-dealer margin rules in terms of establishing an account *equity* requirement; requiring nonbank SBSDs to collect collateral to meet the requirement; and, subject to haircuts, allowing a range of securities for which there is a ready market to be used as collateral.[1097] The goals of modeling proposed new Rule 18a–3 on the broker-dealer margin rules are to create a framework that will limit counterparty exposure of nonbank SBSDs while promoting consistency with existing rules. This consistency may also facilitate the ability to provide portfolio margining of security-based swaps with other types of securities, and in particular single name credit default swaps along with bonds that serve as reference obligations for the credit default swaps.

In the securities markets, margin rules have been set by relevant regulatory authorities (the Federal Reserve and the SROs) since the 1930s.[1098] The requirement that an SRO file proposed margin rules with the Commission has promoted the establishment of consistent margin levels across the SROs, which mitigates the risk that SROs (as well as their member firms) will compete by implementing lower margin levels and helps ensure that margin levels are set at sufficiently prudent levels to reduce systemic risk.[1099] Basing proposed Rule 18a–3 on the broker-dealer margin rules is intended to achieve these same objectives in the market for security-based swaps. This consistency between margin requirements for securities and security-based swaps should ultimately benefit participants in the securities markets, reduce the potential for regulatory arbitrage, and lead to consistent interpretation and enforcement of applicable regulatory requirements across U.S. securities markets.

The discussion below focuses on the impact of specific provisions of proposed new Rule 18a–3 and their potential benefits and costs. With respect to certain provisions, the Commission has identified alternatives to the proposed approach and is seeking comment on the relative costs and benefits of adopting the alternatives, in comparison to the proposed approach. As to whether nonbank SBSDs should be required to collect initial margin in transactions with each other, the Commission is expressly proposing alternative formulations of the rule.

a. Calculation of Margin Amount

Proposed new Rule 18a–3 would require a nonbank SBSD to perform two calculations (and a nonbank MSBSP to perform one calculation) as of the close of each business day with respect to each account carried by the firm for a counterparty to a non-cleared security-based swap transaction.[1100] Even if the counterparty is not required to deliver collateral, the calculation(s) would assist the nonbank SBSD or the nonbank MSBSPs in managing its credit risk (and determining how much needs to be

[1087] *See, e.g., ISDA Margin Survey 2012.* Proposed new Rule 18a–3 would distinguish by counterparty type in that the rule would provide specific exemptions from the rule for certain counterparties, such as *commercial end users. See* section II.B. of this release.

[1088] *ISDA Margin Survey 2012.* The *ISDA Margin Survey 2012* also states that the estimated amount of collateral in circulation in the non-cleared OTC derivatives market at the end of 2011 was approximately $3.6 trillion, which is up 24% from last year's estimated amount of $2.9 trillion.

[1089] *Id.* The threshold for classification as a ''large'' program under the ISDA survey is more than 3,000 agreements. Overall, 84% of all OTC derivatives transactions executed by the largest dealers were subject to collateral agreements. Hedge fund exposures tend to be the most highly collateralized of all types of counterparty exposures with average collateralization levels exceeding 100% of net exposures, a figure that reflects ''Independent Amounts'' (initial margin) posted by such firms. *ISDA Margin Survey 2011* at Table 3.3.

[1090] *ISDA Margin Survey 2012* at Table 3.2. The fourteen largest reporting firms reported an average 96.1% of credit derivatives trades were subject to collateral arrangements during 2011, and 85.5% of equity derivatives trades were subject to collateral agreements. *Id.*

[1091] *See ISDA Margin Survey 2011.* This information was not reported in the *ISDA Margin Survey 2012.*

[1092] *Id.*

[1093] *Id.*

[1094] *Id.*

[1095] *Id.*

[1096] *See generally ISDA Margin Survey 2011; ISDA Margin Survey 2012.* The results of the survey, however, could be substantially different if limited only to U.S. participants, because the data contained in the *ISDA Margin Survey 2011* and *ISDA Margin Survey 2012* is global. *Id.* For example, 47% of the institutions responding to the *ISDA Margin Survey 2012* were based in Europe, the Middle East, or Africa, and 31% were based in the Americas. *ISDA Margin Survey 2012* at Chart 1.1.

[1097] Broker-dealers are subject to margin requirements in Regulation T promulgated by the Federal Reserve (12 CFR 220.1, *et seq.*), in rules promulgated by the SROs (*see, e.g.,* FINRA Rules 4210–4240), and with respect to security futures, in rules jointly promulgated by the Commission and the CFTC (17 CFR 242.400–406).

[1098] The Federal Reserve originally adopted Regulation T pursuant to section 7 of the Exchange Act shortly after the enactment of the Exchange Act. *See* 1934 Fed. Res. Bull. 675. The purposes of the Federal Reserve's margin rules include: (1) Regulation of the amount of credit directed into securities speculation and away from other uses; (2) protection of the securities markets from price fluctuations and disruptions caused by excessive margin credit; (3) protection of investors against losses arising from undue leverage in securities transactions; and (4) protection of broker-dealers from the financial exposure involved in excessive margin lending to customers. *See* Charles F. Rechlin, *Securities Credit Regulation* § 1:3 (2d ed. 2008).

[1099] Pursuant to Section 19(b)(1) of the Exchange Act, each SRO must file with the Commission any proposed change in, addition to, or deletion from the rules of the exchange electronically on a Form 19b–4 through the Electronic Form 19b–4 Filing System, which is a secure Web site operated by the Commission. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b–4.

[1100] *See* paragraphs (c)(1)(i)(A), (B), and (c)(2)(i) of proposed new Rule 18a–3.

collateralized) and understanding the extent of its uncollateralized credit exposure to the counterparty and across all counterparties. These required calculations also would provide examiners with enhanced information about non-cleared security-based swaps, allowing the Commission and other appropriate regulators to gain ''snapshot'' information at a point in time for examination purposes.

As described in section II.B. of the release, paragraph (d) of proposed new Rule 18a–3 would prescribe a standardized method for calculating the margin amount as well as a model-based method if the non-bank SBSD is approved to use internal models.[1101] The benefits of consistent treatment of the standardized haircut and internal models as between the proposed capital rules and proposed new Rule 18a–3 may increase operational efficiencies and reduce costs at the nonbank SBSD by permitting the use of congruent systems and processes to comply with both capital and margin requirements.[1102]

As is the case with the impact of standardized haircuts on regulatory capital, as described in section II.B. of the release, nonbank SBSDs required to use standardized haircuts under Rule 18a–3(d) to determine the margin amount generally will be required to collect higher margin amounts from counterparties for non-cleared security-based swap transactions than nonbank SBSDs that are approved to use internal models will need to collect, because VaR models generally result in lower charges than the standardized haircut provisions.[1103]

In addition, this proposed requirement would impose additional operational and technology costs to install or upgrade systems needed to perform daily calculations under proposed new Rule 18a–3. These costs may vary because broker-dealers registering as nonbank SBSDs may already have systems in place, as current margin rules [1104] for securities require daily margin calculations for customer accounts, while new entrants may incur higher operational or other systems costs to comply with this requirement. Finally, secondary costs (such as reduced profits) could arise if *commercial end users* or other counterparties reduce trading in non-cleared security-based swaps because of the increased collateral requirements required by Rule 18a–3, or if these entities determine to trade instead with non-U.S. entities.

b. Account Equity Requirements

As described in section II.B. to this release, a nonbank SBSD and nonbank MSBSP generally would need to collect cash and/or securities to meet the account *equity* requirements in proposed new Rule 18a–3.[1105] This proposal recognizes that counterparties may engage in a wide range of trading strategies that include security-based swaps. Because of the relation between security-based swaps and other securities positions, permitting various types of securities to count as collateral may be more practical for margin arrangements involving security-based swaps than for other types of derivatives. This flexibility to accept a broad range of securities, along with consistency with existing margin requirements,[1106] takes advantage of efficiencies that result from correlations between securities and security-based swaps.[1107] However, it may increase the risk that SBSDs will incur a shortfall if, as a result, they hold less liquid collateral that cannot be quickly sold for an amount that covers the nonbank SBSD's exposure to the counterparty.[1108] This risk may be mitigated by the collateral haircut and other requirements regarding the liquidity of collateral under the proposed rule.[1109]

As an alternative, the Commission could limit eligible collateral to the most highly liquid categories, as proposed by the prudential regulators and the CFTC and described in section II.B.2.c. of this release.[1110] This alternative could limit the potential that an SBSD would incur a loss following default of a counterparty based on changes in market values of less liquid collateral that occur before the SBSD is able to sell the collateral, and therefore could limit the potential for a default by the SBSD to other counterparties. On the other hand, if Rule 18a–3 required a counterparty to deliver additional collateral beyond assets already held in the counterparty's account because the existing assets did not qualify as eligible collateral, the rule could have the effect of increasing the counterparty's exposure to the SBSD and draining liquidity from the counterparty in a way that may not be necessary to account for the nonbank SBSD's potential future exposure to the counterparty, and may increase costs for both the nonbank SBSD and its counterparties.[1111] Also, granting counterparties the flexibility to post a variety of collateral types to meet margin requirements may result in reduced costs for end users and could encourage increased trading of security-based swaps, thereby increasing competition. The extent of increased trading of non-cleared security-based swaps, however, may depend on the extent to which portfolio margin treatment would materially increase the amount of net equity that counterparties would have available to serve as collateral, compared to the amount that would result if they were limited to very highly liquid securities, such as U.S. Treasury securities.

i. Commercial End Users

As discussed in section II.B.2.c.i. of this release, under proposed new Rule 18a–3, a nonbank SBSD would not be required to collect cash or securities to cover the *negative equity* (current exposure) or margin amount (potential future exposure) in the account of a counterparty that is a *commercial end user.*[1112]

[1101] *See* paragraph (d) of proposed new Rule 18a–3. ''Margin amount'' is generally initial margin or potential future exposure. These terms may be used interchangeably throughout this section.

[1102] *See* proposed new Rule 18a–1; proposed new Rule 18a–3; proposed amendments to Rule 15c3–1.

[1103] *See Alternative Net Capital Requirements Adopting Release,* 69 FR 34428.

[1104] *See, e.g.,* FINRA Rule 4220 (Daily Record of Required Margin); 12 CFR 220.4.

[1105] By requiring most counterparties to deliver collateral, the proposed margin requirements are intended to prevent counterparties from employing undue leverage in their portfolios of security-based swaps, which can exacerbate the magnitude of losses in relation to the financial resources of the counterparty in the case of default.

[1106] *See* the Federal Reserve's Regulation T, 12 CFR 220.1, *et seq.* and SRO margin rules, such as FINRA Rule 4210 and CBOE Rule 12.3. The consideration in adopting final rules will be informed by the comments received.

[1107] The *ISDA Margin Survey 2012* states with regard to the types of assets used as collateral, that the use of cash and government securities as collateral remains predominant, constituting 90.4% of collateral received and 96.8% of collateral delivered. *ISDA Margin Survey 2012* at 8, Table 2.1.

[1108] Gary Gorton and Guillermo Ordoñez, *Collateral Crises,* Yale University Working Paper (Mar. 2012) (arguing that during normal times collateral values are less precise, but during volatile times are reassessed). This reassessment can possibly lead to large negative shocks in their values, which by deduction can lead to market disruptions if collateral needs to be liquidated.

[1109] *See* paragraphs (c)(3)–(c)(4) of proposed new Rule 18a–3.

[1110] Commenters argued that the scope of eligible collateral should be significantly expanded by arguing that there are other assets that are highly liquid and suitable for credit support if a counterparty fails and if eligible collateral remains narrowly defined, the liquidity of eligible assets could be highly affected and sourcing of adequate margin could become difficult. *See, e.g.,* CFTC SIFMA/ISDA Letter.

[1111] This alternative may also increase demand for highly liquid collateral and potentially cause shortages in the supply of cash and government bonds. *See* IMF, *Global Financial Stability Report: The Quest for Lasting Stability* 96 and 120 (Apr. 2012), available at *http://www.imf.org/External/Pubs/FT/GFSR/2012/01/pdf/text.pdf.*

[1112] *See* paragraph (b)(2) of proposed new Rule 18a–3 (defining the term *commercial end user*).

As discussed above in section II.A.2.b.v. of this release, this proposed exception to the requirement to collect collateral is intended to benefit *commercial end users* in order to address concerns that have been expressed by them and others that the imposition of margin requirements on commercial companies that use derivatives to mitigate the risk of business activities that are not financial in nature could unduly disrupt their ability to enter into such hedging transactions. The proposed exception for *commercial end users* also is intended to account for the different risk profiles of *commercial end users* as compared with financial end users.[1113] This exception may increase efficiencies by allowing such end users to more cost efficiently manage business risks and thereby better compete in their respective industries.

At the same time, to the extent of any dealer exposure to *commercial end users,* the proposed exception for *commercial end users* could lead to uncollateralized exposure by nonbank SBSDs to *commercial end users.* To address this concern and because collecting collateral is an important means of mitigating risk, Rule 18a–1 would require nonbank SBSDs not approved to use internal models to take a capital charge equal to the margin amount calculated for the *commercial end user* to the extent the firm does not collect cash or securities equal to that amount.[1114] Requiring a firm to hold capital in lieu of margin [1115] in these cases is designed to reflect both the needs of *commercial end users* and concerns that permitting nonbank SBSDs to assume credit exposure without the protection of margin could lead to the assumption of inappropriate risks. In this way the proposal is intended to ensure the safety and soundness of nonbank SBSDs and be proportionate to the amount of uncollateralized exposures to *commercial end users.*[1116]

The extent of the impact of the intended benefit to *commercial end users,* however, would depend on whether nonbank SBSDs choose to trade with *commercial end user* counterparties on an uncollateralized basis, notwithstanding the capital charges under Rule 18a–1. In addition, nonbank SBSDs subject to this capital charge are expected to, at least partially, pass the increased cost of capital through to *commercial end users* in the form of increased transaction pricing.[1117] Accordingly, any potential economic benefit associated with an exception from Rule 18a–3 for *commercial end users* in non-cleared security-based swaps may be offset to the extent that nonbank SBSDs determine to pass on any costs incurred as a result of the additional capital charges.[1118] In summary, the Commission does not expect those costs will be material, unless *commercial end users* begin to account for meaningful volume in non-cleared security-based swap trading.

As an alternative, the Commission could limit this proposed exception for *commercial end users* and require nonbank SBSDs to collect collateral from *commercial end users* with regard to their transactions in non-cleared security-based swaps. This alternative would protect the nonbank SBSDs by requiring that transactions with *commercial end users* be collateralized. However, in contrast to the Commission's proposal, this alternative would limit the flexibility of nonbank SBSDs and *commercial end users* to negotiate the terms of their non-cleared security-based swap transactions. In considering this approach, the Commission would need to consider the benefit of any additional protections to SBSDs against losses in transactions with *commercial end users* in light of increased costs to such end users or less accessibility to them of hedging instruments.

ii. SBSDs—Alternatives A and B

As described in section II.B. to the release, the Commission is proposing specific alternative margin requirements with respect to counterparties that are nonbank SBSDs. Under Alternative A, which would create an exception from proposed new Rule 18a–3, a nonbank SBSD would need collateral only to cover the current exposure (*negative equity*) in the account of a counterparty that is another SBSD. Under Alternative B, a nonbank SBSD would be required to collect collateral to cover both the current exposure (*negative equity*) and the potential future exposure (margin amount) in the account of a counterparty that is another SBSD [1119] and further segregate the margin amount in an account carried by an independent third-party custodian pursuant to the requirements of Section 3E(f) of the Exchange Act.[1120] Alternative B is consistent with the proposals of the prudential regulators and the CFTC.[1121]

As discussed in section V.A. above, the baseline of this economic analysis is the OTC derivatives markets as they exist today. The *CDS Data Analysis* suggests there is currently a high degree of concentration of potential dealing activity in the single-name credit default swap market. Based on discussions with market participants, the Commission staff understands that dealers in security-based swaps presently collect variation margin covering current exposure but generally do not collect initial margin covering potential future exposure from other dealers.[1122] Accordingly, relative to the existing market for security-based swaps, Alternative A would not create additional costs for dealers resulting from transactions with other dealers in security-based swaps. Alternative B would impose substantially greater costs

[1113] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27571 (''Among end users, financial end users are considered more risky than nonfinancial end users because the profitability and viability of financial end users is more tightly linked to the health of the financial system than nonfinancial end users. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity.''). *See also CFTC Margin Proposing Release,* 76 FR at 27735 (''The Commission believes that financial entities, which are generally not using swaps to hedge or mitigate commercial risk, potentially pose greater risk to CSEs than non-financial entities.'').

[1114] *See* proposed paragraph (c)(2)(xiv) of Rule 15c3–1; paragraph (c)(1)(xiv) of proposed Rule 18a–1.

[1115] *See* section II.A.2.b.v. of this release (discussing proposed charge capital in lieu of margin collateral).

[1116] As discussed above in section II.A. of this release, nonbank SBSDs that have been approved to use internal models for credit risk would take a much smaller capital charge, *i.e.,* 8% of net replacement value multiplied by the counterparty factor. These firms also would be permitted to take a smaller charge with respect to the unsecured receivables from *commercial end user* counterparties, which may provide a competitive advantage for nonbank SBSDs that are capable of and have received approval to model credit risk.

[1117] Even under these conditions, a nonbank SBSD still retains the option to collect margin from its counterparties.

[1118] *See* Antonio S. Mello and John E. Parsons, *Margins, Liquidity and the Cost of Hedging,* MIT Center for Energy and Environmental Policy Research Working Paper 2012–005 (May 2012) (presenting a replication argument to show that a non-margined swap is equivalent to a package of (1) a margined swap, plus (2) a contingent line of credit). The paper concludes that a mandate to clear and therefore to margin derivatives trades forces dealers to market these two components separately, but otherwise makes no additional demand on non-financial corporations, and therefore, a clearing and margin mandate does not add any real costs to a non-financial corporation seeking to hedge its commercial risk). *Id.*

[1119] Alternative B is not an exception to the account *equity* requirements in proposed new Rule 18a–3 because it would require the nonbank SBSD to collect collateral to cover the *negative equity* and margin amount in an account of another SBSD.

[1120] *See* 15 U.S.C. 78c–5(f).

[1121] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564; *CFTC Margin Proposing Release,* 76 FR 23732.

[1122] *See generally ISDA Margin Survey 2011; ISDA Margin Survey 2012.*

to inter-dealer transactions compared to the baseline.

Alternatives A and B would both require the exchange of variation margin; the difference between the alternatives therefore is, first and foremost, whether to require nonbank SBSD counterparties to exchange initial margin. The cost impact would depend on how significant initial margin is in relation to variation margin, which will vary by type of contract, extent of market volatility, and other factors. The goal for either alternative is to reduce systemic risk without imposing undue additional cost to the extent that the ability of counterparties to trade security-based swaps is severely compromised. However, the benefit of collecting the margin amount under Alternative B would be the further protection of a nonbank SBSD from market exposure during the period of unwinding a position from a defaulting counterparty when that counterparty, by definition, would not be able to post additional variation margin.

Requiring a nonbank SBSD to post initial margin, however, could significantly impact its liquidity and therefore limit the ability of the nonbank SBSD to trade in security-based swaps. Permitting a firm to retain a pool of liquid assets that would not otherwise be used to post initial margin could permit the nonbank SBSD to use this capital more efficiently, for example by increasing its investment in information technology or increasing its investments that offer a higher rate of return. The potential benefit of Alternative B is that it would limit the aggregate amount of leverage in the financial system associated with security-based swaps. A principal purpose of Title VII of the Dodd-Frank Act, including those provisions that apply to capital and margin requirements for dealers, is to reduce systemic risk, particularly risks associated with relatively opaque bilateral, non-cleared derivative transactions. Requiring dealers to collateralize their potential future exposure to each other by exchanging both initial and variation margin may further reduce systemic risk by reducing leverage and the potential that a default by a single large dealer could translate to defaults of counterparty dealers with potential ripple effects throughout the system.

On the other hand, the requirement to exchange initial margin would not only impose costs to the extent that it would result in substantially less capital available to support the security-based swap business or other dealer activity, but also it could contribute to the instability of a nonbank SBSD. The instability stems from the possibility that assets posted to the custodian account might in the case of a counterparty default not be immediately returned to a nonbank SBSD to absorb losses or meet other liquidity demands. In this regard, the ability of a dealer counterparty to demand and obtain the return of initial margin held by a third-party custodian could be subject to various uncertainties, including the potential for counterparty disputes that might be subject to court resolution. During periods of general market instability or loss of confidence, even a brief delay in being able to access liquid assets could prove decisive.[1123]

The prudential regulators and the CFTC have received comment letters regarding the liquidity impact of their proposed rules, as well as public research reports attempting to estimate the liquidity impact.[1124] Each of these commenters used different methods, data and assumptions to arrive at a liquidity impact estimate and respond to the amount of initial margin required by the prudential regulators' and CFTC's proposed margin rules. Overall, each of these commenters concluded that the liquidity impact of the proposed initial margin rules proposed by the CFTC and the prudential regulators was significant.[1125] One such estimate, however, noted that the numbers should be viewed as an ''order of magnitude estimate'' and that ''[o]ne cannot predict which entities will use derivatives in the future nor the amounts and types of products that will be used.'' [1126] Consequently, while it is difficult to estimate the costs imposed by requiring dealers to post initial margin, commenters to the CFTC and prudential regulators' proposed margin rules and others have estimated that the cost would be significant. These estimates are discussed in detail below.[1127]

One commenter to the prudential regulators' proposed margin rule stated that imposing segregated initial margin requirements on trades between swap entities would result in a tremendous cost to the financial system in the form of a massive liquidity drain.[1128] This commenter estimated that the effect of the proposed rule would result in a cost of $428 billion in initial margin for swap dealers.[1129] Another commenter predicted that the initial margin requirements will result in a huge drain of liquid assets from the U.S. economy because they would require very large amounts of collateral to be posted as initial margin and placed in segregated custodial accounts.[1130] This commenter attempted to quantify this amount by calculating the amounts of initial margin that the firm would have to collect from 34 of its largest professional dealer counterparties by reference to the ''Lookup Table'' percentages of notional approach set forth in Appendix A to the prudential regulators' margin rulemaking.[1131] Application of this approach to the commenter's existing portfolio with those 34 counterparties yielded an estimated amount of initial margin that the firm would have to collect equal to $1.4 trillion.[1132] The commenter noted that since the interdealer initial margin requirements are reciprocal, it would also be obligated to post $1.4 trillion.[1133]

[1123] *See* Manmohan Singh, *Velocity of Pledged Collateral: Analysis and Implications,* IMF Working Paper, WP/11/256 (Nov. 2011) (stating that the decline in leverage and re-use of collateral may be viewed positively from a financial stability perspective, but from a monetary policy perspective, however, the lubrication in the global financial markets is now lower as the velocity of money-type instruments has declined.). Singh argues that the ''velocity of collateral,'' analogous to the concept of the ''velocity of money'' indicates the liquidity impact of collateral. A security that is owned by an economic agent and can be pledged as re-usable collateral leads to chains. Therefore, Singh argues that a shortage of acceptable collateral would have a negative cascading impact on lending similar to the impact on the money supply of a reduction in the monetary base. *Id.* at 16. *See also* Manmohan Singh and James Aitken, *The (sizable) Role of Rehypothecation in the Shadow Banking System,* IMF Working Paper WP/10/172 (July 2010).

[1124] *See* OCC Economics Department, *Unfunded Mandates Reform Act—Impact Analysis for Swaps Margin and Capital Rule,* (Apr. 15, 2011) (''*OCC Unfunded Mandates Report''*); *SIFMA/ISDA Comment Letter to the Prudential Regulators; J.P. Morgan Letter;* Bank of America-Merrill Lynch, *No Margin for Error, Part 3: Dodd-Frank Implements QE3,* Credit Derivatives Strategist (Nov. 5, 2011) (''*BAML Report''*).

[1125] *See* Manmohan Singh, *Collateral, Netting and Systemic Risk in the OTC Derivatives Market,* IMF Working Paper WP 10/99 (1999) (a study by the IMF arguing that moving OTC derivatives to centralized clearing would require between $170 and $220 billion in initial margin collateral).

[1126] *SIFMA/ISDA Comment Letter to the Prudential Regulators* at 38.

[1127] *See* BCBS, IOSCO, *Margin Requirements for Non-centrally-cleared Derivatives.* The Working Group on Margin Requirements is conducting a Quantitative Impact Study to better quantify the impact of the proposed margin requirements set forth in the consultative paper. *See id.* at Part C.

[1128] *SIFMA/ISDA Comment Letter to the Prudential Regulators.*

[1129] *Id.* at 36.

[1130] *J.P. Morgan Letter.*

[1131] *J.P. Morgan Letter; Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27592.

[1132] *J.P. Morgan Letter* at 5.

[1133] *Id.* In the *J.P. Morgan Letter,* however, it was noted that it is likely that most swap dealers would use the model based approach, and not the ''lookup table'', to calculate initial margin which would likely produce smaller initial margin amounts. In the letter, it was argued that there is substantial uncertainty about the model approval process and timing and accordingly the large amounts resulting from application of the lookup table are relevant. *Id.*

In addition, the OCC Unfunded Mandates Report estimated that the initial margin collected under the prudential regulators' proposed margin rule in one year could total $2.56 trillion.[1134] The report pointed out, however, that several factors are likely to reduce the impact of the proposed rule, including a move to central clearing and the fact that dealers are likely to use internal models that permit netting. The report estimated that currently roughly 20% of swap contracts trade through clearing houses.[1135] Assuming that the proportion of cleared to non-cleared swaps will at a minimum remain at one in five, the report further estimated the required funds to cover the initial margin requirement under the proposed rule to be $2.05 trillion (0.80 × $2.56 trillion).[1136]

Finally, the *BAML Report* stated that its calculations suggested that the regulatory changes may eventually result in initial margin requirements of $200 billion to $600 billion for US banks, as current derivatives portfolios turn over.[1137]

In summary, as stated above, commenters concluded that the liquidity impact of the initial margin rules proposed by the CFTC and the prudential regulators was significant.[1138] However, one commenter acknowledged that the numbers should be viewed as an ''order of magnitude estimate'' and that ''[o]ne cannot predict which entities will use derivatives in the future nor the amounts and types of products that will be used.'' [1139] The Commission seeks comment on the liquidity impact of its proposals below and in section II.B. of this release.

c. Margin Requirements for Nonbank-MSBSPs

As described in section II.B. of this release, a nonbank MSBSP would be required to calculate as of the close of each business day the amount of *equity* in the account of each counterparty to a non-cleared security-based swap.[1140] On the next business day following the calculation, the nonbank MSBSP would be required to either collect or deliver cash, securities, and/or money instruments to the counterparty depending on whether there was *negative* or *positive equity* in the account of the counterparty.[1141] Specifically, if the account had *negative equity* on the previous business day, the nonbank MSBSP would be required to collect cash, securities, and or money market instruments in an amount equal to the *negative equity*.[1142] Conversely, if the account had *positive equity* on the previous business day, the nonbank MSBSP would be required to deliver cash, securities, and/or money market instruments to the counterparty in an amount equal to the *positive equity*.[1143]

Nonbank MSBSPs are not expected to maintain two-sided markets or otherwise engage in activities that would require them to register as an SBSD.[1144] They will, however, by definition, maintain substantial positions in particular categories of security-based swaps.[1145] These positions could create significant risk to counterparties to the extent the counterparties have uncollateralized current exposure to the nonbank SBSD. In addition, they could pose significant risk to the nonbank MSBSP to the extent it has uncollateralized current exposure to its counterparties. The proposed account *equity* requirements for nonbank MSBSPs seek to address these risks by imposing a requirement that nonbank MSBSPs on a daily basis must ''neutralize'' the credit risk between the nonbank MSBSP and the counterparty either by collecting or delivering cash, securities, and/or money market instruments in an amount equal to the *positive* or *negative equity* in the account.

The collection of collateral from counterparties would strengthen the liquidity of the nonbank MSBSP by collateralizing its current exposure to counterparties. The delivery of collateral to counterparties to collateralize their current exposure to the nonbank MSBSP would lessen the impact on the counterparties if the nonbank MSBSP failed.

The requirement for nonbank MSBSPs to post current exposure to certain counterparties under proposed new Rule 18a–3 would impose an incremental opportunity cost for these nonbank MSBSPs only to the extent that they do not currently post collateral to cover current exposure. The requirement that nonbank MSBSPs collect variation margin from certain counterparties also would represent an incremental cost to those counterparties users to the extent they do not currently post such margin.

As stated above, proposed new Rule 18a–3 contains an exception for trades between nonbank MSBSPs and *commercial end users,* so those end users would not face additional costs because of this exception.

Instead of the proposed approach, the Commission could adopt margin requirements for nonbank MSBSPs that are consistent with those proposed for nonbank SBSDs, by requiring them to collect initial margin from all non-dealer counterparties. This approach could better protect the MSBSP from loss in the event of a counterparty default, and thereby lessen the possibility of a default by the MSBSP. On the other hand, such a requirement would increase the credit exposure of counterparties to the MSBSP by the amount of the initial margin that they provide to the MSBSP and could increase their risk of loss if the MSBSP were to fail and they were unsuccessful in obtaining the return of amounts owed to them. The Commission is seeking comment on this alternative.

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

The proposed margin requirements to collect collateral from their counterparties to non-cleared security-based swaps to cover both current exposure and potential future exposure are designed to insulate security-based swap market participants from the negative fallout of a defaulting counterparty. Basing proposed Rule 18a–3 on the broker-dealer margin rules is intended to achieve those objectives in the market for security-based swaps. Moreover, the consistency between margin requirements for securities and security-based swaps should ultimately promote efficiency in the securities

[1134] *OCC Unfunded Mandates Report* at 5. The report also used the ''lookup table'' to estimate the initial margin impact of the prudential regulators' proposed margin rule, and noted the proposed rule would apply to any swap that is a national bank, a federally chartered branch or agency of a foreign bank, or a federal savings association. *Id.* at 2.

[1135] *OCC Unfunded Mandates Report* at 5.

[1136] *Id.* The report also estimated that the actual cost of the initial margin requirement is the opportunity cost of collateral that under the prudential regulators' rule must be segregated into a custodial account with a presumably lower rate of return.

[1137] *BAML Report* at 5.

[1138] *See also* Manmohan Singh, *Collateral, Netting and Systemic Risk in the OTC Derivatives Market.*

[1139] *SIFMA/ISDA Comment Letter to the CFTC* at 38.

[1140] *See* paragraph (c)(2)(i) of proposed new Rule 18a–3.

[1141] *See* paragraph (c)(2)(ii) of proposed new Rule 18a–3. As indicated, the nonbank MSBSP would need to deliver cash, securities, and/or money market instruments and, consequently, other types of assets would not be eligible as collateral.

[1142] *See* paragraph (c)(2)(ii)(A) of proposed new Rule 18a–3. In this case, the nonbank MSBSP would have current exposure to the counterparty in an amount equal to the *negative equity.*

[1143] *See* paragraph (c)(2)(ii)(B) of proposed new Rule 18a–3.

[1144] *See Entity Definitions Adopting Release,* 77 FR 30596.

[1145] *See* 15 U.S.C. 78c(a)(67); *Entity Definitions Adopting Release,* 77 FR 30596.

markets, and in turn, enhance competition in the security-based swap markets.

The proposed rule offers built-in flexibilities that should enhance the efficiency in the application of the rule. For example, granting counterparties the flexibility to post a variety of collateral types to meet margin requirements may result in increased efficiencies for end users, and could encourage increased trading of security-based swaps and thereby increase competition. Furthermore, the proposed exception for *commercial end users* is intended to account for the different risk profiles of *commercial end users* as compared with financial end users.[1146] This exception may increase efficiencies by allowing SBSDs to optimally choose to collect collateral or take a capital charge, which in turn might allow end users to more cost efficiently manage business risks and thereby better compete in their respective industries.

However, the flexibility to use models to calculate margins instead of applying the standard haircuts could have an adverse impact on competition if the differences in these margin amounts are sufficiently large. If this was the case, a nonbank SBSD not approved to use models will find it difficult to compete with an SBSD approved to use models. However, it is conceivable that SBSDs not approved to use models would tend to do business only in cleared security-based swaps and SBSDs that use models would compete in both cleared and non-cleared security-based swaps. This separation could have a negative impact on competition in non-cleared security-based swaps. If, however, SBSDs that are approved to use models manage counterparty risk more efficiently, the market for non-cleared security-based swaps might be systemically less risky than it would be if SBSDs not using models participated actively in that market. It is unclear whether the benefit from the reduction in systemic risk would outweigh the potential cost of the reduced competition.

There also is a trade-off between Alternatives A and B for SBSDs. Under Alternative A the reduced demand on posting and collecting collateral should lead to more efficient allocation of capital and hence improve competition, but it comes at the cost of being less resilient to counterparty defaults and hence might overall increase systemic risk. In addition, if the Commission does not require nonbank SBSDs to collect initial margin in their transactions with each other, as is generally current market practice,[1147] while the prudential regulators require the collection of initial margin for the same trades as their proposed rules suggest, intermediaries could have an incentive to conduct business through nonbank entities.[1148] Under Alternative B, the requirement to exchange initial margin would impose costs on the nonbank SBSD in the form of a capital charge to the extent the nonbank SBSD must post initial margin. This could result in substantially less liquidity available to the nonbank SBSD to support its security-based swap business or other dealer activity, but to the extent it limits the amount of uncleared SBSD transactions among nonbank SBSDs as a whole, it could lead to lower systemic risk. Moreover, if this requirement results in a significant increase in costs because of the required capital charge, nonbank SBSDs could be motivated to conduct trading either in bank SBSDs or offshore because they would not need to take the capital charge. Especially in the latter case, this may not only adversely affect domestic competition if the only dealers able to absorb the increased expenses are the ones currently participating in the market, it also could increase systemic risk worldwide if the regulatory environment in foreign jurisdictions are less stringent.

Request for Comment

The Commission generally requests comment about its analysis of the costs and benefits of proposed Rule 18a–3. In addition, the Commission requests comment in response to the following questions:

1. In many respects, the proposed rules reflect an interplay between capital and margin requirements. How should each set of rules take account of the other? For example, does the proposed alternative capital charge in lieu of collecting margin from *commercial end users* appropriately account for the increased exposure to the dealer? Does it over-state the exposure?

2. What would be the general market impact of requiring that dealers post both variation and initial margin in transactions with each other? Commenters are asked to supply data on the volume of interdealer transactions in security-based swaps and the aggregate dollar impact of this proposal. How does the impact of requiring dealers to exchange both variation and initial margin compare with the aggregate dollar impact of requiring that nonbank SBSDs collect only variation margin?

3. With regard to Alternatives A and B regarding interdealer margin, the Commission requests that commenters provide the following data points to the Commission:

- The relative amounts of variation and initial margin for sample dealer portfolios of security-based swaps;
- The industry dollar impact and liquidity impact of requiring lock up of initial margin for dealer portfolios; and
- How the amount of initial margin would compare to overall dealer capital.

4. The Commission also requests comment on the potential legal limitations involved in obtaining a return of collateral that has been posted to a third party custodian, the costs involved, and whether there are ways to overcome these limitations.

5. The Commission requests comment on the costs and benefits, if the Commission, as an alternative to proposed new Rule 18a–3, permitted nonbank SBSDs to apply to the Commission to use internal models solely to compute the margin amount in paragraph (d) to Rule 18a–3 (without seeking approval to use internal models for capital purposes). Would this alternative impact the Commission's oversight responsibility of nonbank SBSDs?

6. What is the cost impact, if any, of permitting nonbank SBSDs to accept securities as collateral that may be less liquid than Treasury securities in the case of severe market disruptions? Would this cost be mitigated by the haircut and collateral requirements in proposed Rule 18a–3?

7. What would be the costs and benefits of an initial margin requirement between nonbank SBSDs counterparties dependent on the firm's minimum net capital requirement (*e.g.,* based on firm size)?

8. Proposed Rule 18a–3(d) would require that firms approved to use VaR models calculate *margin* amount using a 99%, 10 business-day period. How would this proposal affect sample portfolios of security-based swaps based on existing internal firm models and current market practices, including margin practices at registered clearing

[1146] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR at 27571 (''Among end users, financial end users are considered more risky than nonfinancial end users because the profitability and viability of financial end users is more tightly linked to the health of the financial system than nonfinancial end users. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the covered swap entity.''). *See also CFTC Margin Proposing Release,* 76 FR at 27735 (''The Commission believes that financial entities, which are generally not using swaps to hedge or mitigate commercial risk, potentially pose greater risk to CSEs than non-financial entities.'').

[1147] *See generally ISDA Margin Survey 2011.*

[1148] *See Prudential Regulator Margin and Capital Proposing Release,* 76 FR 27564.

agencies? The Commission requests data from market participants to assist it in evaluating this proposal.

9. Would the margin requirements under proposed new Rule 18a–3 incentivize counterparties to trade in cleared security-based swaps? If certain security-based swaps cannot be cleared, would the proposed margin requirements render the use of these non-cleared contracts inefficient?

10. Will nonbank MSBSPs incur operational, technology or other costs to calculate the amount of *equity* in the account of a counterparty, as required under paragraph (c)(2)(i) of proposed new Rule 18a–3?

4. Proposed Segregation Rule—Rule 18a–4

Proposed new Rule 18a–4 would establish segregation requirements for cleared and non-cleared security-based swap transactions, which would apply to bank SBSDs, nonbank stand-alone SBSDs, and broker-dealer SBSDs.[1149] The goal of proposed new Rule 18a–4 is to protect customer assets by ensuring that cash and securities that SBSDs hold for security-based swap customers are isolated from the proprietary assets of the SBSD and identified as property of such customers.[1150] This approach would facilitate the prompt return of customer property to customers either before or during liquidation proceedings if the firm fails,[1151] and is therefore expected to provide market participants who enter into security-based swap transactions with an SBSD the confidence that their accounts will remain separate from the SBSD in the event of bankruptcy.[1152] As such, proposed new Rule 18a–4 will have a number of benefits as well as impose certain costs on SBSDs and MSBSPs, as well as other market participants. The proposed rules are expected to have possible effects on competition, efficiency, and capital formation, which are discussed below.

As discussed earlier in this release, Rule 18a–4 is in substantial part modeled on provisions of Rule 15c3–3 that require a carrying broker-dealer to take two primary steps to safeguard these assets. The first step required by Rule 15c3–3 is that a carrying broker-dealer must maintain physical possession or control over customers' fully paid and excess margin securities.[1153] The second step is that a carrying broker-dealer must maintain a reserve of funds or qualified securities in a customer reserve account at a bank that is equal in value to the net cash owed to customers, computed in accordance with the Exhibit A formula.[1154] The corollary provisions of Rule 18a–4 are likewise intended to require that customer funds are adequately protected from loss in the event of the SBSD's failure. Further, this protection would be provided to customers who have not affirmatively elected to require individual account segregation of their assets under section 3E(f) of the Exchange Act.

Paragraph (a) of the proposed new rule would define key terms used in the rule.[1155] Paragraph (b) would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all *excess securities collateral* (a term defined in paragraph (a)) and specify certain locations where *excess securities collateral* could be held and deemed in the SBSD's control.[1156] Paragraph (c) would require an SBSD to maintain a special account for the exclusive benefit of security-based swap customers and have on deposit in that account at all times an amount of cash and/or *qualified securities* (a term defined in paragraph (a)) determined through a computation using the formula in Exhibit A to proposed new Rule 18a–4.[1157]

Paragraph (d) of proposed new Rule 18a–4 would contain provisions that are designed to implement the individual account segregation requirements of section 3E(f) of the Exchange Act, and therefore, are not modeled specifically on Rule 15c3–3. First, it would require an SBSD and an MSBSP to provide the notice required by section 3E(f)(1)(A) of the Exchange Act prior to the execution of the first non-cleared security-based swap transaction with the counterparty.[1158] Second, it would require the SBSD to obtain subordination agreements from counterparties that opt out of the segregation requirements in proposed new Rule 18a–4 because they either elect individual segregation pursuant to the self-executing provisions of section 3E(f) of the Exchange Act[1159] or agree that the SBSD need not segregate their assets at all.[1160]

Available information suggests that customer assets related to OTC derivatives are currently not consistently segregated from dealer proprietary assets. With respect to non-cleared derivatives, available information suggests that there is no uniform segregation practice but that collateral for most accounts is not segregated.[1161] According to the *ISDA Margin Survey 2012,* where independent amounts (initial margin) is collected, ISDA members reported that most (approximately 72.2%) was commingled with variation margin and not segregated, and only 4.8% of the amount received was segregated with a third party custodian.[1162]

In the absence of a segregation requirement, the likelihood that security-based swap customers would suffer losses upon a dealer default may substantially increase. The proposed segregation requirements would limit for security-based swap customers these potential losses if an SBSD fails.[1163] The extent to which assets are in fact protected by proposed Rule 18a–4 would depend on how effective they are in practice in allowing assets to be readily returned to customers.

It is difficult to measure these benefits against the current baseline of the OTC derivatives market as it exists today, as discussed in section V.A.1. of this release. Rule 15c3–3, on which proposed Rule 18a–4 is modeled, however, may generally provide a reasonable template for crafting the corresponding requirements for nonbank SBSDs.[1164] Furthermore, the ensuing increased confidence of market participants when transacting in

[1149] *See* proposed new Rule 18a–4. *See also* section II.C. of this release for a more detailed description of the proposal. The provisions of proposed new Rule 18a–4 are modeled on the broker-dealer segregation rule, Rule 15c3–3. 17 CFR 240.15c3–3.

[1150] *See* proposed new Rule 18a–4.

[1151] *See generally* Michael P. Jamroz, *The Customer Protection Rule,* 57 Bus. Law. 1069 (May 2002). *See also* section II.C. of this release for a more detailed description of the proposal.

[1152] *See* 15 U.S.C. 78c–5.

[1153] *See* 17 CFR 240.15c3–3(d).

[1154] 17 CFR 240.15c3–3(e). The term ''qualified security'' is defined in Rule 15c3–3 to mean a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States. *See* 17 CFR 240.15c3–3(a)(6).

[1155] *Compare* 17 CFR 240.15c3–3(a), *with* paragraph (a) of proposed new Rule 18a–4.

[1156] *Compare* 17 CFR 240.15c3–3(b)–(d), *with* paragraph (b) of proposed new Rule 18a–4.

[1157] *Compare* 17 CFR 240.15c3–3(e), *with* paragraph (e) of proposed new Rule 18a–4.

[1158] *See* 15 U.S.C. 78c–5(f)(1)(A); paragraph (d)(1) of proposed new Rule 18a–4.

[1159] *See* 15 U.S.C. 78c–5(f)(1)–(3).

[1160] *See* 15 U.S.C. 78c–5(f)(4).

[1161] *See generally ISDA Margin Survey 2012.*

[1162] *ISDA Margin Survey 2012.* The survey also notes that while the holding of the independent amounts and variation margin together continues to be the industry standard both contractually and operationally, it is interesting to note that the ability to segregate has been made increasingly available to counterparties over the past three years on a voluntary basis, and has led to adoption of 26% of independent amount received and 27.8% of independent amount delivered being segregated in some respects. *Id.* at 10. *See also Independent Amounts.*

[1163] CFTC and Commission, *Statement on MF Global about the deficiencies in customer futures segregated accounts held at the firm* (Oct. 31, 2011).

[1164] *See* 17 CFR 240.15c3–3. *See SIPC 2011 Annual Report.*

security-based swaps, as compared to the OTC derivatives market as it exists today, should enhance liquidity and generally benefit market participants.

Further, modeling the provisions of Rule 18a–4 on existing Rule 15c3–3 will generally promote consistent treatment of collateral in circumstances where a broker-dealer SBSD conducts business in securities and security-based swaps with the same counterparty, and in these cases it will facilitate the ability of firms to offer portfolio margin treatment. In addition, ''omnibus segregation'' requirements of proposed Rule 18a–4 are intended to reduce costs for SBSDs and their customers by providing a less expensive segregation alternative to individual account segregation.[1165]

Currently, because of a lack of trading in cleared security-based swaps for customers,[1166] there is no definitive baseline against which to measure the various costs associated with segregation requirements for those trades. Further, overall costs of segregating collateral for cleared security-based swaps will be heavily affected by the clearing agency rules, which will govern how margin required by, and held at, a clearing agency with respect to customer positions must be segregated.[1167]

As stated above, proposed new Rule 18a–4 also is intended to provide SBSDs and their counterparties a less expensive segregation alternative to individual account segregation. Higher costs for individual segregation derive from, among other things, higher fees charged by custodians to monitor individual account assets and to account for potentially greater legal risks and liabilities of custodians to account beneficiaries or dealers, as well as higher operational costs to account for collateral on an individual customer basis. A commenter to the CFTC raised concerns with the length of time and the costs to comply with an individual segregation mandate. Specifically, the commenter raised concerns regarding the number of collateral arrangements that would be required. The commenter estimated, based on discussion with its members, that ''a rough estimate of the time it would take to establish the necessary collateral arrangements is 1 year and eleven months, with an associated cost of $141.8 million, per covered swap entity.'' [1168] To account for these higher costs, SBSDs likely may increase fees for customers that choose individual rather than omnibus segregation. If higher fees make it prohibitively expensive for some counterparties to elect individual segregation, the proposed omnibus segregation scheme under Rule 18a–4 could be a more cost-effective solution.

Rule 18a–4 will impose on SBSDs operational costs, as well as costs related to the use of customer funds, compared to the baseline, given that dealers in general do not presently segregate customer collateral for security-based swaps, and to the extent collateral is segregated, it is not done so on the terms that would be required by proposed new Rule 18a–4. The operational costs include costs to establish qualifying bank accounts and to perform the calculations required to determine the amount that is required at any one time to be maintained in the reserve account.[1169] In cases where an SBSD is jointly registered as a broker-dealer, the costs of adapting existing systems to account for security-based swap transactions may not be material in light of the similarities between the systems and procedures required by Rule 15c3–3 and those that would be required by proposed new Rule 18a–4.

A further cost would be imposed on SBSDs to the extent that collateral they hold that could otherwise be rehypothecated would no longer be eligible for this purpose.[1170] An SBSD would incur a cost of funds equal to the borrowing cost of the dealer if the dealer was unable to use customer collateral to finance its business activities. The extent of this cost would depend on how much collateral associated with security-based swaps and held by dealers today consists of initial margin that they can rehypothecate, *i.e.,* that is not now segregated as would be required under Rule 18a–4 (the rule would not require the segregation of variation margin).[1171]

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

The proposed segregation requirements for SBSDs are designed to protect and preserve counterparty collateral held at SBSDs. More specifically, the goal of proposed new Rule 18a–4 is to protect customer assets by ensuring that cash and securities that SBSDs hold for security-based swap customers are isolated from the proprietary assets of the SBSD and identified as property of such customers.[1172] These protections may provide market participants who enter into security-based swap transactions with an SBSD the assurance that their accounts will remain separate from the SBSD in the event of bankruptcy.[1173] These proposed protections could reduce the risk of loss of collateral to individual counterparties and, thereby, promote participation in the security-based swap markets. This may result in enhanced competition and more efficient price discovery.

Therefore, proposed segregation rules that promote, or do not unduly restrict, competition may be accompanied by regulatory benefits that minimize the risk of market failure and thus promote efficiency within the market. Such competitive markets would increase the efficiency with which market participants could transact in security-based swaps for speculative, trading, hedging and other purposes. Conversely, increased costs associated with the proposed segregation rules could result in high barriers to entry and negatively affect competition for SBSDs in the security-based swap markets.

Further, modeling the provisions of Rule 18a–4 on existing Rule 15c3–3 will generally promote consistent treatment of collateral in circumstances where a broker-dealer SBSD conducts business in securities and security-based swaps with the same counterparty, increasing efficiencies for counterparties. Finally, the proposed ''omnibus segregation'' requirements of proposed Rule 18a–4 are intended to provide a less expensive segregation alternative to individual account segregation.[1174] This proposed requirement could also result in increased efficiencies, and, in turn, facilitate capital formation through the availability of additional capital for counterparties as a result of decreased costs.

[1165] *See* section 3E(f)(1)(B) of the Exchange Act.

[1166] *See Process for Submissions of Security-Based Swaps,* 77 FR 41602.

[1167] *See Clearing Agency Standards for Operation and Governance,* 76 FR 14472.

[1168] *SIFMA/ISDA Comment Letter to the Prudential Regulators.*

[1169] *See* proposed new Rule 18a–4. *See* section V.C. of this release for a discussion of implementation costs. *See also* section V.B. of this release.

[1170] *See SIFMA/ISDA Comment Letter to the Prudential Regulators* (''First, because the collateral cannot be rehypothecated, and because the collateral amounts will be very large, CSEs will be limited to investing very large amounts of eligible collateral in assets that generate low returns.'').

[1171] *See* Manmohan Singh, *Velocity of Pledged Collateral: Analysis and Implications;* Manmohan Singh and James Aitken, *The (sizable) Role of Rehypothecation in the Shadow Banking System.*

[1172] *See* proposed new Rule 18a–4.

[1173] *See* 15 U.S.C. 78c–5.

[1174] *See* 15 U.S.C. 78c(f)(1)(B).

Request for Comment

The Commission generally requests comment about its analysis of the costs and benefits of the proposed segregation rules. In addition, the Commission requests comment in response to the following questions:

1. To what extent do counterparties presently require that their assets associated with security-based swaps be independently segregated?

2. What would be the overall market impact of a right by customers to demand individual segregation? How would costs to end users be impacted? Would those costs differ depending on the type of end user or size of its positions with the SBSD?

3. How would the existence of omnibus versus independent accounts factor into the ability easily to resolve a defaulting SBSD?

4. Would the proposed segregation requirements prove to be difficult to implement for existing contracts?

C. Implementation Considerations

As discussed above, proposed Rules 18a–1 through 18a–4, as well as the proposed amendments to Rule 15c3–1, would impose certain costs on SBSDs and MSBSPs. The Commission expects that the highest economic cost impact as a result of the proposed new rules and rule amendments would likely result from the additional capital nonbank SBSDs and nonbank SBSDs may have to hold as a result of the proposed capital rules, and the additional margin that SBSDs, MSBSPs, and other market participants may have to post and/or collect as a result of proposed margin requirements.

The proposed new rules and rule amendments, however, as discussed above, would impose certain implementation burdens and related costs on SBSDs, MSBSPs and other market participants. These costs may include start-up costs, including personnel and other costs, such as technology costs, to comply with the proposed new rules and rule amendments. As discussed in section IV.D. of this release, the Commission has estimated the burdens and related costs of these implementation requirements for SBSDs and MDBSPs.[1175] These costs are summarized below.

A stand-alone SBSD that applies to use internal models would be required under proposed new Rule 18a–1 to create and compile various documents to be included with the application, including documents related to the development of its VaR models, and to provide additional documentation to, and respond to questions from, Commission staff throughout the application process.[1176] These firms also would be required to review and backtest these models annually. The requirements are estimated to impose one-time and annual costs in the aggregate of approximately $1.97 million [1177] and $10.6 million, respectively.[1178] These firms would also incur technology costs of $48.0 million in the aggregate.[1179]

Stand-alone SBSDs that use internal models and ANC broker-dealers would be required to develop a liquidity stress test and a written contingency plan under proposed new Rule 18a–1 and proposed amendments to Rule 15c3–1, and periodically review them.[1180] These requirements would impose one-time and annual costs in the aggregate of approximately $1.0 million [1181] and $2.3 million,[1182] respectively.

Rule 18a–1 also would require stand-alone SBSDs to establish, document, and maintain a system of internal risk management controls required under Rule 15c3–4, as well as to review and update these controls.[1183] This requirement would impose one-time and annual costs in the aggregate of $7.5 million [1184] and $971,000, respectively.[1185] These firms also may incur aggregate initial and ongoing information technology costs of $240,000 and $307,500, respectively.[1186]

Finally, nonbank SBSDs and broker-dealers, as applicable, may incur one-time and ongoing costs related to filing notices and subordination agreements and documenting industry sector classifications under proposed new Rule 18a–1, and amendments to Rule 15c3–1.[1187] These requirements would impose one-time and annual costs in the aggregate of $68,040 [1188] and $38,367, respectively.[1189]

Rule 18a–2 also would require nonbank MSBSPs to establish, document, and maintain a system of internal risk management controls required under Rule 15c3–4, as well as to review and update these controls.[1190] This requirement would impose one-time and annual costs in the aggregate of $2.7 million [1191] and $324,000 [1192] for nonbank MSBSPs, respectively. These nonbank MSBSPs also may incur initial and ongoing information technology costs of $80,000 and $102,500, respectively.[1193]

Rule 18a–3 would require nonbank SBSDs to establish a written risk analysis methodology, which would need to be reviewed and updated.[1194] This requirement would impose one-time and annual costs in the aggregate of $1.7 million [1195] and $483,000, respectively.[1196]

Finally, SBSDs and MSBSPs would incur various one-time and ongoing costs in the aggregate in order to comply with the segregation and notification requirements of proposed new Rule 18a–4.[1197] Each SBSD would incur one-time and annual costs in establishing special bank accounts required by the rule. This requirement would impose one-time and annual costs of $2.9 million [1198] and $377,000 [1199] in the aggregate on SBSDs, respectively. In addition, SBSDs would be required to perform a reserve computation required by Appendix A to proposed new Rule 18a–4, which would impose on these firms annual costs in the aggregate of $9.7 million.[1200]

In addition, both SBSDs and MSBSPs would be required to prepare and send to their counterparties segregation-related notices pursuant to section 3E(f)

[1175] *See* section IV.D. of this release (discussing total initial and annual recordkeeping and reporting burden of the proposed rules and rule amendments).

[1176] *See* section IV.A.1. of this release.

[1177] This consists of external costs of $600,000, plus internal costs of $1.37 million. *See* section IV.D.1. of this release.

[1178] This consists of external costs of $3.7 million, plus internal costs of $6.9 million. *See* section IV.D.1. of this release.

[1179] *See* section IV.D.1. of this release.

[1180] *See* section IV.A.1. of this release.

[1181] *See* section IV.D.1. of this release.

[1182] *Id.*

[1183] *See* section IV.A.1. of this release.

[1184] *See* section IV.D.1. of this release.

[1185] *Id.*

[1186] *Id.*

[1187] *See* section IV.A.1. of this release.

[1188] *See* section IV.D.1 of this release (one-time cost to draft subordinated loan agreement template under Appendix D to proposed new Rule 18a–1).

[1189] *Id.* (annual costs of $2,898, $1,449 and $34,020 related to documenting industry sector classifications for credit default swap haircuts under Rule 18a–1, equity withdrawal notices under paragraph (i) under Rule 18a–1, and preparing and filing proposed subordinated loan agreements with the Commission under Appendix D to Rule 18a–1).

[1190] *See* section IV.A.2. of this release.

[1191] This consists of external costs of $400,000, plus internal costs of $2.3 million. *See* section IV.D.2. of this release.

[1192] *See* section IV.D.2. of this release.

[1193] *Id.*

[1194] *See* section IV.A.3. of this release.

[1195] *See* section IV.D.3. of this release. This consists of external costs of $18,000, plus internal costs of $1.7 million.

[1196] *Id.*

[1197] *See* section IV.A.4. of this release.

[1198] *See* section IV.D.4. of this release.

[1199] *Id.*

[1200] *Id.*

of the Exchange Act.[1201] This requirement would impose one-time and annual costs in the aggregate to SBSDs and MSBSPs of $770,000 [1202] and $110,000, respectively.[1203]

Finally, proposed new Rule 18a–4 would require each SBSD to draft, prepare, and enter into subordination agreements with certain counterparties.[1204] This requirement would impose on these firms one-time and annual costs in the aggregate of $99.7 million [1205] and $19.1 million,[1206] respectively.

D. General Request for Comment

The Commission requests data to quantify, and estimates of, the costs and the value of the benefits of the proposed rules described above. Commenters should provide estimates of these costs and benefits, as well as any costs and benefits not already defined, that may result from the adoption of the proposed rules. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposals. The Commission requests comment on any effect the proposed new rules and rule amendments may have on efficiency, competition, and capital formation, including the competitive or anticompetitive effects the proposals may have on market participants. In addition, the Commission requests comment on whether other provisions of the Dodd-Frank Act for which Commission rulemaking is required are likely to have an effect on the costs and benefits of the proposed rules. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposed rules.

VI. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (''RFA'') [1207] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) [1208] of the Administrative Procedure Act,[1209] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on ''small entities.'' [1210] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment, which, if adopted, would not have a significant economic impact on a substantial number of small entities.[1211]

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) When used with reference to an ''issuer'' or a ''person,'' other than an investment company, an ''issuer'' or ''person'' that, on the last day of its most recent fiscal year, had total assets of $5 million or less,[1212] or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a–5(d) under the Exchange Act,[1213] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[1214] Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (1) For entities in credit intermediation and related activities,[1215] firms with $175 million or less in assets; (2) for non-depository credit intermediation and certain other activities,[1216] firms with $7 million or less in annual receipts; (3) for entities in financial investments and related activities,[1217] firms with $7 million or less in annual receipts; (4) for insurance carriers and entities in related activities,[1218] firms with $7 million or less in annual receipts; and (5) for funds, trusts, and other financial vehicles,[1219] firms with $7 million or less in annual receipts.[1220]

Based on available information about the security-based swap market,[1221] the market, while broad in scope, is largely dominated by entities such as those that would be covered by the SBSD and MSBSP definitions. Subject to certain exceptions, section 3(a)(71)(A) of the Exchange Act defines *security-based swap dealer* to mean any person who: (1) Holds itself out as a dealer in security-based swaps; (2) makes a market in security-based swaps; (3) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (4) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. Section 3(a)(67)(A) of the Exchange Act defines *major security-based swap participant* to be any person: (1) Who is not an SBSD; and (2) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; whose outstanding security-based swaps create substantial

[1201] *See* section IV.A.4. of this release.

[1202] *See* section IV.D.4. of this release. This consists of external costs of $220,000, plus internal costs of $550,020.

[1203] *Id.*

[1204] *See* section IV.A.4. of this release.

[1205] *See* section IV.D.4. of this release. This consists of external costs of $400,000, plus internal costs of $3,780,000 and $95,580,000.

[1206] *Id.*

[1207] 5 U.S.C. 601 *et seq.*

[1208] 5 U.S.C. 603(a).

[1209] 5 U.S.C. 551 *et seq.*

[1210] Although section 601(b) of the RFA defines the term ''small entity,'' the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term ''small entity'' for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0–10, 17 CFR 240.0–10. *See Statement of Management on Internal Accounting Control,* Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

[1211] *See* 5 U.S.C. 605(b).

[1212] *See* 17 CFR 240.0–10(a).

[1213] *See* 17 CFR 240.17a–5(d).

[1214] *See* 17 CFR 240.0–10(c).

[1215] Including commercial banks, savings institutions, credit unions, firms involved in other depository credit intermediation, credit card issuing, sales financing, consumer lending, real estate credit, and international trade financing.

[1216] Including firms involved in secondary market financing, all other non-depository credit intermediation, mortgage and nonmortgage loan brokers, financial transactions processing, reserve and clearing house activities, and other activities related to credit intermediation.

[1217] Including firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities.

[1218] Including direct life insurance carriers, direct health and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance (except life, health and medical) carriers, reinsurance carriers, insurance agencies and brokerages, claims adjusting, third party administration of insurance and pension funds, and all other insurance related activities.

[1219] Including pension funds, health and welfare funds, other insurance funds, open-end investment funds, trusts, estates, and agency accounts, real estate investment trusts, and other financial vehicles.

[1220] *See* 13 CFR 121.201 (Jan. 1, 2010).

[1221] *See CDS Data Analysis.*

counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or that is a financial entity that is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking regulator; and maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission.[1222]

Based on feedback from industry participants about the security-based swap markets, entities that will qualify as SBSDs and MSBSPs, whether registered broker-dealers or not, will likely exceed the thresholds defining ''small entities'' set out above. Thus, it is unlikely that proposed Rules 18a–1 to 18a–4 and the amendments to Rule 15c3–1 would have a significant economic impact on any small entity.

The Commission estimates that there are approximately 808 broker-dealers that were ''small'' for the purposes Rule 0–10. The amendments to Rule 15c3–1 relating to the standardized haircuts for swaps and security-based swaps, as well as the proposed CDS maturity grid would apply to all broker-dealers with such proprietary positions. These proposed amendments, therefore, would apply to all ''small'' broker-dealers in that they would be subject to the requirements in the proposed amendments. It is likely, however, that these proposed amendments would have no, or little, impact on ''small'' broker-dealers, since most, if not all, of these firms generally would not hold these types of positions.

For the foregoing reasons, the Commission certifies that the proposed new Rules 18a–1 through 18a–4, amendments to Rule 15c3–1, and amendments to Rule 15c3–3 would not have a significant economic impact on any small entity for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

[1222] *See also Entity Definitions Adopting Release,* 77 FR 30596 (''The SEC continues to believe that the types of entities that would engage in more than a de minimis amount of dealing activity involving security-based swaps—which generally would be major banks—would not be 'small entities' for purposes of the RFA. Similarly, the SEC continues to believe that the types of entities that may have security-based swap positions above the level required to be a 'major security-based swap participant' would not be a 'small entity' for purposes of the RFA. Accordingly, the SEC certifies that the final rules defining 'security-based swap dealer' or 'major security-based swap participant' would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.''). *Id.* at 30743.

VII. Statutory Basis and Text of the Proposed Amendments

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.,* and particularly, sections 3(b), 3E, 15, 15F, 23(a), and 36 (15 U.S.C. 78c(b), 78c–5, 78o, 78o–10, 78w(a), and 78mm), thereof, the Commission is proposing to amend §§ 240.15c3–1, 240.15c3–1a, 240.15c3–1b, 240.15c3–1d, 240.15c3–1e, and 240.15c3–3, and proposing §§ 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c, 240.18a–1d, 240.18a–2, 240.18a–3, 240.18a–4, and 240.18a–4a under the Exchange Act.

List of Subjects in 17 CFR Parts 240

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

Text of Amendment

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

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

1. The general authority citation for part 240 is revised, the sectional authorities for §§ 240.15c3–1 and 240.15c3–3 are revised, add sectional authorities for §§ 240.15c3–1a, 240.15c3–1e, 240.15c3–3, 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c, 240.18a–1d, 240–18a–2, 240.18a–3 and 240.18a–4 in numerical order to read as follows.

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l,* 78m, 78n, 78n–1, 78o, 78o–10 78o–4, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.;* 12 U.S.C. 5221(e)(3), 15 U.S.C. 8302, and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Section 240.15c3–1 is also issued under 15 U.S.C. 78o(c)(3), 78o–10(d), and 78o–10(e).

Section 240.15c3–3 is also issued under 15 U.S.C. 78c–5, 78o(c)(2), 78(c)(3), 78q(a), 78w(a); sec. 6(c), 84 Stat. 1652; 15 U.S.C. 78fff.

* * * * *

Sections 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c, 240.18a–1d, 240.18a–2, and 240.18a–3 are also issued under 15 U.S.C. 78o–10(d) and 78o–10(e).

Section 240.18a–4 is also issued under 15 U.S.C. 78c–5(f).

* * * * *

2. Section 240.15c3–1 is amended by:

a. Revising the center heading above paragraph (a)(7);

b. In paragraph (a)(7) removing the phrase ''and using the credit risk standards of Appendix E to compute a deduction for credit risk on certain credit exposures arising from transactions in derivatives instruments, instead of the provisions of paragraph (c)(2)(iv) of this section'' and in its place adding the phrase ''and using the credit risk standards of Appendix E to compute a deduction for credit risk for security-based swap transactions with *commercial end users* as defined in § 240.18a–3(b)(2), instead of the provisions of paragraphs (c)(2)(iv) and (c)(2)(xiv)(B)(*1*) of this section'';

c. Revising paragraph (a)(7)(i);

d. In paragraph (a)(7)(ii), remove ''$5 billion'' and in its place add ''$6 billion'';

e. Adding a center heading and paragraph (a)(10);

f. Adding paragraph (c)(2)(vi)(O);

g. Re-designating paragraph (c)(2)(xii) as paragraph (c)(2)(xii)(A) and adding new paragraph (c)(2)(xii)(B);

h. Adding paragraph (c)(2)(xiv);

i. Adding paragraph (c)(16); and

j. Adding paragraph (f).

The revisions and additions read as follows:

§ 240.15c3–1 Net capital requirements for brokers or dealers.

* * * * *

(a) * * *

Alternative Net Capital Computation For Broker-Dealers Authorized To Use Models

(7) * * *

(i) At all times maintain tentative net capital of not less than $5 billion and net capital of not less than the greater of $1 billion or the sum of the ratio requirement under paragraph (a)(1) of this section and eight percent (8%) of the risk margin amount;

* * * * *

Broker-Dealers Registered as Security-Based Swap Dealers

(10) A broker or dealer registered with the Commission as a security-based swap dealer, other than a broker or dealer subject to the provisions of (a)(7) of this section, must:

(i) At all times maintain net capital of not less than the greater of $20 million or the sum of the ratio requirement under paragraph (a)(1) of this section and eight percent (8%) of the risk margin amount; and

(ii) Comply with § 240.15c3–4 as though it were an OTC derivatives dealer with respect to all of its business

activities, except that paragraphs (c)(5)(xiii), (c)(5)(xiv), (d)(8), and (d)(9) of § 240.15c3–4 shall not apply.

* * * * *

(c) * * *

(2) * * *

(vi)(O) *Security-based swaps.* (*1*) *Credit default swaps.* (*i*) *Short positions (selling protection).* In the case of a security-based swap that is a short credit default swap, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with the following table:

Length of time to maturity of CDS contract	Basis point spread					
	100 or less (%)	101–300	301–400	401–500	501–699	700 or more
12 months or less	1.00	2.00	5.00	7.50	10.00	15.00
13 months to 24 months	1.50	3.50	7.50	10.00	12.50	17.50
25 months to 36 months	2.00	5.00	10.00	12.50	15.00	20.00
37 months to 48 months	3.00	6.00	12.50	15.00	17.50	22.50
49 months to 60 months	4.00	7.00	15.00	17.50	20.00	25.00
61 months to 72 months	5.50	8.50	17.50	20.00	22.50	27.50
73 months to 84 months	7.00	10.00	20.00	22.50	25.00	30.00
85 months to 120 months	8.50	15.00	22.50	25.00	27.50	40.00
121 months and longer	10.00	20.00	25.00	27.50	30.00	50.00

(*ii*) *Long positions (purchasing protection).* In the case of a security-based swap that is a long credit default swap, deducting 50% of the deduction that would be required by paragraph (c)(2)(vi)(O)(*1*)(*i*) of this section if the security-based swap was a short credit default swap.

(*iii*) *Long and short positions.* (*A*) *Long and short credit default swaps.* In the case of security-based swaps that are long and short credit default swaps referencing the same entity (in the case of credit default swap securities-based swaps referencing a corporate entity) or obligation (in the case of credit default swap securities-based swaps referencing an asset-backed security), that have the same credit events which would trigger payment by the seller of protection, that have the same basket of obligations which would determine the amount of payment by the seller of protection upon the occurrence of a credit event, that are in the same or adjacent spread category, and that are in the same or adjacent maturity category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amount specified in the higher maturity category under paragraph (c)(2)(vi)(O)(*1*)(*i*) or (*ii*) on the excess of the long or short position. In the case of security-based swaps that are long and short credit default swaps referencing corporate entities in the same industry sector and the same spread and maturity categories prescribed in paragraph (c)(2)(vi)(O)(*1*)(*i*) of this section, deducting 50% of the amount required by paragraph (c)(2)(vi)(O)(*1*)(*i*) of this section on the short position plus the deduction required by paragraph (c)(2)(vi)(O)(*1*)(*ii*) of this section on the excess long position, if any. For the purposes of this section, the broker or dealer must use an industry sector classification system that is reasonable in terms of grouping types of companies with similar business activities and risk characteristics and the broker-dealer must document the industry sector classification system used pursuant to this section.

(*B*) *Long security and long credit default swap.* In the case of a security-based swap that is a long credit default swap referencing a debt security and the broker or dealer is long the same debt security, deducting 50% of the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the bond, provided that the broker or dealer can deliver the debt security to satisfy the obligation of the broker or dealer on the credit default swap.

(*C*) *Short security and short credit default swap.* In the case of a security-based swap that is a short credit default swap referencing a bond or a corporate entity, and the broker or dealer is short the bond or a bond issued by the corporate entity, deducting the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the bond. In the case of a security-based swap that is a short credit default swap referencing an asset-backed security and the broker or dealer is short the asset-backed security, deducting the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the asset-backed security.

(*2*) *Security-based swaps that are not credit default swaps.* In the case of any security-based swap that is not a credit default swap, deducting the amount calculated by multiplying the notional amount of the security-based swap and the percentage specified in paragraph (c)(2)(vi) of this section applicable to the reference security. A broker or dealer may reduce the deduction under this paragraph (c)(2)(vi)(O)(*2*) by an amount equal to any reduction recognized for a comparable long or short position in the reference security under paragraph (c)(2)(vi) of this section and, in the case of a security-based swap referencing an equity security, the method specified in § 240.15c3–1a.

* * * * *

(xii) * * *

(B) Deducting the amount of cash required in the account of each security-based swap customer to meet the margin requirements of a clearing agency, Examining Authority, or the Commission, after application of calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.

* * * * *

(xiv) *Deduction from net worth in lieu of collecting margin amounts for security-based swaps.* (A) *Cleared security-based swap transactions.* Deducting the amount of the margin difference for each account carried by the broker or dealer for another person that holds cleared security-based swap transactions. The margin difference is the amount of the deductions that the positions in the account would incur pursuant to paragraph (c)(2)(vi)(O) of this section if owned by the broker or dealer less the margin value of collateral held in the account.

(B) *Non-cleared security-based swap transactions.* (*1*) *Commercial end users.* Deducting, with respect to a counterparty that is a *commercial end user* as that term is defined in § 240.18a–3(b)(2), the margin amount calculated pursuant to § 240.18a–3(c)(1)(i)(B) for the account of the counterparty at the broker or dealer less any *positive equity* in that account as that term is defined in § 240.18a–3(b)(7).

(*2*) *Margin collateral held by third-party custodian.* Deducting, with

respect to a counterparty that is not a *commercial end user* as that term is defined in § 240.18a–3(b)(2) and that elects to have collateral segregated in an account at an independent third-party custodian pursuant to section 3E(f) of the Act (15 U.S.C. 78c–5(f)), the margin amount calculated pursuant to § 240.18a–3(c)(1)(i)(B) for the account of the counterparty less any *positive equity* in the account as that term is defined in § 240.18a–3(b)(7).

(*3*) *Security-based swap legacy accounts.* Deducting, with respect to a *security-based swap legacy account* as that term is defined in § 240.18a–3(b)(9) of a counterparty that is not a *commercial end user* as that term is defined in § 240.18a–3(b)(2), the margin amount calculated pursuant § 240.18a–3(c)(1)(i)(B) for the account less any *positive equity* in the account as that term is defined in § 240.18a–3(b)(7).

* * * * *

(16) The term *risk margin amount* means the sum of:

(i) The greater of the total margin required to be delivered by the broker or dealer with respect to security-based swap transactions cleared for security-based swap customers at a clearing agency or the amount of the deductions that would apply to the cleared security-based swap positions of the security-based swap customers pursuant to paragraph (c)(2)(vi)(O) of this section; and

(ii) The total margin amount calculated by the broker or dealer with respect to non-cleared security-based swaps pursuant to § 240.18a–3(c)(1)(i)(B).

* * * * *

(f) *Liquidity requirements.* (1) *Liquidity stress test.* A broker or dealer whose application, including amendments, has been approved, in whole or in part, to calculate net capital under Appendix E of this section must run a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the broker or dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the broker or dealer and at least annually by senior management of the broker or dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

(i) A stress event that includes a decline in creditworthiness of the broker or dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;

(ii) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding, including intercompany advances and unfunded committed lines of credit;

(iii) The potential for a material net loss of secured funding;

(iv) The loss of the ability to procure repurchase agreement financing for less liquid assets;

(v) The illiquidity of collateral required by and on deposit at registered clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;

(vi) A material increase in collateral required to be maintained at registered clearing agencies of which it is a member; and

(vii) The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the broker or dealer, including those related to customer businesses of the broker or dealer.

(2) *Stress test of consolidated entity.* The broker or dealer must justify and document any differences in the assumptions used in the liquidity stress test of the broker or dealer from those used in the liquidity stress test of the consolidated entity of which the broker or dealer is a part.

(3) *Liquidity reserves.* The broker or dealer must maintain at all times liquidity reserves based on the results of the liquidity stress test. The liquidity reserves used to satisfy the liquidity stress test must be:

(i) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and

(ii) Unencumbered and free of any liens at all times. Securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool contemporaneously.

(4) *Contingency funding plan.* The broker or dealer must have a written contingency funding plan that addresses the broker's or dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the broker or dealer and communications with the public and other market participants during a liquidity stress event.

* * * * *

3. Section 240.15c3–1a is amended by:

a. In paragraph (a)(4), revising the first and last sentences; and

b. Adding paragraph (b)(1)(v)(C)(*5*).

The addition to read as follows:

§ 240.15c3–1a Options (Appendix A to 17 CFR 240.15c3–1).

(a) * * *

(4) The term *underlying instrument* refers to long and short positions, as appropriate, covering the same foreign currency, the same security, security future, or security-based swap, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. * * * The term *underlying instrument* shall not be deemed to include securities options, futures contracts, options on futures contracts, qualified stock baskets, or unlisted instruments (other than security-based swaps).

* * * * *

(b) * * *

(1) * * *

(v) * * *

(C) * * *

(*5*) In the case of portfolio types involving security futures and equity options on the same underlying instrument and positions in that underlying instrument, there will be a minimum charge of 25% times the multiplier for each security-future and equity option.

* * * * *

4. Section 240.15c3–1b is amended by adding a paragraph (b) to read as follows:

§ 240.15c3–1b Adjustments to net worth and aggregate indebtedness for certain commodities transactions (Appendix B to 17 CFR 240.15c3–1).

* * * * *

(b) Every broker or dealer in computing net capital pursuant to § 240.15c3–1 must comply with the following:

(1) *Swaps.* In the case of any swap for which the deductions in Appendix E of this section do not apply:

(i) *Credit default swaps referencing broad-based securities indices.* (A) *Short positions (selling protection).* In the case of a swap that is a short credit default swap referencing a broad-based securities index, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with the following table:

Length of time to maturity of CDS contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
12 months or less	0.67	1.33	3.33	5.00	6.67	10.00
13 months to 24 months	1.00	2.33	5.00	6.67	8.33	11.67
25 months to 36 months	1.33	3.33	6.67	8.33	10.00	13.33
37 months to 48 months	2.00	4.00	8.33	10.00	11.67	15.00
49 months to 60 months	2.67	4.67	10.00	11.67	13.33	16.67
61 months to 72 months	3.67	5.67	11.67	13.33	15.00	18.33
73 months to 84 months	4.67	6.67	13.33	15.00	16.67	20.00
85 months to 120 months	5.67	10.00	15.00	16.67	18.33	26.67
121 months and longer	6.67	13.33	16.67	18.33	20.00	33.33

(B) *Long positions (purchasing protection).* In the case of a swap that is a long credit default swap referencing a broad-based securities index, deducting 50% of the deduction that would be required by paragraph (b)(1)(i)(A) of this Appendix B if the swap was a short credit default swap.

(C) *Long and short positions.* (*1*) *Long and short credit default swaps.* In the case of swaps that are long and short credit default swaps referencing the same broad-based security index, have the same credit events which would trigger payment by the seller of protection, have the same basket of obligations which would determine the amount of payment by the seller of protection upon the occurrence of a credit event, that are in the same or adjacent spread category, and that are in the same or adjacent maturity category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amount specified in the higher maturity category under paragraph (b)(1)(i)(A) or (b)(1)(i)(B) of this Appendix B on the excess of the long or short position.

(*2*) *Long basket of obligors and long credit default swap.* In the case of a swap that is a long credit default swap referencing a broad-based securities index and the broker or dealer is long a basket of debt securities comprising all of the components of the securities index, deducting 50% of the amount specified in § 240.15c3–1(c)(2)(vi) for the component securities, provided the broker or dealer can deliver the component securities to satisfy the obligation of the broker or dealer on the credit default swap.

(*3*) *Short basket of obligors and short credit default swap.* In the case of a swap that is a short credit default swap referencing a broad-based securities index and the broker or dealer is short a basket of debt securities comprising all of the components of the securities index, deducting the amount specified in § 240.15c3–1(c)(2)(vi) for the component securities.

(2) *All other swaps.* (i) In the case of any swap that is not a credit default swap, deducting the amount calculated by multiplying the notional value of the swap by the percentage specified in:

(A) Section 240.15c3–1 applicable to the reference asset if § 240.15c3–1 specifies a percentage deduction for the type of asset;

(B) 17 CFR 1.17 applicable to the reference asset if 17 CFR 1.17 specifies a percentage deduction for the type of asset and § 240.15c3–1 does not specify a percentage deduction for the type of asset; or

(C) In the case of an interest rate swap, § 240.15c3–1(c)(2)(vi)(A) based on the maturity of the swap, provided that the percentage deduction must be no less than 0.5%.

(ii) A security-based swap dealer may reduce the deduction under this paragraph (b)(2)(ii) by an amount equal to any reduction recognized for a comparable long or short position in the reference asset or interest rate under § 240.15c3–1 or 17 CFR 1.17.

§ 240.15c3–1d [Amended]

5. Section 240.15c3–1d is amended by:

a. Adding to the end of the second sentence of paragraph (b)(7) the phrase ‘‘, or if, in the case of a broker or dealer operating pursuant to paragraph (a)(10) of § 240.15c3–1, its net capital would be less than either $24 million or 10% of the risk margin amount under § 240.15c3–1’’;

b. In the first sentence of paragraph (b)(8)(i), adding after the phrase ‘‘if greater, or’’ the phrase ‘‘, in the case of a broker or dealer operating pursuant to paragraph (a)(10) of § 240.15c3–1, its net capital would be less than either $24 million or 10% of the risk margin amount under § 240.15c3–1, or’’;

c. In paragraph (b)(10)(ii)(B), adding after the phrase ‘‘if greater,’’ the phrase ‘‘or, in the case of a broker or dealer operating pursuant to paragraph (a)(10) of § 240.15c3–1, its net capital is less than either $20 million or 8% of the risk margin amount under § 240.15c3–1,’’;

d. In paragraph (c)(2), adding at the end of the sentence the phrase ‘‘, or, in the case of a broker or dealer operating pursuant to paragraph (a)(10) of § 240.15c3–1, its net capital would be less than either $24 million or 10% of the risk margin amount under § 240.15c3–1’’; and

e. In paragraph (c)(5)(i)(B), adding after the phrase ‘‘if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section,’’ the phrase ‘‘, or, in the case of a broker or dealer operating pursuant to paragraph (a)(10) of § 240.15c3–1, its net capital would be less than either $24 million or 10% of the risk margin amount under § 240.15c3–1,’’.

§ 240.15c3–1e [Amended]

6. Section 240.15c3–1e is amended by:

a. In the first sentence of paragraph (a) before the first ‘‘:’’, removing the phrase ‘‘transactions in derivatives instruments’’ and adding in its place the phrase ‘‘security-based swap transactions with *commercial end users* as defined in § 240.18a–3(b)(2)’’;

b. In the first sentence of paragraph (c) before the first ‘‘:’’, removing the phrase ‘‘transactions in derivatives instruments’’ and adding in its place the phrase ‘‘security-based swap transactions with *commercial end users* as defined in § 240.18a–3(b)(2)’’;

c. In paragraph (c)(2)(ii), removing the phrase ‘‘$5 billion’’ and adding in its place the phrase ‘‘$6 billion’’; and

d. In paragraph (e)(1), removing the phrase ‘‘$5 billion’’ and adding in its place the phrase ‘‘$6 billion’’.

7. Section 240.15c3–3 is amended by adding new paragraph (p) to read as follows:

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

* * * * *

(p) *Security-based swaps.* A broker or dealer that is registered as a security-based swap dealer pursuant to section 15F of the Act (15 U.S.C. 78o-8) must

also comply with the provisions of § 240.18a–4.

8. Section 240.18a–1 is added to read as follows:

§ 240.18a–1 Net capital requirements for security-based swap dealers for which there is not a prudential regulator.

Note to § 240.18a–1: Rule 18a–1 and its appendices do not apply to a security-based swap dealer that has a prudential regulator as such a security-based swap dealer is subject to the capital requirement of the prudential regulator. In addition, Rule 18a–1 and its appendices do not apply to a security-based swap dealer that also is registered as a broker or dealer pursuant to section 15(b) of the Act (15 U.S.C. 78o(b)) as such a security-based swap dealer is subject to the net capital requirements in § 240.15c3–1 and its appendices.

(a) *Minimum requirements.* Every registered security-based swap dealer must at all times have and maintain net capital no less than the greater of the highest minimum requirements applicable to its business under paragraphs (a)(1) or (2) of this section, and tentative net capital no less than the minimum requirement under paragraph (a)(2) of this section.

(1) A security-based swap dealer must at all times maintain net capital of not less than the greater of $20 million or eight percent (8%) of the risk margin amount.

(2) In accordance with paragraph (d) of this section, the Commission may approve, in whole or in part, an application or an amendment to an application by a security-based swap dealer to calculate net capital using the market risk standards of paragraph (d) to compute a deduction for market risk on some or all of its positions, instead of the provisions of paragraphs (c)(1)(iv), (vi), and (vii) of this section, and using the credit risk standards of paragraph (d) to compute a deduction for credit risk for security-based swap transactions with *commercial end users* as defined in § 240.18a–3(b)(2), instead of the provisions of paragraphs (c)(1)(iii) and (c)(1)(viii)(B)(*1*) of this section, subject to any conditions or limitations on the security-based swap dealer the Commission may require as necessary or appropriate in the public interest or for the protection of investors. A security-based swap dealer that has been approved to calculate its net capital under paragraph (d) of this section must at all times maintain tentative net capital of not less than $100 million and net capital of not less than the greater of $20 million or eight percent (8%) of the risk margin amount; and

(b) A security-based swap dealer must at all times maintain net capital in addition to the amounts required under paragraph (a)(1) or (2) of this section, as applicable, in an amount equal to 10 percent of:

(1) The excess of the market value of United States Treasury Bills, Bonds and Notes subject to reverse repurchase agreements with any one party over 105 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party;

(2) The excess of the market value of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act subject to reverse repurchase agreements with any one party over 110 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party; and

(3) The excess of the market value of other securities subject to reverse repurchase agreements with any one party over 120 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party.

(c) *Definitions.* For purpose of this section:

(1) The term *net capital* shall be deemed to mean the net worth of a security-based swap dealer, adjusted by:

(i) *Adjustments to net worth related to unrealized profit or loss and deferred tax provisions.* (A) Adding unrealized profits (or deducting unrealized losses) in the accounts of the security-based swap dealer;

(B)(*1*) In determining net worth, all long and all short positions in listed options shall be marked to their market value and all long and all short securities and commodities positions shall be marked to their market value.

(*2*) In determining net worth, the value attributed to any unlisted option shall be the difference between the option's exercise value and the market value of the underlying security. In the case of an unlisted call, if the market value of the underlying security is less than the exercise value of such call it shall be given no value and in the case of an unlisted put if the market value of the underlying security is more than the exercise value of the unlisted put it shall be given no value.

(C) Adding to net worth the lesser of any deferred income tax liability related to the items in paragraphs (c)(1)(i)(C)(*1*), (*2*), and (*3*) of this section, or the sum of paragraphs (c)(1)(i)(C)(*1*), (*2*), and (*3*) of this section;

(*1*) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with paragraphs (c)(1)(vii) and (viii) of this section and Appendices A and B, § 240.18a–1a and § 240.18a–1b, the appropriate Federal and State tax rate(s) applicable to any unrealized gain on the asset on which the deduction was computed.

(*2*) Any deferred tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section;

(*3*) Any deferred tax liability related to unrealized appreciation in value of any asset(s) which has been otherwise deducted from net worth in accordance with the provisions of this section; and

(D) Adding, in the case of future income tax benefits arising as a result of unrealized losses, the amount of such benefits not to exceed the amount of income tax liabilities accrued on the books and records of the security-based swap dealer, but only to the extent such benefits could have been applied to reduce accrued tax liabilities on the date of the capital computation, had the related unrealized losses been realized on that date.

(E) Adding to net worth any actual tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section.

(ii) *Subordinated liabilities.* Excluding liabilities of the security-based swap dealer that are subordinated to the claims of creditors pursuant to a satisfactory subordinated loan agreement, as defined in Appendix D (§ 240.18a–1d).

(iii) *Assets not readily convertible into cash.* Deducting fixed assets and assets which cannot be readily converted into cash, including, among other things:

(A) *Fixed assets and prepaid items.* Real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and other expenses; goodwill, organization expenses;

(B) *Certain unsecured and partly secured receivables.* All unsecured advances and loans; deficits in customers' and non-customers' unsecured and partly secured notes; deficits in customers' and non-customers' unsecured and partly secured accounts after application of calls for margin, marks to the market or other required deposits that are outstanding for more than one business day; and the market value of stock loaned in excess of the value of any collateral received therefore.

(C) *Insurance claims.* Insurance claims that, after seven (7) business days from the date the loss giving rise to the claim is discovered, are not covered by an opinion of outside counsel that the claim is valid and is covered by insurance policies presently in effect; insurance claims that after twenty (20)

business days from the date the loss giving rise to the claim is discovered and that are not accompanied by an opinion of outside counsel described above, have not been acknowledged in writing by the insurance carrier as due and payable; and insurance claims acknowledged in writing by the carrier as due and payable outstanding longer than twenty (20) business days from the date they are so acknowledged by the carrier; and

(D) *Other deductions.* All other unsecured receivables; all assets doubtful of collection less any reserves established therefore; the amount by which the market value of securities failed to receive outstanding thirty (30) calendar days exceeds the contract value of such fails to receive, and the funds on deposit in a ''segregated trust account'' in accordance with 17 CFR 270.27d–1 under the Investment Company Act of 1940, but only to the extent that the amount on deposit in such segregated trust account exceeds the amount of liability reserves established and maintained for refunds of charges required by sections 27(d) and 27(f) of the Investment Company Act of 1940; *Provided,* That any amount deposited in the ''special account for the exclusive benefit of security-based swap customers'' established pursuant to § 240.18a–4 and clearing deposits shall not be so deducted.

(E)(*1*) For purposes of this paragraph:

(*i*) The term *reverse repurchase agreement deficit* shall mean the difference between the contract price for resale of the securities under a reverse repurchase agreement and the market value of those securities (if less than the contract price).

(*ii*) The term *repurchase agreement deficit* shall mean the difference between the market value of securities subject to the repurchase agreement and the contract price for repurchase of the securities (if less than the market value of the securities).

(*iii*) As used in paragraph (c)(1)(iii)(E)(*1*) of this section, the term *contract price* shall include accrued interest.

(*iv*) Reverse repurchase agreement deficits and the repurchase agreement deficits where the counterparty is the Federal Reserve Bank of New York shall be disregarded.

(*2*)(*i*) In the case of a reverse repurchase agreement, the deduction shall be equal to the reverse repurchase agreement deficit.

(*ii*) In determining the required deductions under paragraph (c)(1)(iii)(E)(*2*)(*i*) of this section, the security-based swap dealer may reduce the reverse repurchase agreement deficit by:

(*A*) Any margin or other deposits held by the security-based swap dealer on account of the reverse repurchase agreement;

(*B*) Any excess market value of the securities over the contract price for resale of those securities under any other reverse repurchase agreement with the same party;

(*C*) The difference between the contract price for resale and the market value of securities subject to repurchase agreements with the same party (if the market value of those securities is less than the contract price); and

(*D*) Calls for margin, marks to the market, or other required deposits that are outstanding one business day or less.

(*3*)(*i*) In the case of repurchase agreements, the deduction shall be:

(*A*) The excess of the repurchase agreement deficit over 5 percent of the contract price for resale of United States Treasury Bills, Notes and Bonds, 10 percent of the contract price for the resale of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act and 20 percent of the contract price for the resale of other securities; and

(*B*) The excess of the aggregate repurchase agreement deficits with any one party over 25 percent of the security-based swap dealer's net capital before the application of paragraphs (c)(1)(vii) and (viii) of this section (less any deduction taken with respect to repurchase agreements with that party under paragraph (c)(1)(iii)(E)(*3*)(*i*)(*A*) of this section) or, if greater;

(*C*) The excess of the aggregate repurchase agreement deficits over 300 percent of the security-based swap dealer's net capital before the application of paragraphs (c)(1)(vii) and (viii) of this section.

(*ii*) In determining the required deduction under paragraph (c)(1)(iii)(E)(*3*)(*i*) of this section, the security-based swap dealer may reduce a repurchase agreement by:

(*A*) Any margin or other deposits held by the security-based swap dealer on account of a reverse repurchase agreement with the same party to the extent not otherwise used to reduce a reverse repurchase agreement deficit;

(*B*) The difference between the contract price and the market value of securities subject to other repurchase agreements with the same party (if the market value of those securities is less than the contract price) not otherwise used to reduce a reverse repurchase agreement deficit; and

(*C*) Calls for margin, marks to the market, or other required deposits that are outstanding one business day or less to the extent not otherwise used to reduce a reverse repurchase agreement deficit.

(F) *Securities borrowed.* One percent of the market value of securities borrowed collateralized by an irrevocable letter of credit.

(G) Any receivable from an affiliate of the security-based swap dealer (not otherwise deducted from net worth) and the market value of any collateral given to an affiliate (not otherwise deducted from net worth) to secure a liability over the amount of the liability of the security-based swap dealer unless the books and records of the affiliate are made available for examination when requested by the representatives of the Commission in order to demonstrate the validity of the receivable or payable. The provisions of this subsection shall not apply where the affiliate is a registered security-based swap dealer, registered broker or dealer, registered government securities broker or dealer, bank as defined in section 3(a)(6) of the Act, insurance company as defined in section 3(a)(19) of the Act, investment company registered under the Investment Company Act of 1940, federally insured savings and loan association, or futures commission merchant or swap dealer registered pursuant to the Commodity Exchange Act.

(iv) *Non-marketable securities.* Deducting 100 percent of the carrying value in the case of securities or evidence of indebtedness in the proprietary or other accounts of the security-based swap dealer, for which there is no ready market, as defined in paragraph (c)(4) of this section, and securities, in the proprietary or other accounts of the security-based swap dealer, that cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions.

(v) Deducting from the contract value of each failed to deliver contract that is outstanding five business days or longer (21 business days or longer in the case of municipal securities) the percentages of the market value of the underlying security that would be required by application of the deduction required by paragraph (c)(1)(vii) of this section. Such deduction, however, shall be increased by any excess of the contract price of the failed to deliver contract over the market value of the underlying security or reduced by any excess of the market value of the underlying security

over the contract value of the failed to deliver contract, but not to exceed the amount of such deduction. The Commission may, upon application of the security-based swap dealer, extend for a period up to 5 business days, any period herein specified when it is satisfied that the extension is warranted. The Commission upon expiration of the extension may extend for one additional period of up to 5 business days, any period herein specified when it is satisfied that the extension is warranted.

(vi) *Security-based swaps.* Deducting the percentages specified in paragraphs (c)(1)(vi)(A) and (B) of this section (or the deductions prescribed in § 240.18a–1a) of the notional amount of any security-based swaps in the proprietary account of the security-based swap dealer.

(A) *Credit default swaps.* (*1*) *Short positions (selling protection).* In the case of a security-based swap that is a short credit default swap, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with the following table:

Length of time to maturity of CDS contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
12 months or less	1.00	2.00	5.00	7.50	10.00	15.00
13 months to 24 months	1.50	3.50	7.50	10.00	12.50	17.50
25 months to 36 months	2.00	5.00	10.00	12.50	15.00	20.00
37 months to 48 months	3.00	6.00	12.50	15.00	17.50	22.50
49 months to 60 months	4.00	7.00	15.00	17.50	20.00	25.00
61 months to 72 months	5.50	8.50	17.50	20.00	22.50	27.50
73 months to 84 months	7.00	10.00	20.00	22.50	25.00	30.00
85 months to 120 months	8.50	15.00	22.50	25.00	27.50	40.00
121 months and longer	10.00	20.00	25.00	27.50	30.00	50.00

(*2*) *Long positions (purchasing protection).* In the case of a security-based swap that is a long credit default swap, deducting 50% of the deduction that would be required by paragraph (c)(1)(vi)(A)(*1*) of this section if the security-based swap was a short credit default swap.

(*3*) *Long and short positions.* (*i*) *Long and short credit default swaps.* In the case of security-based swaps that are long and short credit default swaps referencing the same obligor or obligation, that are in the same spread category, and that are in the same maturity category or are in the next maturity category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amount specified in the higher maturity category under paragraphs (c)(1)(vi)(A)(*1*) or (*2*) on the excess of the long or short position. In the case of security-based swaps that are long and short credit default swaps referencing obligors or obligations of obligors in the same industry sector and the same spread and maturity categories prescribed in paragraph (c)(1)(vi)(A)(*1*) of this section, deducting 50% of the amount required by paragraph (c)(1)(vi)(A)(*1*) of this section on the short position plus the deduction required by paragraph (c)(1)(vi)(A)(*2*) of this section on the excess long position, if any. For the purposes of this section, the security-based swap dealer must use an industry sector classification system that is reasonable in terms of grouping types of companies with similar business activities and risk characteristics and document the industry sector classification system used pursuant to this section.

(*ii*) *Long security and long credit default swap.* In the case of a security-based swap that is a long credit default swap referencing a debt security and the security-based swap dealer is long the same debt security, deducting 50% of the amount specified in § 240.15c3–1(c)(2)(vi) or (vii) for the bond, provided that the security-based swap dealer can deliver the bond to satisfy the obligation of the security-based swap dealer on the credit default swap.

(*iii*) *Short security and short credit default swap.* In the case of a security-based swap that is a short credit default swap referencing a bond or a corporate entity and the security-based swap dealer is short the bond or a bond issued by the corporate entity, deducting the amount specified in § 240.15c3–1(c)(2)(vi) or (vii) for the bond. In the case of a security-based swap that is a short credit default swap referencing an asset-backed security and the security-based swap dealer is short the asset-backed security, deducting the amount specified in § 240.15c3–1(c)(2)(vi) or (vii) for the asset-backed security.

(B) *All other security-based swaps.* In the case of any security-based swap that is not a credit default swap, deducting the amount calculated by multiplying the notional amount of the security-based swap and the percentage specified in § 240.15c3–1(c)(2)(vi) applicable to the reference security. A security-based swap dealer may reduce the deduction under this paragraph (c)(1)(vi)(B) by an amount equal to any reduction recognized for a comparable long or short position in the reference security under § 240.15c3–1(c)(2)(vi) and, in the case of a security-based swap referencing an equity security, the method specified in § 240.18a–1a.

(vii) *All other securities, money market instruments or options.* Deducting the percentages specified in § 240.15c3–1(c)(2)(vi) of the market value of all securities, money market instruments, and options in the proprietary accounts of the security-based swap dealer.

(viii) *Deduction from net worth in lieu of collecting margin amounts for security-based swaps.* (A) *Cleared security-based swap transactions.* Deducting the amount of the margin difference for each account carried by the security-based swap dealer for another person that holds cleared security-based swap transactions. The margin difference is the amount of the deductions that the positions in the account would incur pursuant to paragraph (c)(1)(vi) of this section if owned by the security-based swap dealer less the margin value of collateral held in the account.

(B) *Non-cleared security-based swap transactions.* (*1*) *Commercial end users.* Deducting, with respect to a counterparty that is a *commercial end user* as that term is defined in § 240.18a–3(b)(2), the margin amount calculated pursuant to § 240.18a–3(c)(1)(i)(B) for the account of the counterparty less any *positive equity* in the account as that term is defined in § 240.18a–3(b)(7).

(*2*) *Margin collateral held by third-party custodian.* Deducting, with respect to a counterparty that is not a *commercial end user* as that term is defined in § 240.18a–3(b)(2) and that elects to have collateral segregated in an account at an independent third-party custodian pursuant to section 3E(f) of the Act (15 U.S.C. 78c–5(f)), the margin amount calculated pursuant to § 240.18a–3(c)(1)(i)(B) for the account of the counterparty at the security-based swap dealer less any *positive equity* in that account as that term is defined in § 240.18a–3(b)(7).

(*3*) *Security-based swap legacy accounts.* Deducting, with respect to a *security-based swap legacy account* as that term is defined in § 240.18a–3(b)(9) of a counterparty that is not a *commercial end user* as that term is defined in § 240.18a–3(b)(2), the margin amount calculated pursuant § 240.18a–3(c)(1)(i)(B) for the account less any *positive equity* in the account as that term is defined in § 240.18a–3(b)(7).

(ix) *Deduction from net worth for certain undermargined accounts.* Deducting the amount of cash required in the account of each security-based swap customer to meet the margin requirements of a clearing agency or the Commission, after application of calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.

(2) The term *exempted securities* shall mean those securities deemed exempted securities by section 3(a)(12) of the Securities Exchange Act of 1934 and the rules thereunder.

(3) *Customer.* The term *customer* shall mean any person from whom, or on whose behalf, a security-based swap dealer has received, acquired or holds funds or securities for the account of such person, but shall not include a security-based swap dealer, a broker or dealer, a registered municipal securities dealer, or a general, special or limited partner or director or officer of the security-based swap dealer, or any person to the extent that such person has a claim for property or funds which by contract, agreement, or understanding, or by operation of law, is part of the capital of the security-based swap dealer.

(4) *Ready market.* The term *ready market* shall include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom.

(5) The term *tentative net capital* means the net capital of the security-based swap dealer before deductions for market and credit risk computed pursuant to this section and increased by the balance sheet value (including counterparty net exposure) resulting from transactions in derivative instruments which would otherwise be deducted. Tentative net capital shall include securities for which there is no ready market, as defined in paragraph (c)(4) of this section, if the use of mathematical models has been approved for purposes of calculating deductions from net capital for those securities pursuant to paragraph (d) of this section.

(6) The term *risk margin amount* means the sum of:

(i) The greater of the total margin required to be delivered by the security-based swap dealer with respect to security-based swap transactions cleared for security-based swap customers at a clearing agency or the amount of the deductions that would apply to the cleared security-based swap positions of the security-based swap customers pursuant to paragraph (c)(1)(vi) of this section; and

(ii) The total margin amount calculated by the security-based swap dealer with respect to non-cleared security-based swaps pursuant to § 240.18a–3(c)(1)(i)(B).

(d) *Application to use models to compute deductions for market and credit risk.* (1) A security-based swap dealer may apply to the Commission for authorization to compute deductions for market risk under this paragraph (d) in lieu of computing deductions pursuant to paragraphs (c)(1)(iv), (vi), and (vii) of this section and to compute deductions for credit risk pursuant to this paragraph (d) on credit exposures arising from transactions in derivatives instruments (if this paragraph (d) is used to calculate deductions for market risk on these instruments) in lieu of computing deductions pursuant to paragraph (c)(1)(iii) of this section.

(i) A security-based swap dealer shall submit the following information to the Commission with its application:

(A) An executive summary of the information provided to the Commission with its application and an identification of the ultimate holding company of the security-based swap dealer;

(B) A comprehensive description of the internal risk management control system of the security-based swap dealer and how that system satisfies the requirements set forth in § 240.15c3–4;

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

(D) 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 security-based swap 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 model incorporates empirical correlations across risk categories, a description of the process for measuring correlations; a description of the backtesting procedures the security-based swap dealer will use to backtest the mathematical models used to calculate maximum potential exposure; a description of how each mathematical model satisfies the applicable qualitative and quantitative requirements set forth in this paragraph (d); and a statement describing the extent to which each mathematical model used to compute deductions for market risk and credit risk will be used as part of the risk analyses and reports presented to senior management;

(E) If the security-based swap dealer is applying to the Commission for approval to use scenario analysis to calculate deductions for market risk for certain positions, a list of those types of positions, a description of how those deductions will be calculated using scenario analysis, and an explanation of why each scenario analysis is appropriate to calculate deductions for market risk on those types of positions;

(F) A description of how the security-based swap dealer will calculate current exposure;

(G) A description of how the security-based swap dealer will determine internal credit ratings of counterparties and internal credit risk weights of counterparties, if applicable;

(H) For each instance in which a mathematical model to be used by the security-based swap dealer to calculate a deduction for market risk or to calculate maximum potential exposure for a particular product or counterparty differs from the mathematical model used by the ultimate holding company to calculate an allowance for market risk or to calculate maximum potential

exposure for that same product or counterparty, a description of the difference(s) between the mathematical models; and

(I) Sample risk reports that are provided to management at the security-based swap dealer who are responsible for managing the security-based swap dealer's risk.

(ii) [Reserved].

(2) The application of the security-based swap dealer shall be supplemented by other information relating to the internal risk management control system, mathematical models, and financial position of the security-based swap dealer that the Commission may request to complete its review of the application;

(3) The application shall be considered filed when received at the Commission's principal office in Washington, DC A person who files an application pursuant to this section for which it seeks confidential treatment may clearly mark each page or segregable portion of each page with the words ''Confidential Treatment Requested.'' All information submitted in connection with the application will be accorded confidential treatment, to the extent permitted by law;

(4) If any of the information filed with the Commission as part of the application of the security-based swap dealer is found to be or becomes inaccurate before the Commission approves the application, the security-based swap dealer must notify the Commission promptly and provide the Commission with a description of the circumstances in which the information was found to be or has become inaccurate along with updated, accurate information;

(5) The Commission may approve the application or an amendment to the application, in whole or in part, subject to any conditions or limitations the Commission may require if the Commission finds the approval to be necessary or appropriate in the public interest or for the protection of investors, after determining, among other things, whether the security-based swap dealer has met the requirements of this paragraph (d) and is in compliance with other applicable rules promulgated under the Act;

(6) A security-based swap dealer shall amend its application to calculate certain deductions for market and credit risk under this paragraph (d) and submit the amendment to the Commission for approval before it may change materially a mathematical model used to calculate market or credit risk or before it may change materially its internal risk management control system;

(7) As a condition for the security-based swap dealer to compute deductions for market and credit risk under this paragraph (d), the security-based swap dealer agrees that:

(i) It will notify the Commission 45 days before it ceases to compute deductions for market and credit risk under this paragraph (d); and

(ii) The Commission may determine by order that the notice will become effective after a shorter or longer period of time if the security-based swap dealer consents or if the Commission determines that a shorter or longer period of time is necessary or appropriate in the public interest or for the protection of investors; and

(8) Notwithstanding paragraph (d)(7) of this section, the Commission, by order, may revoke a security-based swap dealer's exemption that allows it to use the market risk standards of this paragraph (d) to calculate deductions for market risk, and the exemption to use the credit risk standards of this paragraph (d) to calculate deductions for credit risk on certain credit exposures arising from transactions in derivatives instruments if the Commission finds that such exemption is no longer necessary or appropriate in the public interest or for the protection of investors. In making its finding, the Commission will consider the compliance history of the security-based swap dealer related to its use of models, the financial and operational strength of the security-based swap dealer and its ultimate holding company, and the security-based swap dealer's compliance with its internal risk management controls.

(9) *VaR models.* To be approved, each value-at-risk (''VaR'') model must meet the following minimum qualitative and quantitative requirements:

(i) *Qualitative requirements.* (A) The VaR model used to calculate market or credit risk for a position must be integrated into the daily internal risk management system of the security-based swap dealer;

(B) The VaR model must be reviewed both periodically and annually. The periodic review may be conducted by the security-based swap dealer's internal audit staff, but the annual review must be conducted by a registered public accounting firm, as that term is defined in section 2(a)(12) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 *et seq.*); and

(C) For purposes of computing market risk, the security-based swap dealer must determine the appropriate multiplication factor as follows:

(*1*) Beginning three months after the security-based swap dealer begins using the VaR model to calculate market risk, the security-based swap dealer must conduct backtesting of the model by comparing its actual daily net trading profit or loss with the corresponding VaR measure generated by the VaR model, using a 99 percent, one-tailed confidence level with price changes equivalent to a one business-day movement in rates and prices, for each of the past 250 business days, or other period as may be appropriate for the first year of its use;

(*2*) On the last business day of each quarter, the security-based swap dealer must identify the number of backtesting exceptions of the VaR model using clean profit and loss, that is, the number of business days in the past 250 business days, or other period as may be appropriate for the first year of its use, for which the actual net trading loss, if any, exceeds the corresponding VaR measure; and

(*3*) The security-based swap dealer must use the multiplication factor indicated in Table 1 of this paragraph (d) in determining its market risk until it obtains the next quarter's backtesting results;

TABLE 1—MULTIPLICATION FACTOR BASED ON THE NUMBER OF BACKTESTING EXCEPTIONS OF THE VAR MODEL

Number of exceptions	Multiplication factor
4 or fewer	3.00
5	3.40
6	3.50
7	3.65
8	3.75
9	3.85
10 or more	4.00

(*4*) For purposes of incorporating specific risk into a VaR model, a security-based swap dealer must demonstrate that it has methodologies in place to capture liquidity, event, and default risk adequately for each position. Furthermore, the models used to calculate deductions for specific risk must:

(*i*) Explain the historical price variation in the portfolio;

(*ii*) Capture concentration (magnitude and changes in composition);

(*iii*) Be robust to an adverse environment;

(*iv*) Capture name-related basis risk;

(*v*) Capture event risk; and

(*vi*) Be validated through backtesting.

(*5*) For purposes of computing the credit equivalent amount of the security-based swap dealer's exposures

to a counterparty, the security-based swap dealer must determine the appropriate multiplication factor as follows:

(*i*) Beginning three months after it begins using the VaR model to calculate maximum potential exposure, the security-based swap dealer must conduct backtesting of the model by comparing, for at least 80 counterparties with widely varying types and sizes of positions with the firm, the ten business day change in its current exposure to the counterparty based on its positions held at the beginning of the ten-business day period with the corresponding ten-business day maximum potential exposure for the counterparty generated by the VaR model;

(*ii*) As of the last business day of each quarter, the security-based swap dealer must identify the number of backtesting exceptions of the VaR model, that is, the number of ten-business day periods in the past 250 business days, or other period as may be appropriate for the first year of its use, for which the change in current exposure to a counterparty exceeds the corresponding maximum potential exposure; and

(*iii*) The security-based swap dealer will propose, as part of its application, a schedule of multiplication factors, which must be approved by the Commission based on the number of backtesting exceptions of the VaR model. The security-based swap dealer must use the multiplication factor indicated in the approved schedule in determining the credit equivalent amount of its exposures to a counterparty until it obtains the next quarter's backtesting results, unless the Commission determines, based on, among other relevant factors, a review of the security-based swap dealer's internal risk management control system, including a review of the VaR model, that a different adjustment or other action is appropriate.

(ii) Quantitative requirements.

(A) For purposes of determining market risk, the VaR model must use a 99 percent, one-tailed confidence level with price changes equivalent to a ten business-day movement in rates and prices;

(B) For purposes of determining maximum potential exposure, the VaR model must use a 99 percent, one-tailed confidence level with price changes equivalent to a one-year movement in rates and prices; or based on a review of the security-based swap dealer's procedures for managing collateral and if the collateral is marked to market daily and the security-based swap dealer has the ability to call for additional collateral daily, the Commission may approve a time horizon of not less than ten business days;

(C) The VaR model must use an effective historical observation period of at least one year. The security-based swap dealer must consider the effects of market stress in its construction of the model. Historical data sets must be updated at least monthly and reassessed whenever market prices or volatilities change significantly; and

(D) The VaR model must take into account and incorporate all significant, identifiable market risk factors applicable to positions in the accounts of the security-based swap dealer, including:

(*1*) Risks arising from the non-linear price characteristics of derivatives and the sensitivity of the market value of those positions to changes in the volatility of the derivatives' underlying rates and prices;

(*2*) Empirical correlations with and across risk factors or, alternatively, risk factors sufficient to cover all the market risk inherent in the positions in the proprietary or other trading accounts of the security-based swap dealer, including interest rate risk, equity price risk, foreign exchange risk, and commodity price risk;

(*3*) Spread risk, where applicable, and segments of the yield curve sufficient to capture differences in volatility and imperfect correlation of rates along the yield curve for securities and derivatives that are sensitive to different interest rates; and

(*4*) Specific risk for individual positions.

(iii) *Additional conditions.* (A) As a condition for the security-based swap dealer to use this paragraph (d) to calculate certain of its capital charges, the Commission may impose additional conditions on the security-based swap dealer, which may include, but are not limited to restricting the security-based swap dealer's business on a product-specific, category-specific, or general basis; submitting to the Commission a plan to increase the security-based swap dealer's net capital or tentative net capital; filing more frequent reports with the Commission; modifying the security-based swap dealer's internal risk management control procedures; or computing the security-based swap dealer's deductions for market and credit risk in accordance with paragraphs (c)(1) (iii), (iv), (vii), or (viii) as appropriate. If the Commission finds it is necessary or appropriate in the public interest or for the protection of investors, the Commission may impose additional conditions on the security-based swap dealer, if:

(*1*) The security-based swap dealer is required by § 240.18a–8 to provide notice to the Commission that the security-based swap dealer's tentative net capital is less than $100 million;

(*2*) The security-based swap dealer fails to meet the reporting requirements set forth in § 240.18a–8;

(*3*) Any event specified in § 240.18a–8 occurs;

(*4*) There is a material deficiency in the internal risk management control system or in the mathematical models used to price securities or to calculate deductions for market and credit risk or allowances for market and credit risk, as applicable, of the security-based swap dealer;

(*5*) The security-based swap dealer fails to comply with this paragraph (d); or

(*6*) The Commission finds that imposition of other conditions is necessary or appropriate in the public interest or for the protection of investors.

(e) *Models to compute deductions for market risk and credit risk.* (1) *Market risk.* A security-based swap dealer whose application, including amendments, has been approved under paragraph (d) of this section, shall compute a deduction for market risk in an amount equal to the sum of the following:

(i) For positions for which the Commission has approved the security-based swap dealer's use of VaR models, the VaR of the positions multiplied by the appropriate multiplication factor determined according to paragraph (d) of this section, except that the initial multiplication factor shall be three, unless the Commission determines, based on a review of the security-based swap dealer's application or an amendment to the application under paragraph (d) of this section, including a review of its internal risk management control system and practices and VaR models, that another multiplication factor is appropriate;

(ii) For positions for which the VaR model does not incorporate specific risk, a deduction for specific risk to be determined by the Commission based on a review of the security-based swap dealer's application or an amendment to the application under paragraph (d) of this section and the positions involved;

(iii) For positions for which the Commission has approved the security-based swap dealer's application to use scenario analysis, the greatest loss resulting from a range of adverse movements in relevant risk factors, prices, or spreads designed to represent a negative movement greater than, or equal to, the worst ten-day movement of

the four years preceding calculation of the greatest loss, or some multiple of the greatest loss based on the liquidity of the positions subject to scenario analysis. If historical data is insufficient, the deduction shall be the largest loss within a three standard deviation movement in those risk factors, prices, or spreads over a ten-day period, multiplied by an appropriate liquidity adjustment factor. Irrespective of the deduction otherwise indicated under scenario analysis, the resulting deduction for market risk must be at least $25 per 100 share equivalent contract for equity positions, or one-half of one percent of the face value of the contract for all other types of contracts, even if the scenario analysis indicates a lower amount. A qualifying scenario must include the following:

(A) A set of pricing equations for the positions based on, for example, arbitrage relations, statistical analysis, historic relationships, merger evaluations, or fundamental valuation of an offering of securities;

(B) Auxiliary relationships mapping risk factors to prices; and

(C) Data demonstrating the effectiveness of the scenario in capturing market risk, including specific risk; and

(iv) For all remaining positions, the deductions specified in § 240.15c3–1(c)(2)(vi), § 240.15c3–1(c)(2)(vii), and applicable appendices to § 240.15c3–1.

(2) *Credit risk.* A security-based swap dealer whose application, including amendments, has been approved under paragraph (d) of this section with respect to positions in security-based swaps may compute a deduction for credit risk on security-based swap transactions with *commercial end users* as defined in § 240.18a–3(b)(2) in an amount equal to the sum of the following:

(i) A counterparty exposure charge in an amount equal to the sum of the following:

(A) The net replacement value in the account of each counterparty that is insolvent, or in bankruptcy, or that has senior unsecured long-term debt in default; and

(B) For a counterparty not otherwise described in paragraph (e)(2)(i)(A) of this section, the *credit equivalent amount* of the security-based swap dealer's exposure to the counterparty, as defined in paragraph (e)(2)(iv)(A) of this section, multiplied by the credit risk weight of the counterparty, as determined in accordance with paragraph (e)(2)(iv)(F) of this section, multiplied by 8%;

(ii) A concentration charge by counterparty in an amount equal to the sum of the following:

(A) For each counterparty with a credit risk weight of 20% or less, 5% of the amount of the current exposure to the counterparty in excess of 5% of the tentative net capital of the security-based swap dealer;

(B) For each counterparty with a credit risk weight of greater than 20% but less than 50%, 20% of the amount of the current exposure to the counterparty in excess of 5% of the tentative net capital of the security-based swap dealer; and

(C) For each counterparty with a credit risk weight of greater than 50%, 50% of the amount of the current exposure to the counterparty in excess of 5% of the tentative net capital of the security-based swap dealer; and

(iii) A portfolio concentration charge of 100% of the amount of the security-based swap dealer's aggregate current exposure for all counterparties in excess of 50% of the tentative net capital of the security-based swap dealer.

(iv) *Terms.* (A) The *credit equivalent amount* of the security-based swap dealer's exposure to a counterparty is the sum of the security-based swap dealer's *maximum potential exposure* to the counterparty, as defined in paragraph (e)(2)(iv)(B) of this section, multiplied by the appropriate multiplication factor, and the security-based swap dealer's *current exposure* to the counterparty, as defined in paragraph (e)(2)(iv)(C) of this section. The security-based swap dealer must use the multiplication factor determined according to paragraph (d)(9)(i)(C)(*5*) of this section, except that the initial multiplication factor shall be one, unless the Commission determines, based on a review of the security-based swap dealer's application or an amendment to the application approved under paragraph (d) of this section, including a review of its internal risk management control system and practices and VaR models, that another multiplication factor is appropriate;

(B) The *maximum potential exposure* is the VaR of the counterparty's positions with the security-based swap dealer, after applying netting agreements with the counterparty meeting the requirements of paragraph (e)(2)(iv)(D) of this section, taking into account the value of collateral from the counterparty held by the security-based swap dealer in accordance with paragraph (e)(2)(iv)(E) of this section, and taking into account the current replacement value of the counterparty's positions with the security-based swap dealer;

(C) The *current exposure* of the security-based swap dealer to a counterparty is the current replacement value of the counterparty's positions with the security-based swap dealer, after applying netting agreements with the counterparty meeting the requirements of paragraph (e)(2)(iv)(D) of this section and taking into account the value of collateral from the counterparty held by the security-based swap dealer in accordance with paragraph (e)(2)(iv)(E) of this section;

(D) *Netting agreements.* A security-based swap dealer may include the effect of a netting agreement that allows the security-based swap dealer to net gross receivables from and gross payables to a counterparty upon default of the counterparty if:

(*1*) The netting agreement is legally enforceable in each relevant jurisdiction, including in insolvency proceedings;

(*2*) The gross receivables and gross payables that are subject to the netting agreement with a counterparty can be determined at any time; and

(*3*) For internal risk management purposes, the security-based swap dealer monitors and controls its exposure to the counterparty on a net basis.

(E) *Collateral.* When calculating maximum potential exposure and current exposure to a counterparty, the fair market value of collateral pledged and held may be taken into account provided:

(*1*) The collateral is marked to market each day and is subject to a daily margin maintenance requirement;

(*2*) The security-based swap dealer maintains physical possession or sole control of the collateral;

(*3*) The collateral is liquid and transferable;

(*4*) The collateral may be liquidated promptly by the firm without intervention by any other party;

(*5*) The collateral agreement is legally enforceable by the security-based swap dealer against the counterparty and any other parties to the agreement;

(*6*) The collateral does not consist of securities issued by the counterparty or a party related to the security-based swap dealer or to the counterparty;

(*7*) The Commission has approved the security-based swap dealer's use of a VaR model to calculate deductions for market risk for the type of collateral in accordance with paragraph (d) of this section; and

(*8*) The collateral is not used in determining the credit rating of the counterparty.

(F) *Credit risk weights of counterparties.* A security-based swap

dealer that computes its deductions for credit risk pursuant to paragraph (e)(2) of this section shall apply a credit risk weight for transactions with a counterparty of either 20%, 50%, or 150% based on an internal credit rating the security-based swap dealer determines for the counterparty.

(*1*) As part of its initial application or in an amendment, the security-based swap dealer may request Commission approval to apply a credit risk weight of either 20%, 50%, or 150% based on internal calculations of credit ratings, including internal estimates of the maturity adjustment. Based on the strength of the security-based swap dealer's internal credit risk management system, the Commission may approve the application. The security-based swap dealer must make and keep current a record of the basis for the credit risk weight of each counterparty;

(*2*) As part of its initial application or in an amendment, the security-based swap dealer may request Commission approval to determine credit risk weights based on internal calculations, including internal estimates of the maturity adjustment. Based on the strength of the security-based swap dealer's internal credit risk management system, the Commission may approve the application. The security-based swap dealer must make and keep current a record of the basis for the credit risk weight of each counterparty; and

(*3*) As part of its initial application or in an amendment, the security-based swap dealer may request Commission approval to reduce deductions for credit risk through the use of credit derivatives.

(f) *Liquidity requirements.* (1) *Liquidity stress test.* A security-based swap dealer that computes net capital under paragraph (a)(2) of this Rule 18a–1 must perform a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the security-based swap dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the security-based swap dealer and at least annually by senior management of the security-based swap dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

(i) A stress event includes a decline in creditworthiness of the broker or dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;

(ii) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding, including intercompany advances and unfunded committed lines of credit;

(iii) The potential for a material net loss of secured funding;

(iv) The loss of the ability to procure repurchase agreement financing for less liquid assets;

(v) The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;

(vi) A material increase in collateral required to be maintained at registered clearing agencies of which it is a member; and

(vii) The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the security-based swap dealer, including those related to customer businesses of the security-based swap dealer.

(2) *Stress test of consolidated entity.* The security-based swap dealer must justify and document any differences in the assumptions used in the liquidity stress test of the security-based swap dealer from those used in the liquidity stress test of the consolidated entity of which the security-based swap dealer is a part.

(3) *Liquidity reserves.* The security-based swap dealer must maintain at all times liquidity reserves based on the results of the liquidity stress test. The liquidity reserves used to satisfy the liquidity stress test must be:

(i) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and

(ii) Unencumbered and free of any liens at all times.

Securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool contemporaneously.

(4) *Contingency funding plan.* The security-based swap dealer must have a written contingency funding plan that addresses the security-based swap dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the security-based swap dealer and communications with the public and other market participants during a liquidity stress event.

(g) *Internal risk management control systems.* A security-based swap dealer must comply with § 240.15c3–4 as if it were an OTC derivatives dealer with respect to all of its business activities, except that paragraphs (c)(5)(xiii) and (xiv) and (d)(8) and (9) of § 240.15c3–4 shall not apply.

(h) *Debt-equity requirements.* No security-based swap dealer shall permit the total of outstanding principal amounts of its satisfactory subordination agreements (other than such agreements which qualify under this paragraph (h) as equity capital) to exceed 70 percent of its debt-equity total, as hereinafter defined, for a period in excess of 90 days or for such longer period which the Commission may, upon application of the security-based swap dealer, grant in the public interest or for the protection of investors. In the case of a corporation, the debt-equity total shall be the sum of its outstanding principal amounts of satisfactory subordination agreements, par or stated value of capital stock, paid in capital in excess of par, retained earnings, unrealized profit and loss or other capital accounts. In the case of a partnership, the debt-equity total shall be the sum of its outstanding principal amounts of satisfactory subordination agreements, capital accounts of partners (exclusive of such partners' securities accounts) subject to the provisions of paragraph (i) of this section, and unrealized profit and loss. *Provided, however,* that a satisfactory subordinated loan agreement entered into by a partner or stockholder which has an initial term of at least three years and has a remaining term of not less than 12 months shall be considered equity for the purposes of this paragraph (h) if:

(1) It does not have any of the provisions for accelerated maturity provided for by paragraphs (b)(8)(i), (9)(i), or (9)(ii) of Appendix D of this section and is maintained as capital subject to the provisions restricting the withdrawal thereof required by paragraph (i) of this section; or

(2) The partnership agreement provides that capital contributed pursuant to a satisfactory subordination agreement as defined in Appendix D of this section shall in all respects be partnership capital subject to the provisions restricting the withdrawal thereof required by paragraph (i) of this section.

(i) *Notice provisions relating to limitations on the withdrawal of equity capital.* (1) No equity capital of the security-based swap dealer or a

subsidiary or affiliate consolidated pursuant to Appendix C of this section may be withdrawn by action of a stockholder or a partner or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, employee or affiliate without written notice given in accordance with paragraph (i)(1)(iv) of this section:

(i) Two business days prior to any withdrawals, advances or loans if those withdrawals, advances or loans on a net basis exceed in the aggregate in any 30 calendar day period, 30 percent of the security-based swap dealer's excess net capital. A security-based swap dealer, in an emergency situation, may make withdrawals, advances or loans that on a net basis exceed 30 percent of the security-based swap dealer's excess net capital in any 30 calendar day period without giving the advance notice required by this paragraph, with the prior approval of the Commission. Where a security-based swap dealer makes a withdrawal with the consent of the Commission, it shall in any event comply with paragraph (i)(1)(ii) of this section; or

(ii) Two business days after any withdrawals, advances or loans if those withdrawals, advances or loans on a net basis exceed in the aggregate in any 30 calendar day period, 20 percent of the security-based swap dealer's excess net capital.

(iii) This paragraph (i)(1) does not apply to:

(A) Securities or commodities transactions in the ordinary course of business between a security-based swap dealer and an affiliate where the security-based swap dealer makes payment to or on behalf of such affiliate for such transaction and then receives payment from such affiliate for the securities or commodities transaction within two business days from the date of the transaction; or

(B) Withdrawals, advances or loans which in the aggregate in any thirty calendar day period, on a net basis, equal $500,000 or less.

(iv) Each required notice shall be effective when received by the Commission in Washington, DC, the regional office of the Commission for the region in which the security-based swap dealer has its principal place of business, and the Commodity Futures Trading Commission if such security-based swap dealer is registered with that Commission.

(2) *Limitations on withdrawal of equity capital.* No equity capital of the security-based swap dealer or a subsidiary or affiliate consolidated pursuant to Appendix C of this section may be withdrawn by action of a stockholder or a partner or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, employee or affiliate, if after giving effect thereto and to any other such withdrawals, advances or loans and any Payments of Payments Obligations (as defined in Appendix D of this section) under satisfactory subordinated loan agreements which are scheduled to occur within 180 days following such withdrawal, advance or loan if:

(i) The security-based swap dealer's net capital would be less than 120 percent of the minimum dollar amount required by paragraph (a) of this section; and

(ii) The total outstanding principal amounts of satisfactory subordinated loan agreements of the security-based swap dealer and any subsidiaries or affiliates consolidated pursuant to Appendix C of this section (other than such agreements which qualify as equity under paragraph (h) of this section) would exceed 70% of the debt-equity total as defined in paragraph (h) of this section.

(3) *Temporary restrictions on withdrawal of net capital.* (i) The Commission may by order restrict, for a period up to twenty business days, any withdrawal by the security-based swap dealer of equity capital or unsecured loan or advance to a stockholder, partner, member, employee or affiliate under such terms and conditions as the Commission deems necessary or appropriate in the public interest or consistent with the protection of investors if the Commission, based on the information available, concludes that such withdrawal, advance or loan may be detrimental to the financial integrity of the security-based swap dealer, or may unduly jeopardize the security-based swap dealer's ability to repay its customer claims or other liabilities which may cause a significant impact on the markets or expose the customers or creditors of the security-based swap dealer to loss.

(ii) An order temporarily prohibiting the withdrawal of capital shall be rescinded if the Commission determines that the restriction on capital withdrawal should not remain in effect. A hearing on an order temporarily prohibiting withdrawal of capital will be held within two business days from the date of the request in writing by the security-based swap dealer.

(4) *Miscellaneous provisions.* (i) Excess net capital is that amount in excess of the amount required under paragraph (a) of this section. For the purposes of paragraphs (i)(1) and (2) of this section, a security-based swap dealer may use the amount of excess net capital and deductions required under paragraphs (c)(1)(vii) and (viii) and Appendix A of this section reported in its most recently required filed Form X–18A–7 for the purposes of calculating the effect of a projected withdrawal, advance or loan relative to excess net capital or deductions. The security-based swap dealer must assure itself that the excess net capital or the deductions reported on the most recently required filed Form X–18A–7 have not materially changed since the time such report was filed.

(ii) The term equity capital includes capital contributions by partners, par or stated value of capital stock, paid-in capital in excess of par, retained earnings or other capital accounts. The term equity capital does not include securities in the securities accounts of partners and balances in limited partners' capital accounts in excess of their stated capital contributions.

(iii) Paragraphs (i)(1) and (2) of this section shall not preclude a security-based swap dealer from making required tax payments or preclude the payment to partners of reasonable compensation, and such payments shall not be included in the calculation of withdrawals, advances, or loans for purposes of paragraphs (i)(1) and (2) of this section.

(iv) For the purpose of this paragraph (i), any transactions between a security-based swap dealer and a stockholder, partner, employee or affiliate that results in a diminution of the security-based swap dealer's net capital shall be deemed to be an advance or loan of net capital.

9. Section 240.18a–1a is added to read as follows:

§ 240.18a–1a Options (Appendix A to 17 CFR 240.18a–1).

(a)(1) *Definitions.* The term *unlisted option* means any option not included in the definition of listed option provided in § 240.15c3–1(c)(2)(x).

(2) The term *option series* refers to listed option contracts of the same type (either a call or a put) and exercise style, covering the same underlying security with the same exercise price, expiration date, and number of underlying units.

(3) The term *related instrument* within an option class or product group refers to futures contracts and options

on futures contracts covering the same underlying instrument. In relation to options on foreign currencies, a related instrument within an option class also shall include forward contracts on the same underlying currency.

(4) The term *underlying instrument* refers to long and short positions, as appropriate, covering the same foreign currency, the same security, security future, or security-based swap, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. If the exchange or conversion requires the payment of money or results in a loss upon conversion at the time when the security is deemed an underlying instrument for purposes of this Appendix A, the security-based swap dealer will deduct from net worth the full amount of the conversion loss. The term underlying instrument shall not be deemed to include securities options, futures contracts, options on futures contracts, qualified stock baskets, or unlisted instruments (other than security-based swaps).

(5) The term *options class* refers to all options contracts covering the same underlying instrument.

(6) The term *product group* refers to two or more option classes, related instruments, underlying instruments, and qualified stock baskets in the same portfolio type (see paragraph (b)(1)(ii) of this section) for which it has been determined that a percentage of offsetting profits may be applied to losses at the same valuation point.

(b) The deduction under this Appendix A must equal the sum of the deductions specified in paragraph (b)(1)(iv)(C) of this section.

Theoretical Pricing Charges

(1)(i) *Definitions.* (A) The terms *theoretical gains and losses* mean the gain and loss in the value of individual option series, the value of underlying instruments, related instruments, and qualified stock baskets within that option's class, at 10 equidistant intervals (valuation points) ranging from an assumed movement (both up and down) in the current market value of the underlying instrument equal to the percentage corresponding to the deductions otherwise required under § 240.15c3–1 for the underlying instrument (see paragraph (b)(1)(iii) of this section). Theoretical gains and losses shall be calculated using a theoretical options pricing model that satisfies the criteria set forth in paragraph (b)(1)(i)(B) of this section.

(B) The term *theoretical options pricing model* means any mathematical model, other than a security-based swap dealer's proprietary model, the use of which has been approved by the Commission. Any such model shall calculate theoretical gains and losses as described in paragraph (b)(1)(i)(A) of this section for all series and issues of equity, index and foreign currency options and related instruments, and shall be made available equally and on the same terms to all security-based swap dealers. Its procedures shall include the arrangement of the vendor to supply accurate and timely data to each security-based swap dealer with respect to its services, and the fees for distribution of the services. The data provided to security-based swap dealers shall also contain the minimum requirements set forth in paragraphs (b)(1)(iv)(C) of this section and the product group offsets set forth in paragraphs (b)(1)(iv)(B) of this section. At a minimum, the model shall consider the following factors in pricing the option:

(*1*) The current spot price of the underlying asset;

(*2*) The exercise price of the option;

(*3*) The remaining time until the option's expiration;

(*4*) The volatility of the underlying asset;

(*5*) Any cash flows associated with ownership of the underlying asset that can reasonably be expected to occur during the remaining life of the option; and

(*6*) The current term structure of interest rates.

(C) The term *major market foreign currency* means the currency of a sovereign nation for which there is a substantial inter-bank forward currency market.

(D) The term *qualified stock basket* means a set or basket of stock positions which represents no less than 50% of the capitalization for a high-capitalization or non-high-capitalization diversified market index, or, in the case of a narrow-based index, no less than 95% of the capitalization for such narrow-based index.

(ii) With respect to positions involving listed option positions in its proprietary or other account, the security-based swap dealer shall group long and short positions into the following portfolio types:

(A) Equity options on the same underlying instrument and positions in that underlying instrument;

(B) Options on the same major market foreign currency, positions in that major market foreign currency, and related instruments within those options' classes;

(C) High-capitalization diversified market index options, related instruments within the option's class, and qualified stock baskets in the same index;

(D) Non-high-capitalization diversified index options, related instruments within the index option's class, and qualified stock baskets in the same index; and

(E) Narrow-based index options, related instruments within the index option's class, and qualified stock baskets in the same index.

(iii) Before making the computation, each security-based swap dealer shall obtain the theoretical gains and losses for each option series and for the related and underlying instruments within those options' class in the proprietary or other accounts of that security-based swap dealer. For each option series, the theoretical options pricing model shall calculate theoretical prices at 10 equidistant valuation points within a range consisting of an increase or a decrease of the following percentages of the daily market price of the underlying instrument:

(A) +(−)15% for equity securities with a ready market, narrow-based indexes, and non-high-capitalization diversified indexes;

(B) +(−)6% for major market foreign currencies;

(C) +(−)20% for all other currencies; and

(D) +(−)10% for high-capitalization diversified indexes.

(iv)(A) The security-based swap dealer shall multiply the corresponding theoretical gains and losses at each of the 10 equidistant valuation points by the number of positions held in a particular option series, the related instruments and qualified stock baskets within the option's class, and the positions in the same underlying instrument.

(B) In determining the aggregate profit or loss for each portfolio type, the security-based swap dealer will be allowed the following offsets in the following order, provided, that in the case of qualified stock baskets, the security-based swap dealer may elect to net individual stocks between qualified stock baskets and take the appropriate deduction on the remaining, if any, securities:

(*1*) First, a security-based swap dealer is allowed the following offsets within an option's class:

(*i*) Between options on the same underlying instrument, positions covering the same underlying instrument, and related instruments within the option's class, 100% of a position's gain shall offset another position's loss at the same valuation point;

(*ii*) Between index options, related instruments within the option's class, and qualified stock baskets on the same index, 95%, or such other amount as designated by the Commission, of gains shall offset losses at the same valuation point;

(*2*) Second, a security-based swap dealer is allowed the following offsets within an index product group:

(*i*) Among positions involving different high-capitalization diversified index option classes within the same product group, 90% of the gain in a high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in a different high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class;

(*ii*) Among positions involving different non-high-capitalization diversified index option classes within the same product group, 75% of the gain in a non-high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in another non-high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class or product group;

(*iii*) Among positions involving different narrow-based index option classes within the same product group, 90% of the gain in a narrow-based market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in another narrow-based market index option, related instruments, and qualified stock baskets within that index option's class or product group;

(*iv*) No qualified stock basket should offset another qualified stock basket; and

(*3*) Third, a security-based swap dealer is allowed the following offsets between product groups: Among positions involving different diversified index product groups within the same market group, 50% of the gain in a diversified market index option, a related instrument, or a qualified stock basket within that index option's product group shall offset the loss at the same valuation point in another product group;

(C) For each portfolio type, the total deduction shall be the larger of:

(*1*) The amount for any of the 10 equidistant valuation points representing the largest theoretical loss after applying the offsets provided in paragraph (b)(1)(iv)(B) if this section; or

(*2*) A minimum charge equal to 25% times the multiplier for each equity and index option contract and each related instrument within the option's class or product group, or $25 for each option on a major market foreign currency with the minimum charge for futures contracts and options on futures contracts adjusted for contract size differentials, not to exceed market value in the case of long positions in options and options on futures contracts; plus

(*3*) In the case of portfolio types involving index options and related instruments offset by a qualified stock basket, there will be a minimum charge of 5% of the market value of the qualified stock basket for high-capitalization diversified and narrow-based indexes; and

(*4*) In the case of portfolio types involving index options and related instruments offset by a qualified stock basket, there will be a minimum charge of 7½% of the market value of the qualified stock basket for non-high-capitalization diversified indexes.

(*5*) In the case of portfolio types involving security futures and equity options on the same underlying instrument and positions in that underlying instrument, there will be a minimum charge of 25% times the multiplier for each security-future and equity option.

10. Section 240.18a–1b is added to read as follows:

§ 240.18a–1b Adjustments to net worth for certain commodities transactions (Appendix B to 17 CFR 240.18a–1).

(a) Every registered security-based swap dealer in computing net capital pursuant to § 240.18a–1 shall comply with the following:

(1) Where a security-based swap dealer has an asset or liability which is treated or defined in paragraph § 240.18a–1, the inclusion or exclusion of all or part of such asset or liability for net capital shall be in accordance with § 240.18a–1, except as specifically provided otherwise in this Appendix B. Where a commodity related asset or liability is specifically treated or defined in 17 CFR 1.17 and is not generally or specifically treated or defined in § 240.18a–1 or this Appendix B, the inclusion or exclusion of all or part of such asset or liability for net capital shall be in accordance with 17 CFR 1.17.

(2) In computing net capital as defined in paragraph (c)(1) of § 240.18a–1, the net worth of a security-based swap dealer shall be adjusted as follows with respect to commodity-related transactions:

(i) *Unrealized profit or loss for certain commodities transactions.* (A) Unrealized profits shall be added and unrealized losses shall be deducted in the commodities accounts of the security-based swap dealer, including unrealized profits and losses on fixed price commitments and forward contracts; and

(B) The value attributed to any commodity option which is not traded on a contract market shall be the difference between the option's strike price and the market value for the physical or futures contract which is the subject of the option. In the case of a long call commodity option, if the market value for the physical or futures contract which is the subject of the option is less than the strike price of the option, it shall be given no value. In the case of a long put commodity option, if the market value for the physical commodity or futures contract which is the subject of the option is more than the striking price of the option, it shall be given no value.

(ii) Deduct any unsecured commodity futures or option account containing a ledger balance and open trades, the combination of which liquidates to a deficit or containing a debit ledger balance only: *Provided, however,* Deficits or debit ledger balances in unsecured customers', non-customers' and proprietary accounts, which are the subject of calls for margin or other required deposits need not be deducted until the close of business on the business day following the date on which such deficit or debit ledger balance originated;

(iii) Deduct all unsecured receivables, advances and loans except for:

(A) Management fees receivable from commodity pools outstanding no longer than thirty (30) days from the date they are due;

(B) Receivables from foreign clearing organizations;

(C) Receivables from registered futures commission merchants or brokers, resulting from commodity futures or option transactions, except those specifically excluded under paragraph (a)(2)(ii) of this Appendix B.

(iv) Deduct all inventories (including work in process, finished goods, raw materials and inventories held for resale) except for readily marketable spot commodities; or spot commodities which adequately collateralize indebtedness under 17 CFR 1.17(c)(7);

(v) Guarantee deposits with commodities clearing organizations are not required to be deducted from net worth;

(vi) Stock in commodities clearing organizations to the extent of its margin value is not required to be deducted from net worth;

(vii) Deduct from net worth the amount by which any advances paid by the security-based swap dealer on cash commodity contracts and used in computing net capital exceeds 95 percent of the market value of the commodities covered by such contracts.

(viii) Do not include equity in the commodity accounts of partners in net worth.

(ix) In the case of all inventory, fixed price commitments and forward contracts, except for inventory and forward contracts in the inter-bank market in those foreign currencies which are purchased or sold for further delivery on or subject to the rules of a contract market and covered by an open futures contract for which there will be no charge, deduct the applicable percentage of the net position specified below:

(A) Inventory which is currently registered as deliverable on a contract market and covered by an open futures contract or by a commodity option on a physical—No charge.

(B) Inventory which is covered by an open futures contract or commodity option—5% of the market value.

(C) Inventory which is not covered—20% of the market value.

(D) Fixed price commitments (open purchases and sales) and forward contracts which are covered by an open futures contract or commodity option—10% of the market value.

(E) Fixed price commitments (open purchases and sales) and forward contracts which are not covered by an open futures contract or commodity option—20% of the market value.

(x) Deduct for undermargined customer commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or, if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding three business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements on such accounts, then deduct the amount of funds required to provide margin equal to the amount necessary after application of calls for margin, or other required deposits outstanding three days or less to restore original margin when the original margin has been depleted by 50 percent or more. *Provided,* To the extent a deficit is deducted from net worth in accordance with paragraph (a)(2)(ii) of this Appendix B, such amount shall not also be deducted under this paragraph (a)(2)(x). In the event that an owner of a customer account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this paragraph shall be the lesser of (A) the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of such asset after application of the percentage deductions specified in paragraph (a)(2)(ix) of this Appendix B or, where appropriate, specified in paragraph (c)(1)(iv), (vi), or (vii) of § 240.18a–1 of this chapter;

(xi) Deduct for undermargined non-customer and omnibus commodity futures accounts the amount of funds required in each such account to meet maintenance margin requirements of the applicable board of trade or, if there are no such maintenance margin requirements, clearing organization margin requirements applicable to such positions, after application of calls for margin, or other required deposits which are outstanding two business days or less. If there are no such maintenance margin requirements or clearing organization margin requirements, then deduct the amount of funds required to provide margin equal to the amount necessary after application of calls for margin, or other required deposits outstanding two days or less to restore original margin when the original margin has been depleted by 50 percent or more. *Provided,* To the extent a deficit is deducted from net worth in accordance with paragraph (a)(2)(ii) of this Appendix B such amount shall not also be deducted under this paragraph (a)(2)(xi). In the event that an owner of a non-customer or omnibus account has deposited an asset other than cash to margin, guarantee or secure his account, the value attributable to such asset for purposes of this paragraph shall be the lesser of (A) the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or (B) the market value of such asset after application of the percentage deductions specified in paragraph (a)(2)(ix) of this Appendix B or, where appropriate, specified in paragraph (c)(1)(iv), (vi), or (vii) of § 240.18a–1 of this chapter;

(xii) In the case of open futures contracts and granted (sold) commodity options held in proprietary accounts carried by the security-based swap dealer which are not covered by a position held by the security-based swap dealer or which are not the result of a ''changer trade'' made in accordance with the rules of a contract market, deduct:

(A) For a security-based swap dealer which is a clearing member of a contract market for the positions on such contract market cleared by such member, the applicable margin requirement of the applicable clearing organization; (B) For a security-based swap dealer which is a member of a self-regulatory organization, 150% of the applicable maintenance margin requirement of the applicable board of trade or clearing organization, whichever is greater; or

(C) For all other security-based swap dealers, 200% of the applicable maintenance margin requirement of the applicable board of trade or clearing organization, whichever is greater; or

(D) For open contracts or granted (sold) commodity options for which there are no applicable maintenance margin requirements, 200% of the applicable initial margin requirement; *Provided,* the equity in any such proprietary account shall reduce the deduction required by this paragraph (a)(2)(xii) if such equity is not otherwise includable in net capital.

(xiii) In the case of a security-based swap dealer which is a purchaser of a commodity option which is traded on a contract market, the deduction shall be the same safety factor as if the security-based swap dealer were the grantor of such option in accordance with paragraph (a)(2)(xii), but in no event shall the safety factor be greater than the market value attributed to such option.

(xiv) In the case of a security-based swap dealer which is a purchaser of a commodity option not traded on a contract market which has value and such value is used to increase net capital, the deduction is ten percent of the market value of the physical or futures contract which is the subject of such option but in no event more than the value attributed to such option.

(xv) A loan or advance or any other form of receivable shall not be considered ''secured'' for the purposes of paragraph (a)(2) of this Appendix B unless the following conditions exist:

(A) The receivable is secured by readily marketable collateral which is otherwise unencumbered and which can be readily converted into cash: *Provided, however,* That the receivable will be considered secured only to the extent of the market value of such collateral after application of the percentage deductions specified in

paragraph (a)(2)(ix) of this Appendix B; and

(B)(1) The readily marketable collateral is in the possession or control of the security-based swap dealer; or

(2) The security-based swap dealer has a legally enforceable, written security agreement, signed by the debtor, and has a perfected security interest in the readily marketable collateral within the meaning of the laws of the State in which the readily marketable collateral is located.

(xvi) The term *cover* for purposes of this Appendix B shall mean cover as defined in 17 CFR 1.17(j).

(xvii) The term *customer* for purposes of this Appendix B shall mean customer as defined in 17 CFR 1.17(b)(2). The term *non-customer* for purposes of this Appendix B shall mean non-customer as defined in 17 CFR 1.17(b)(4).

(b) Every registered security-based swap dealer in computing net capital pursuant to § 240.18a–1 shall comply with the following:

(1) *Swaps.* Where a swap-related asset or liability is specifically treated or defined in 17 CFR 1.17 and is not generally or specifically treated or defined in § 240.15c3–1 or this Appendix B, the inclusion or exclusion of all or part of such asset or liability for net capital shall be in accordance with 17 CFR 1.17.

(i) *Credit default swaps referencing broad-based securities indices.* (A) *Short positions (selling protection).* In the case of a swap that is a short credit default swap referencing a broad-based securities index, deducting the percentage of the notional amount based upon the current basis point spread of the credit default swap and the maturity of the credit default swap in accordance with the following table:

Length of time to maturity of CDS contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
12 months or less	0.67	1.33	3.33	5.00	6.67	10.00
13 months to 24 months	1.00	2.33	5.00	6.67	8.33	11.67
25 months to 36 months	1.33	3.33	6.67	8.33	10.00	13.33
37 months to 48 months	2.00	4.00	8.33	10.00	11.67	15.00
49 months to 60 months	2.67	4.67	10.00	11.67	13.33	16.67
61 months to 72 months	3.67	5.67	11.67	13.33	15.00	18.33
73 months to 84 months	4.67	6.67	13.33	15.00	16.67	20.00
85 months to 120 months	5.67	10.00	15.00	16.67	18.33	26.67
121 months and longer	6.67	13.33	16.67	18.33	20.00	33.33

(B) *Long positions (purchasing protection).* In the case of a swap that is a long credit default swap referencing a broad-based securities index, deducting 50% of the deduction that would be required by paragraph (b)(1)(i)(A) of this Appendix B if the swap was a short credit default swap.

(C) *Long and short positions.* (*1*) *Long and short credit default swaps.* In the case of swaps that are long and short credit default swaps referencing the same obligor or obligation, that are in the same spread category, and that are in the same maturity category or are in the next maturity category and have a maturity date within three months of the other maturity category, deducting the percentage of the notional amount specified in the higher maturity category under paragraph (b)(1)(i)(A) of this Appendix B on the excess of the long or short position.

(*2*) *Long basket of obligors and long credit default swap.* In the case of a swap that is a long credit default swap referencing a broad-based securities index and the security-based swap dealer is long a basket on the same underlying obligors, deducting 50% of the amount specified in § 240.15c3–1(c)(2)(vi) for the components of the basket, provided the security-based swap dealer can deliver the components of the basket to satisfy the obligation of the security-based swap dealer on the credit default swap.

(*3*) *Short basket of obligors and short credit default swap.* In the case of a swap that is a short credit default swap referencing a broad-based securities index and the security-based swap dealer is short a basket on the same underlying obligors, deducting the amount specified in § 240.15c3–1(c)(2)(vi) for the components of the basket.

(2) *All other swaps.* (i) In the case of any swap that is not a credit default swap, deducting the amount calculated by multiplying the notional value of the swap by the percentage specified in:

(A) § 240.15c3–1 applicable to the reference asset if § 240.15c3–1 specifies a percentage deduction for the type of asset;

(B) 17 CFR 1.17 applicable to the reference asset if 17 CFR 1.17 specifies a percentage deduction for the type of asset and § 240.15c3–1 does not specify a percentage deduction for the type of asset; or

(C) In the case of an interest rate swap, § 240.15c3–1(c)(2)(vi)(A) based on the maturity of the swap, provided that the percentage deduction must be no less than 1%.

(ii) A security-based swap dealer may reduce the deduction under this paragraph (b)(2)(ii) by an amount equal to any reduction recognized for a comparable long or short position in the reference asset or interest rate under 17 CFR 1.17 or § 240.15c3–1.

11. Section 240.18a–1c is added to read as follows:

§ 240.18a–1c Consolidated Computations of Net Capital for Certain Subsidiaries and Affiliates of Security-Based Swap Dealers (Appendix C to 17 CFR 240.18a–1).

Every security-based swap dealer in computing its net capital pursuant to § 240.18a–1 shall include in its computation all liabilities or obligations of a subsidiary or affiliate that the security-based swap dealer guarantees, endorses, or assumes either directly or indirectly.

12. Section 240.18a–1d is added to read as follows:

§ 240.18a–1d Satisfactory Subordinated Loan Agreements (Appendix D to 17 CFR 240.18a–1).

(a) *Introduction.* (1) This Appendix sets forth minimum and non-exclusive requirements for satisfactory subordinated loan agreements. The Commission may require or the security-based swap dealer may include such other provisions as deemed necessary or appropriate to the extent such provisions do not cause the subordinated loan agreement to fail to meet the minimum requirements of this Appendix D.

(2) *Certain definitions.* For purposes of § 240.18a–1 and this Appendix D:

(i) The term ''*subordinated loan agreement*'' shall mean the agreement or

agreements evidencing or governing a subordinated borrowing of cash.

(ii) The term ''*Payment Obligation*'' shall mean the obligation of a security-based swap dealer to repay cash loaned to the security-based swap dealer pursuant to a subordinated loan agreement and ''Payment'' shall mean the performance by a security-based swap dealer of a Payment Obligation.

(iii) The term ''*lender*'' shall mean the person who lends cash to a security-based swap dealer pursuant to a subordinated loan agreement.

(b) *Minimum requirements for subordinated loan agreements.* (1) Subject to paragraph (a) of this section, a subordinated loan agreement shall mean a written agreement between the security-based swap dealer and the lender, which has a minimum term of one year, and 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 security-based swap dealer and the lender and their respective heirs, executors, administrators, successors and assigns.

(2) *Specific amount.* All subordinated loan 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 subordinated loan 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 security-based swap dealer arising out of any matter occurring prior to the date on which the related Payment Obligation matures consistent with the provisions of § 240.18a–1 and § 240.18a–1d, except for claims which are the subject of subordinated loan agreements that rank on the same priority as or junior to the claim of the lender under such subordinated loan 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 security-based swap dealer as part of its capital and shall be subject to the risks of the business.

(5) *Certain rights of the security-based swap dealer.* The subordinated loan agreement shall provide that the security-based swap dealer shall have the right to deposit any cash proceeds of a subordinated loan agreement in an account or accounts in its own name in any bank or trust company;

(6) *Permissive prepayments.* A security-based swap dealer at its option but not at the option of the lender may, if the subordinated loan 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 subordinated loan agreement became effective. No Prepayment shall be made, if, after giving effect thereto (and to all Payments of Payment Obligations under any other subordinated loan 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 security-based swap dealer, either its net capital would fall below $24 million, its net capital would fall below 10% of the risk margin amount under § 240.18a–1, or, if the security-based swap dealer is approved to calculate net capital under § 240.18a–1(d), its tentative net capital would fall to an amount below $120 million. Notwithstanding the above, no Prepayment shall occur without the prior written approval of the Commission.

(7) *Suspended repayment.* The Payment Obligation of the security-based swap dealer in respect of any subordinated loan 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 security-based swap dealer under any other subordinated loan agreement(s) then outstanding that are scheduled to mature on or before such Payment Obligation) either its net capital would fall below $24 million, its net capital would fall below 10% of the risk margin amount under § 240.18a–1, or, if the security-based swap dealer is approved to calculate net capital under § 240.18a–1(d), its tentative net capital would fall to an amount below $120 million. The subordinated loan agreement may provide that if the Payment Obligation of the security-based swap dealer thereunder does not mature and is suspended as a result of the requirement of this paragraph (b)(7) for a period of not less than six months, the security-based swap 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 § 240.18a–1 and § 240.18a–1d.

(8) *Accelerated maturity—obligation to repay to remain subordinate.* (i) Subject to the provisions of paragraph (b)(7) of this appendix, a subordinated loan agreement may provide that the lender may, upon prior written notice to the security-based swap dealer and the Commission given not earlier than six months after the effective date of such subordinated loan agreement, accelerate the date on which the Payment Obligation of the security-based swap 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 §§ 240.18a–1 and 240.18a–1d.

(ii) Notwithstanding the provisions of paragraph (b)(7) of this appendix, the Payment Obligation of the security-based swap dealer with respect to a subordinated loan agreement, together with accrued interest and compensation, shall mature in the event of any receivership, insolvency, liquidation, 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 security-based swap 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 § 240.18a–1 and § 240.18a–1d.

(9) *Accelerated maturity of subordinated loan agreements on event of default and event of acceleration—obligation to repay to remain subordinate.* (i) A subordinated loan agreement may provide that the lender may, upon prior written notice to the security-based swap dealer and the Commission of the occurrence of any Event of Acceleration (as hereinafter defined) given no sooner than six months after the effective date of such subordinated loan agreement, accelerate the date on which the Payment Obligation of the security-based swap 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 security-based swap dealer and the Commission. Any subordinated loan agreement containing such Events of Acceleration may also provide, that if upon such accelerated maturity date the Payment Obligation of the security-based swap dealer is suspended as required by paragraph (b)(7) of this Appendix D and liquidation of the security-based swap dealer has not commenced on or prior to such accelerated maturity date, then notwithstanding paragraph (b)(7) of this appendix the Payment Obligation of the security-based swap dealer with respect to such subordinated loan agreement shall mature on the day immediately following such accelerated maturity date and in any such event the Payment Obligations of the security-based swap dealer with respect to all other subordinated loan 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 subordinated loan agreement complying with this paragraph (b)(9) shall be limited to:

(A) Failure to pay interest or any installment of principal on a subordinated loan 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 security-based swap dealer which is included in the subordinated loan agreement and on which the subordinated loan 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 subordinated loan agreement and which the lender and the security-based swap dealer agree:

(*1*) Is a significant indication that the financial position of the security-based swap dealer has changed materially and adversely from agreed upon specified norms; or

(*2*) Could materially and adversely affect the ability of the security-based swap dealer to conduct its business as conducted on the date the subordinated loan agreement was made; or

(*3*) Is a significant change in the senior management of the security-based swap dealer or in the general business conducted by the security-based swap dealer from that which obtained on the date the subordinated loan agreement became effective;

(E) Any continued failure to perform agreed covenants included in the subordinated loan agreement relating to the conduct of the business of the security-based swap dealer or relating to the maintenance and reporting of its financial position; and

(ii) Notwithstanding the provisions of paragraph (b)(7) of this appendix, a subordinated loan agreement may provide that, if liquidation of the business of the security-based swap dealer has not already commenced, the Payment Obligation of the security-based swap 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 security-based swap dealer has not already commenced, the rapid and orderly liquidation of the business of the security-based swap dealer shall then commence upon the happening of an Event of Default. Any subordinated loan 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 security-based swap dealer has not already commenced, be the date on which the Payment Obligations of the security-based swap dealer with respect to all other subordinated loan 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 subordinated loan agreement shall be limited to:

(A) The net capital of the security-based swap dealer falling to an amount below either of $20 million or 8% of the risk margin amount under § 240.18a–1, or, if the security-based swap dealer is approved to calculate net capital under § 240.18a–1(d), its tentative net capital falling below $100 million, throughout a period of 15 consecutive business days, commencing on the day the security-based swap dealer first determines and notifies the Commission, or the Commission first determines and notifies the security-based swap dealer of such fact;

(B) The Commission revoking the registration of the security-based swap dealer;

(C) The Commission suspending (and not reinstating within 10 days) the registration of the security-based swap dealer;

(D) Any receivership, insolvency, liquidation, 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 security-based swap dealer. A subordinated loan agreement that contains any of the provisions permitted by this paragraph (b)(9) shall not contain the provision otherwise permitted by paragraph (b)(8)(i) of this section.

(c) *Miscellaneous provisions.* (1) *Prohibited cancellation.* The subordinated loan 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 §§ 240.18a–1 and 240.18a–1d.

(2) Every security-based swap dealer shall immediately notify the Commission if, after giving effect to all Payments of Payment Obligations under subordinated loan agreements then outstanding that are then due or mature within the following six months without reference to any projected profit or loss of the security-based swap dealer, either its net capital would fall below $24 million, its net capital would fall below 10% of the risk margin amount under § 240.18a–1, or, if the security-based swap dealer is approved to calculate net capital under § 240.18a–1(d), its tentative net capital would fall to an amount below $120 million.

(3) *Certain legends.* If all the provisions of a satisfactory subordinated loan 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 subordinated loan agreement which shall be adequately referred to and incorporated by reference.

(4) *Revolving subordinated loan agreements.* A security-based swap dealer shall be permitted to enter into a revolving subordinated loan agreement that provides for prepayment within less than one year of all or any portion of the Payment Obligation thereunder at the option of the security-based swap dealer upon the prior written approval of the Commission. The Commission, however, shall not approve any prepayment if:

(i) After giving effect thereto (and to all Payments of Payment Obligations

under any other subordinated loan 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 security-based swap dealer, either its net capital would fall below $24 million, its net capital would fall below 10% of the risk margin amount under § 240.18a–1, or, if the security-based swap dealer is approved to calculate net capital under § 240.18a–1(d), its tentative net capital would fall to an amount below $120 million; or

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

Any subordinated loan agreement entered into pursuant to this paragraph (c)(4) shall be subject to all the other provisions of this Appendix D. Any such subordinated loan agreement shall not be considered equity for purposes of paragraph (h) of § 240.18a–1, despite the length of the initial term of the loan.

(5) *Filing.* Two copies of any proposed subordinated loan agreement (including nonconforming subordinated loan agreements) shall be filed at least 30 days prior to the proposed execution date of the agreement with the Commission. The security-based swap dealer shall also file with the Commission a statement setting forth the name and address of the lender, the business relationship of the lender to the security-based swap dealer, and whether the security-based swap dealer carried an account for the lender for effecting transactions in security-based swaps at or about the time the proposed agreement was so filed. All agreements shall be examined by the Commission prior to their becoming effective. No proposed agreement shall be a satisfactory subordinated loan agreement for the purposes of this section unless and until the Commission has found the agreement acceptable and such agreement has become effective in the form found acceptable.

13. Section 240.18a–2 is added to read as follows:

§ 240.18a–2 Capital requirements for major security-based swap participants for which there is not a prudential regulator.

(a) Every major security-based swap participant for which there is not a prudential regulator must at all times have and maintain positive tangible net worth.

(b) The term *tangible net worth* means the net worth of the major security-based swap participant as determined in accordance with generally accepted accounting principles in the United States, excluding goodwill and other intangible assets. In determining net worth, all long and short positions in security-based swaps, swaps, and related positions must be marked to their market value. A major security-based swap participant must include in its computation of tangible net worth all liabilities or obligations of a subsidiary or affiliate that the participant guarantees, endorses, or assumes either directly or indirectly.

(c) Every major security-based swap participant must comply with § 240.15c3–4 as though it were an OTC derivatives dealer with respect to its security-based swap and swap activities, except that paragraphs (c)(5)(xiii) and (xiv) and (d)(8) and (9) of § 240.15c3–4 shall not apply.

14. Section 240.18a–3 is added to read as follows:

§ 240.18a–3 Non-cleared security-based swap margin requirements for security-based swap dealers and major security-based swap participants for which there is not a prudential regulator.

(a) Every security-based swap dealer and major security-based swap participant for which there is not a prudential regulator must comply with this section.

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

(1) The term *account* means an account carried by a security-based swap dealer or major security-based swap participant for a counterparty that holds non-cleared security-based swaps.

(2) The term *commercial end user* means any person (other than a natural person) that:

(i) Engages primarily in commercial activities that are not financial in nature and that is not a *financial entity* as that term is defined in 3C(g)(3) of the Act (15 U.S.C. 78o–3(g)(3)); and

(ii) Is using non-cleared security-based swaps to hedge or mitigate risk relating to the commercial activities.

(3) The term *counterparty* means a person with whom the security-based swap dealer or major security-based swap participant has entered into a non-cleared security-based swap transaction.

(4) The term *equity* means the total current fair market value of securities positions in an account of a counterparty (excluding the time value of an over-the-counter option), plus any credit balance and less any debit balance in the account after applying a qualifying netting agreement with respect to gross derivatives payables and receivables.

(5) The term *margin* means the amount of positive equity in an account of a counterparty.

(6) The term *negative equity* means equity of less than $0.

(7) The term *positive equity* means equity of greater than $0.

(8) The term *non-cleared security-based swap* means a security-based swap that is not, directly or indirectly, cleared by a clearing agency registered pursuant to section 17A of the Act.

(9) The term *security-based swap legacy account* means an account that holds no security-based swaps entered into after the effective date of this section and that only is used to hold security-based swaps entered into prior to the effective date of this section and collateral for those security-based swaps.

(c) *Margin requirements.* (1) *Security-based swap dealers.* (i) *Calculation required.* A security-based swap dealer must calculate with respect to each account of a counterparty as of the close of each business day:

(A) The amount of equity in the account of the counterparty; and

(B) The margin amount for the account of the counterparty calculated pursuant to paragraph (d) of this section.

(ii) *Account equity requirements.* Except as provided in paragraph (c)(1)(iii) of this section, a security-based swap dealer must collect from a counterparty by noon of each business day cash, securities, and/or money market instruments in an amount at least equal to, as applicable:

(A) The negative equity in the account calculated as of the previous business day; and

(B) The margin amount calculated under paragraph (c)(1)(i)(B) of this section as of the previous business day to the extent that amount is greater than the amount of positive equity in the account on the previous business day.

(iii) *Exceptions.* (A) *Commercial end users.* The requirements of paragraph (c)(1)(ii) of this section do not apply to an account of a counterparty that is a commercial end user.

Alternative A to § 240.18a–3(c)(1)(iii)(B)

(B) *Security-based swap dealers.* The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that is a security-based swap dealer.

Alternative B to § 240.18a–3(c)(1)(iii)(B)

(B) *Security-based swap dealers.* Cash, securities and money market

instruments posted by a counterparty that is a security-based swap dealer to meet the requirements of paragraph (c)(1)(ii)(B) of this section must be carried by an independent third-party custodian pursuant to the requirements of section 3E(f) of the Act.

(C) *Counterparties that require third-party custodians.* The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that is not a commercial end user and that requires the cash, securities, and money market instruments delivered to meet the margin amount to be carried by an independent third-party custodian pursuant to the requirements of section 3E(f) of the Act, provided cash, securities, and money market instruments necessary to meet the requirements of paragraph (c)(1)(ii)(B) of this section are delivered to the independent third-party custodian.

(D) *Security-based swap legacy accounts.* The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to a legacy security-based swap account of a counterparty that is not a commercial end user.

(2) *Major security-based swap participants.* (i) *Calculation required.* A major security-based swap participant must calculate as of the close of each business day the amount of equity in the account of each counterparty.

(ii) *Account equity requirements.* Except as provided in paragraph (c)(2)(iii) of this section, a major security-based swap participant must by noon of each business day:

(A) Collect from a counterparty cash, securities and/or money market instruments in an amount equal to the negative equity in the account calculated on the previous business day pursuant to paragraph (c)(2)(i) of this section; and

(B) Deliver to a counterparty cash, securities and/or money market instruments in an amount equal to the positive equity in the account calculated on the previous business day pursuant to paragraph (c)(2)(i) of this section.

(iii) *Exceptions.* (A) *Transactions with commercial end users.* The requirements of paragraph (c)(2)(ii)(A) of this section do not apply to a counterparty that is a commercial end user.

(B) *Transactions with security-based swap dealers.* The requirements of paragraph (c)(2)(ii)(A) of this section do not apply to a counterparty that is a security-based swap dealer.

Note to paragraph (c)(2)(iii)(B): A security-based swap dealer must collect from a counterparty that is a major security-based swap participant cash, securities, and/or money market instruments as required by paragraph (c)(1)(ii) of this section.

(C) *Security-based swap legacy accounts.* The requirements of paragraph (c)(2)(ii) of this section do not apply to a legacy security-based swap account of a counterparty that is not a commercial end user.

(3) *Deductions for securities held as collateral.* The fair market value of securities and money market instruments held in the account of a counterparty must be reduced by the amount of the deductions the security-based swap dealer would apply to the securities and money market instruments pursuant to § 240.15c3–1 or § 240.18a–1, as applicable, for the purpose of determining whether the level of equity in the account meets the requirement of paragraph (c)(1)(ii) of this section.

(4) *Collateral requirements.* A security-based swap dealer and a major security-based swap participant when calculating the amount of equity in the account of a counterparty may take into account cash and the fair market value of securities and money market instruments pledged and held as collateral in the account provided:

(i) The collateral is subject to the physical possession or control of the security-based swap dealer or the major security-based swap participant;

(ii) The collateral is liquid and transferable;

(iii) The collateral may be liquidated promptly by the security-based swap dealer or the major security-based swap participant without intervention by any other party;

(iv) The collateral agreement between the security-based swap dealer or the major security-based swap participant and the counterparty is legally enforceable by the security-based swap dealer or the major security-based swap participant against the counterparty and any other parties to the agreement;

(v) The collateral does not consist of securities issued by the counterparty or a party related to the security-based swap dealer, the major security-based swap participant, or to the counterparty; and

(vi) If the Commission has approved the security-based swap dealer's use of a VaR model to compute net capital, the approval allows the security-based swap dealer to calculate deductions for market risk for the type of collateral.

(5) *Qualified netting agreements.* A security-based swap dealer or major security-based swap participant may include the effect of a netting agreement that allows the security-based swap dealer or major security-based swap participant to net gross receivables from and gross payables to a counterparty upon the default of the counterparty, for the purposes of the calculations required pursuant to paragraphs (c)(1)(i)(A) and (c)(2)(i) of this section, if:

(i) The netting agreement is legally enforceable in each relevant jurisdiction, including in insolvency proceedings;

(ii) The gross receivables and gross payables that are subject to the netting agreement with a counterparty can be determined at any time; and

(iii) For internal risk management purposes, the security-based swap dealer or major security-based swap participant monitors and controls its exposure to the counterparty on a net basis.

(6) *Minimum transfer amount.* Notwithstanding any other provision of this rule, a security-based swap dealer or major security-based swap participant is not required to collect or deliver cash, securities or money market instruments pursuant to this section with respect to a particular counterparty unless and until the total amount of cash, securities or money market instruments that is required to be collected or delivered, and has not yet been collected or delivered, with respect to the counterparty is greater than $100,000.

(7) *Frequency of calculations increased.* The calculations required pursuant to paragraphs (c)(1)(i) and (c)(2)(i) of this section must be made more frequently than the close of each business day during periods of extreme volatility and for accounts with concentrated positions.

(8) *Liquidation.* A security-based swap dealer and major security-based swap participant must take prompt steps to liquidate securities and money market instruments in an account that does not meet the account equity requirements of this section to the extent necessary to eliminate the account equity deficiency.

(d) *Calculating margin amount.* A security-based swap dealer must calculate the margin amount required by paragraph (c)(1)(i)(B) of this section for non-cleared security-based swaps as follows:

(1) *Standardized approach.* (i) *Credit default swaps.* For credit default swaps, the security-based swap dealer must use the method specified in § 240.18a–1(c)(1)(vi)(A) or, if the security-based swap dealer is registered with the Commission as a broker or dealer, the method specified in § 240.15c3–1(c)(2)(vi)(O)(*1*).

(ii) *All other security-based swaps.* For security-based swaps other than credit default swaps, the security-based swap dealer must use the method specified in § 240.18a–1(c)(1)(vi)(B) or, if the security-based swap dealer is registered with the Commission as a broker or dealer, the method specified in § 240.15c3–1(c)(2)(vi)(O)(*2*).

(2) *Model approach.* For security-based swaps other than equity security-based swaps, a security-based swap dealer authorized by the Commission to compute net capital pursuant to § 240.18a–1(d) or § 240.15c3–1e may use its internal market risk model subject to the requirements in § 240.18a–1(d) or § 240.15c3–1e in lieu of using the methods required in paragraphs (d)(1)(i) and (ii) of this section.

(e) *Risk monitoring and procedures.* A security-based swap dealer must monitor the risk of each account and establish, maintain, and document procedures and guidelines for monitoring the risk of accounts as part of the risk management control system required by § 240.15c3–4. The security-based swap dealer must review, in accordance with written procedures, at reasonable periodic intervals, its non-cleared security-based swap activities for consistency with the risk monitoring procedures and guidelines required by this section. The security-based swap dealer also must determine whether information and data necessary to apply the risk monitoring procedures and guidelines required by this section are accessible on a timely basis and whether information systems are available to adequately capture, monitor, analyze, and report relevant data and information. The risk monitoring procedures and guidelines must include, at a minimum, procedures and guidelines for:

(1) Obtaining and reviewing account documentation and financial information necessary for assessing the amount of current and potential future exposure to a given counterparty permitted by the security-based swap dealer;

(2) Determining, approving, and periodically reviewing credit limits for each counterparty, and across all counterparties;

(3) Monitoring credit risk exposure to the security-based swap dealer from non-cleared security-based swaps, including the type, scope, and frequency of reporting to senior management;

(4) Using stress tests to monitor potential future exposure to a single counterparty and across all counterparties over a specified range of possible market movements over a specified time period;

(5) Managing the impact of credit exposure related to non-cleared security-based swaps on the security-based swap dealer's overall risk exposure;

(6) Determining the need to collect collateral from a particular counterparty, including whether that determination was based upon the creditworthiness of the counterparty and/or the risk of the specific non-cleared security-based swap contracts with the counterparty;

(7) Monitoring the credit exposure resulting from concentrated positions with a single counterparty and across all counterparties, and during periods of extreme volatility; and

(8) Maintaining sufficient equity in the account of each counterparty to protect against the largest individual potential future exposure of a non-cleared security-based swap carried in the account of the counterparty as measured by computing the largest maximum possible loss that could result from the exposure.

15. Section 240.18a–4 is added to read as follows:

§ 240.18a–4 Segregation requirements for security-based swap dealers and major security-based swap participants.

(a) *Definitions.* For the purposes of this section:

(1) The term *cleared security-based swap* means any security-based swap that is, directly or indirectly, submitted to and cleared by a clearing agency registered with the Commission pursuant to section 17A of the Act (15 U.S.C. 78q–1);

(2) The term *excess securities collateral* means securities and money market instruments carried for the account of a security-based swap customer that have a market value in excess of the current exposure of the security-based swap dealer to the customer, excluding:

(i) Securities and money market instruments held in a qualified clearing agency account but only to the extent the securities and money market instruments are being used to meet a margin requirement of the clearing agency resulting from a security-based swap transaction of the customer; and

(ii) Securities and money market instruments held in a qualified registered security-based swap dealer account but only to the extent the securities and money market instruments are being used to meet a margin requirement of the other security-based swap dealer resulting from the security-based swap dealer entering into a non-cleared security-based swap transaction with the other security-based swap dealer to offset the risk of a non-cleared security-based swap transaction between the security-based swap dealer and the customer.

(3) The term *qualified clearing agency account* means an account of a security-based swap dealer at a clearing agency established to hold funds and other property in order to purchase, margin, guarantee, secure, adjust, or settle cleared security-based swap transactions for the security-based swap customers of the security-based swap dealer that meets the following conditions:

(i) The account is designated ''Special Clearing Account for the Exclusive Benefit of the Cleared Security-Based Swap Customers of [name of security-based swap dealer]'';

(ii) The clearing agency has acknowledged in a written notice provided to and retained by the security-based swap dealer that the funds and other property in the account are being held by the clearing agency for the exclusive benefit of the security-based swap customers of the security-based swap dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the security-based swap dealer with the clearing agency; and

(iii) The account is subject to a written contract between the security-based swap dealer and the clearing agency which provides that the funds and other property in the account shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the clearing agency or any person claiming through the clearing agency, except a right, charge, security interest, lien, or claim resulting from a cleared security-based swap transaction effected in the account.

(4) The term *qualified registered security-based swap dealer account* means an account at another security-based swap dealer registered with the Commission pursuant to section 15F of the Act that is not an affiliate of the security-based swap dealer and that meets the following conditions:

(i) The account is designated ''Special Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of security-based swap dealer]'';

(ii) The account is subject to a written acknowledgement by the other security-based dealer provided to and retained by the security-based swap dealer that the funds and other property held in the account are being held by the other security-based swap dealer for the exclusive benefit of the security-based

swap customers of the security-based swap dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the security-based swap dealer with the other security-based swap dealer;

(iii) The account is subject to a written contract between the security-based swap dealer and the other security-based swap dealer which provides that the funds and other property in the account shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the other security-based swap dealer or any person claiming through the other security-based swap dealer, except a right, charge, security interest, lien, or claim resulting from a non-cleared security-based swap transaction effected in the account; and

(iv) The account and the assets in the account are not subject to any type of subordination agreement between the security-based swap dealer and the other security-based swap dealer.

(5) The term *qualified security* means:

(i) Obligations of the United States;

(ii) Obligations fully guaranteed as to principal and interest by the United States; and

(iii) General obligations of any State or subdivision of a State that:

(A) Are not traded flat and are not in default;

(B) Were part of an initial offering of $500 million or greater; and

(C) Were issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year-end.

(6) The term *security-based swap customer* means any person from whom or on whose behalf the security-based swap dealer has received or acquired or holds funds or other property for the account of the person with respect to a cleared or non-cleared security-based swap transaction. The term does not include a person to the extent that person has a claim for funds or other property which by contract, agreement or understanding, or by operation of law, is part of the capital of the security-based swap dealer or is subordinated to all claims of security-based swap customers of the security-based swap dealer.

(7) The term *special account for the exclusive benefit of security-based swap customers* means an account at a bank that is not the security-based swap dealer or an affiliate of the security-based swap dealer and that meets the following conditions:

(i) The account is designated ''Special Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of security-based swap dealer]'';

(ii) The account is subject to a written acknowledgement by the bank provided to and retained by the security-based swap dealer that the funds and other property held in the account are being held by the bank for the exclusive benefit of the security-based swap customers of the security-based swap dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the security-based swap dealer with the bank; and

(iii) The account is subject to a written contract between the security-based swap dealer and the bank which provides that the funds and other property in the account shall at no time be used directly or indirectly as security for a loan or other extension of credit to the security-based swap dealer by the bank and, shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank.

(b) *Physical possession or control of excess securities collateral.* (1) A security-based swap dealer must promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers.

(2) A security-based swap dealer has *control* of excess securities collateral only if the securities and money market instruments:

(i) Are represented by one or more certificates in the custody or control of a clearing corporation or other subsidiary organization of either national securities exchanges, or of a custodian bank in accordance with a system for the central handling of securities complying with the provisions of §§ 240.8c–1(g) and 240.15c2–1(g) the delivery of which certificates to the security-based swap dealer does not require the payment of money or value, and if the books or records of the security-based swap dealer identify the security-based swap customers entitled to receive specified quantities or units of the securities so held for such security-based swap customers collectively;

(ii) Are the subject of bona fide items of transfer; provided that securities and money market instruments shall be deemed not to be the subject of bona fide items of transfer if, within 40 calendar days after they have been transmitted for transfer by the security-based swap dealer to the issuer or its transfer agent, new certificates conforming to the instructions of the security-based swap dealer have not been received by the security-based swap dealer, the security-based swap dealer has not received a written statement by the issuer or its transfer agent acknowledging the transfer instructions and the possession of the securities or money market instruments, or the security-based swap dealer has not obtained a revalidation of a window ticket from a transfer agent with respect to the certificate delivered for transfer;

(iii) Are in the custody or control of a bank as defined in section 3(a)(6) of the Act, the delivery of which securities or money market instruments to the security-based swap dealer does not require the payment of money or value and the bank having acknowledged in writing that the securities and money market instruments in its custody or control are not subject to any right, charge, security interest, lien or claim of any kind in favor of a bank or any person claiming through the bank;

(iv)(A) Are held in or are in transit between offices of the security-based swap dealer; or

(B) Are held by a corporate subsidiary if the security-based swap dealer owns and exercises a majority of the voting rights of all of the voting securities of such subsidiary, assumes or guarantees all of the subsidiary's obligations and liabilities, operates the subsidiary as a branch office of the security-based swap dealer, and assumes full responsibility for compliance by the subsidiary and all of its associated persons with the provisions of the Federal securities laws as well as for all of the other acts of the subsidiary and such associated persons; or

(v) Are held in such other locations as the Commission shall upon application from a security-based swap dealer find and designate to be adequate for the protection of customer securities.

(3) Each business day the security-based swap dealer must determine from its books and records the quantity of excess securities collateral in its possession and control as of the close of the previous business day and the quantity of excess securities collateral not in its possession and control as of the previous business day. If the security-based swap dealer did not obtain possession or control of all excess securities collateral on the previous business day as required by this section and there are securities or money market instruments of the same issue and class in any of the following non-control locations:

(i) Securities or money market instruments subject to a lien securing an obligation of the security-based swap dealer, then the security-based swap dealer, not later than the next business

day on which the determination is made, must issue instructions for the release of the securities or money market instruments from the lien and must obtain physical possession or control of the securities or money market instruments within two business days following the date of the instructions;

(ii) Securities or money market instruments held in a qualified clearing agency account, then the security-based swap dealer, not later than the next business day on which the determination is made, must issue instructions for the release of the securities or money market instruments by the clearing agency and must obtain physical possession or control of the securities or money market instruments within two business days following the date of the instructions;

(iii) Securities or money market instruments held in a qualified registered security-based swap dealer account maintained by another security-based swap dealer, then the security-based swap dealer, not later than the next business day on which the determination is made, must issue instructions for the release of the securities or money market instruments by the other security-based swap dealer and must obtain physical possession or control of the securities or money market instruments within two business days following the date of the instructions;

(iv) Securities or money market instruments loaned by the security-based swap dealer, then the security-based swap dealer, not later than the next business day on which the determination is made, must issue instructions for the return of the loaned securities or money market instruments and must obtain physical possession or control of the securities or money market instruments within five business days following the date of the instructions;

(v) Securities or money market instruments failed to receive more than 30 calendar days, then the security-based swap dealer, not later than the next business day on which the determination is made, must take prompt steps to obtain physical possession or control of the securities or money market instruments through a buy-in procedure or otherwise;

(vi) Securities or money market instruments receivable by the security-based swap dealer as a security dividend, stock split or similar distribution for more than 45 calendar days, then the security-based swap dealer, not later than the next business day on which the determination is made, must take prompt steps to obtain physical possession or control of the securities or money market instruments through a buy-in procedure or otherwise; or

(vii) Securities or money market instruments included on the books or records of the security-based swap dealer as a proprietary short position or as a short position for another person more than 10 business days (or more than 30 calendar days if the security-based swap dealer is a market maker in the securities), then the security-based swap dealer must, not later than the business day following the day on which the determination is made, take prompt steps to obtain physical possession or control of such securities or money market instruments.

(c) *Deposit requirement for special account for the exclusive benefit of security-based swap customers.* (1) A security-based swap dealer must maintain a special account for the exclusive benefit of security-based swap customers that is separate from any other bank account of the security-based swap dealer. The security-based swap dealer must at all times maintain in the special account for the exclusive benefit of security-based swap customers, through deposits into the account, cash and/or qualified securities in amounts computed in accordance with the formula set forth in § 240.18a–4a. In determining the amount maintained in a special account for the exclusive benefit of security-based swap customers, the security-based swap dealer must deduct:

(i) The percentage of the value of a general obligation of a State or subdivision of a State specified in § 240.15c3–1(c)(2)(vi);

(ii) The aggregate value of general obligations of a State or subdivision of a State to the extent the amount of the obligations of a single issuer exceeds 2% of the amount required to be maintained in the special account for the exclusive benefit of security-based swap customers;

(iii) The aggregate value of all general obligations of a State or subdivision of a State to the extent the amount of the obligations exceeds 10% of the amount required to be maintained in the special account for the exclusive benefit of security-based swap customers; and

(iv) The amount of funds held at a single bank to the extent the amount exceeds 10% of the equity capital of the bank as reported by the bank in its most recent Consolidated Reports of Condition and Income.

(2) It is unlawful for a security-based swap dealer to accept or use credits identified in the items of the formula set forth in § 240.18a–4a except to establish debits for the specified purposes in the items of the formula.

(3) The computations necessary to determine the amount required to be maintained in the special account for the exclusive benefit of security-based swap customers must be made daily as of the close of the previous business day and any deposit required to be made into the account must be made on the next business day following the computation no later than 1 hour after the opening of the bank that maintains the account. The security-based swap dealer may make a withdrawal from the special account for the exclusive benefit of security-based swap customers only if the amount remaining in the account after the withdrawal is equal to or exceeds the amount required to be maintained in the account pursuant to paragraph (c)(1) of this section.

(4) A security-based swap dealer must promptly deposit into a special account for the exclusive benefit of security-based swap customers funds or qualified securities of the security-based swap dealer if the amount of funds and/or qualified securities in one or more special accounts for the exclusive benefit of security-based swap customers falls below the amount required to be maintained pursuant to this section.

(d) *Requirements for non-cleared security-based swaps.* (1) *Notice.* A security-based dealer and a major security-based swap participant must provide the notice required pursuant to section 3E(f)(1)(A) of the Act (15 U.S.C. 78c–5(f)) to a counterparty in writing prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the effective date of this section.

(2) *Subordination.* (i) *Counterparty that elects to have individual segregation at an independent third-party custodian.* A security-based swap dealer must obtain an agreement from a counterparty that chooses to require segregation of funds or other property pursuant to section 3E(f) of the Act (15 U.S.C. 78c–5(f)) in which the counterparty agrees to subordinate all of its claims against the security-based swap dealer to the claims of security-based swap customers of the security-based swap dealer but only to the extent that funds or other property provided by the counterparty to the independent third-party custodian are not treated as *customer property* as that term is defined in 11 U.S.C. 741 in a liquidation of the security-based swap dealer.

(ii) *Counterparty that elects to have no segregation.* A security-based swap dealer must obtain an agreement from a

counterparty that does not choose to require segregation of funds or other property pursuant to section 3E(f) of the Act (15 U.S.C. 78c–5(f)) or paragraph (c)(3) of this section in which the counterparty agrees to subordinate all of its claims against the security-based swap dealer to the claims of security-based swap customers of the security-based swap dealer.

16. Section 240.18a–4a is added to read as follows:

RULE 18A–4A—FORMULA FOR DETERMINING THE AMOUNT TO BE MAINTAINED IN THE SPECIAL ACCOUNT FOR THE EXCLUSIVE BENEFIT OF SECURITY-BASED SWAP CUSTOMERS

	Credits	Debits
1. Free credit balances and other credit balances in the accounts carried for security-based swap customers	$_____	
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers	$_____	
3. Monies payable against security-based swap customers' securities loaned	$_____	
4. Security-based swap customers' securities failed to receive	$_____	
5. Credit balances in firm accounts which are attributable to principal sales to security-based swap customers	$_____	
6. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	$_____	
7. Market value of short security count differences over 30 calendar days old	$_____	
8. Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days.	$_____	
9. Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days.	$_____	
10. Debit balances in accounts carried for security-based swap customers, excluding unsecured accounts and accounts doubtful of collection.		$_____
11. Securities borrowed to effectuate short sales by security-based swap customers and securities borrowed to make delivery on security-based swap customers' securities failed to deliver.		$_____
12. Failed to deliver of security-based swap customers' securities not older than 30 calendar days		$_____
13. Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in accounts carried for security-based swap customers.		$_____
14. Margin related to security future products written, purchased or sold in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 78q–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. 7a–1).		$_____
15. Margin related to cleared security-based swap transactions in accounts carried for security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency registered with the Commission pursuant to section 17A of the Act (15 U.S.C. 78q–1).		$_____
16. Margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held in a qualified registered security-based swap dealer account at another security-based swap dealer.		$_____
Total Credits	$_____	
Total Debits		$_____
Excess of Credits over Debits	$_____	

Note A. Item 1 shall include all outstanding drafts payable to security-based swap customers which have been applied against free credit balances or other credit balances and shall also include checks drawn in excess of bank balances per the records of the security-based swap dealer.

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 security-based swap customers' securities, to the extent of the member's margin requirement at the registered clearing agency or derivatives clearing organization.

Note C. Item 3 shall include in addition to monies payable against security-based swap customer's securities loaned the amount by which the market value of securities loaned exceeds the collateral value received from the lending of such securities.

Note D. Item 4 shall include in addition to security-based swap customers' securities failed to receive the amount by which the market value of securities failed to receive and outstanding more than thirty (30) calendar days exceeds their contract value.

Note E. (1) Debit balances in accounts shall be reduced by the amount by which a specific security (other than an exempted security) which is collateral for margin requirements exceeds in aggregate value 15 percent of the aggregate value of all securities which collateralize all accounts receivable; provided, however, the required reduction shall not be in excess of the amount of the debit balance required to be excluded because of this concentration rule. A specified security is deemed to be collateral for an account only to the extent it is not an excess margin security.

(2) Debit balances in special omnibus accounts, maintained in compliance with the requirements of section 4(b) of Regulation T under the Act (12 CFR 220.4(b)) or similar accounts carried on behalf of another security-based swap dealer, shall be reduced by any deficits in such accounts (or if a credit, such credit shall be increased) less any calls for margin, marks to the market, or other required deposits which are outstanding 5 business days or less.

(3) Debit balances in security-based swap customers' accounts included in the formula under item 10 shall be reduced by an amount equal to 1 percent of their aggregate value.

(4) Debit balances in accounts of household members and other persons related to principals of a security-based swap dealer and debit balances in cash and margin accounts of affiliated persons of a security-based swap dealer shall be excluded from the Reserve Formula, unless the security-based swap dealer can demonstrate that such debit balances are directly related to credit items in the formula.

(5) Debit balances in accounts (other than omnibus accounts) shall be reduced by the amount by which any single security-based swap customer's debit balance exceeds 25% (to the extent such amount is greater than $50,000) of the broker-dealer's tentative net capital (*i.e.,* net capital prior to securities haircuts) unless the security-based swap dealer can demonstrate that the debit balance is directly related to credit items in the Reserve Formula. Related accounts (*e.g.,* the separate accounts of an individual, accounts under common control or subject to cross guarantees) shall be deemed to be a single security-based swap customer's accounts for purposes of this provision.

If the Commission is satisfied, after taking into account the circumstances of the concentrated account including the quality, diversity, and marketability of the collateral securing the debit balances in accounts subject to this provision, that the concentration of debit balances is appropriate, then the Commission may, by order, grant a partial or plenary exception from this provision.

The debit balance may be included in the reserve formula computation for five

business days from the day the request is made.

(6) Debit balances of joint accounts, custodian accounts, participations in hedge funds or limited partnerships or similar type accounts or arrangements of a person who would be excluded from the definition of security-based swap customer (''non-security-based swap customer'') which persons includible in the definition of security-based swap customer shall be included in the Reserve Formula in the following manner: if the percentage ownership of the non-security-based swap customer is less than 5 percent then the entire debit balance shall be included in the formula; if such percentage ownership is between 5 percent and 50 percent then the portion of the debit balance attributable to the non-security-based swap customer shall be excluded from the formula unless the security-based swap dealer can demonstrate that the debit balance is directly related to credit items in the formula; if such percentage ownership is greater than 50 percent, then the entire debit balance shall be excluded from the formula unless the security-based swap dealer can demonstrate that the debit balance is directly related to credit items in the formula.

Note F. Item 13 shall include the amount of margin required and on deposit with Options Clearing Corporation to the extent such margin is represented by cash, proprietary qualified securities, and letters of credit collateralized by security-based swap customers' securities.

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. 78q–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. 7a–1) for security-based swap customer accounts to the extent that the margin is represented by cash, proprietary qualified securities, and letters of credit collateralized by security-based swap customers' securities.

(b) Item 14 shall apply only if the security-based swap dealer has the margin related to security futures products on deposit with:

(1) A registered clearing agency or derivatives clearing organization that:

(i) Maintains security deposits from clearing members in connection with regulated options or futures transactions and assessment power over member firms that equal a combined total of at least $2 billion, at least $500 million of which must be in the form of security deposits. For purposes of this Note G, the term ''security deposits'' refers to a general fund, other than margin deposits or their equivalent, that consists of cash or securities held by a registered clearing agency or derivative clearing organization;

(ii) Maintains at least $3 billion in margin deposits; or

(iii) Does not meet the requirements of paragraphs (b)(1)(i) through (b)(1)(ii) of this Note G, if the Commission has determined, upon a written request for exemption by or for the benefit of the security-based swap dealer, that the security-based swap dealer may utilize such a registered clearing agency or derivatives clearing organization. The Commission may, in its sole discretion, grant such an exemption subject to such conditions as are appropriate under the circumstances, if the Commission determines that such conditional or unconditional exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors; and

(2) A registered clearing agency or derivatives clearing organization that, if it holds funds or securities deposited as margin for security futures products in a bank, as defined in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)), obtains and preserves written notification from the bank at which it holds such funds and securities or at which such funds and securities are held on its behalf. The written notification shall state that all funds and/or securities deposited with the bank as margin (including security-based swap customer security futures products margin), or held by the bank and pledged to such registered clearing agency or derivatives clearing agency as margin, are being held by the bank for the exclusive benefit of clearing members of the registered clearing agency or derivatives clearing organization (subject to the interest of such registered clearing agency or derivatives clearing organization therein), and are being kept separate from any other accounts maintained by the registered clearing agency or derivatives clearing organization with the bank. The written notification also shall provide that such funds and/or securities shall at no time be used directly or indirectly as security for a loan to the registered clearing agency or derivatives clearing organization by the bank, and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank. This provision, however, shall not prohibit a registered clearing agency or derivatives clearing organization from pledging security-based swap customer funds or securities as collateral to a bank for any purpose that the rules of the Commission or the registered clearing agency or derivatives clearing organization otherwise permit; and

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

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

(ii) Fidelity bond coverage for its employees and agents who handle security-based swap customer funds or securities. In the case of agents of a registered clearing agency or derivatives clearing organization, the agent may provide the fidelity bond coverage; and

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

(4) A derivatives clearing organization that, if it is not otherwise registered with the Commission, has provided the Commission with a written undertaking, in a form acceptable to the Commission, executed by a duly authorized person at the derivatives clearing organization, to the effect that, with respect to the clearance and settlement of the security-based swap customer security futures products of the broker-dealer, the derivatives clearing organization will permit the Commission to examine the books and records of the derivatives clearing organization for compliance with the requirements set forth in § 240.15c3–3a, Note G. (b)(1) through (3).

(c) Item 14 shall apply only if a security-based swap dealer determines, at least annually, that the registered clearing agency or derivatives clearing organization with which the security-based swap dealer has on deposit margin related to security futures products meets the conditions of this Note G.

By the Commission.

Dated: October 18, 2012.

Elizabeth M. Murphy,

Secretary.

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